# REPORTING UNDER IASB IN THE UNITED STATES: A STEP FORWARD OR BACKWARD

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***Abstract***
*In August, 2007 the SEC published a concept release asking a series of questions on whether U.S. issuers should be allowed to choose, or should be required, to prepare financial statements under International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. In this paper we examine the perceived advantages and disadvantages of adopting IFRS's. Arguments in favor of adopting IFRS's in the U.S. include: capital flows more freely across national boundaries now than in the past; as a result, an increasing proportion of the holders of securities reside outside the legal jurisdiction in which the issuers of the securities reside, whether governments or private organizations or individuals; Additionally, financial statements prepared using a common set of accounting standards help investors better understand investment opportunities as opposed to financial statements prepared under differing sets of national accounting standards. And, embracing a common set of accounting standards can also lower costs for issuers. Those against adopting IFRS's maintain: convergence would decrease the quality of U.S. financial reporting. There is a lack of accounting standard enforcement mechanisms throughout the world. Adoption of IFRS will result in a return to the days of opinion shopping and result in an increase in earnings management. IFRS adoption will encounter many of the same problems encountered in SOX-404 adoption including the large cost burden to small companies. We conclude that adopting of IFRS is not desirable at this time.*

## BACKGROUND

The International Accounting Standards Committee (IASC) was formed in 1973 to develop worldwide accounting standards. It was an independent private sector body whose objective was to achieve uniformity in accounting principles that are used for worldwide financial reporting. In 2001 the IASC was replaced by the International Accounting Standards Board (IASB). The IASB's *Agreement and Constitution* gives it the authority to promulgate standards for the presentation of financial statements that are audited by its member organizations. The constitution of the IASB also establishes its role in promoting worldwide acceptance of IASB standards[i]. This requirement had arisen because many countries did not have a program of developing accounting standards and because of the need to harmonize differences among national standards (Hepworth, 1977). Many observers consider harmonization desirable because of the perceived need to increase the reliability of foreign financial statements. They maintain that improved decision making would occur because it would no longer be necessary to interpret foreign financial statements and because comparability would be improved (Sawani, 2009).

In the mid-1990s, the IASB entered into partnership with the International Organization of Securities Commissions to work together to encourage stock exchanges throughout the world to accept financial statements prepared under IASB standards. This project resulted in revisiting a number of existing standards. Later in 2003, the IASB published thirteen revised International Accounting Standards. The "Improvements Project" was a central element of the IASB's strategy to raise the quality and consistency of financial reporting generally and of the body of existing IASs in particular.

In 2005 the European Union (EU) began requiring companies incorporated in its member states, whose securities are listed on an EU-regulated stock exchange, to prepare their consolidated financial statements in accordance with IASB standards. However, the EU's decision to require the use of IFRS did not come without a cost to the IASB. The EU requires that all new or revised IASB standards be reviewed by the European Commission before they can be required for use by listed companies in the EU. This rule, in effect, gives the EU veto power over the adoption of any new IASB standards.

Many other countries throughout the world have also adopted IASB accounting standards. Australia, New Zealand, and Israel have essentially adopted IFSB pronouncements as their national standards. Canada, which previously planned convergence with U.S. GAAP, now is developing a plan to implement IASB standards over the next five years. The Accounting Standards Board of Japan and the IASB are also working on a convergence plan. China adopted IASB standards, with some, additions it considered necessary and maintained some standards dealing with matters that are not specially covered by IASB standards to reflect China's unique circumstances and business requirements; as a result all major economies except the U.S. will soon be using IASB accounting standards.

This article presents a concise overview of the 10 year-plus collaboration between the IASB and the U.S. to develop consistent and high quality accounting standards that can be used for domestic and cross-border financial reporting and analysis. Additionally, current issues surrounding this effort are examined.

## THE U.S. AND IASB STANDARDS

The Financial Accounting Standards Board (FASB) and the IASB held a joint meeting in Norwalk, Connecticut on September 18, 2002. Both standard-setting bodies acknowledged their commitment to the development of high-quality compatible accounting standards that can be used for both domestic and cross-border financial reporting. They also promised to use their best efforts to make their existing financial reporting standards compatible as soon as practicable and to coordinate their future work programs to maintain compatibility. To this end, both boards agreed to the following proposals:

1. Undertake a short-term project aimed at removing a variety of differences between U.S. GAAP and IFRS's.
2. Remove any other differences between IFRS's and U.S. GAAP that remained on January 1, 2005, by undertaking projects that both boards would address concurrently.
3. Continue the progress on the joint projects currently under way.
4. Encourage their respective interpretative bodies to coordinate their activities (FASB, 2002).

The goal of this project is to achieve compatibility by identifying common high-quality solutions.

In 2005, the chief accountant of the SEC described a "roadmap" for arriving at a common set of high-quality global standards and the removal of the need for the reconciliation requirement for non-U.S. companies that use IFRS's and are registered in the United States (Nicolaisen, 2005). Later, the FASB and IASB jointly issued a Memorandum of Understanding in 2006 (updated in 2008) that identified the standard-setting projects that the Boards considered to be most in need of improvement in the near-term. The Boards agreed to develop a plan to address each of the identified projects, primarily through the development of new standards in an effort to improve the quality of both sets of standards and achieve greater convergence between U.S. GAAP and IFRS (FASB, 2008). .

In 2008, the SEC voted to publish for public comment a proposed roadmap that could lead to the use of International Financial Reporting Standards by U.S. issuers beginning in 2014. This roadmap included the following seven milestones:

1. Improvements to accounting standards.
2. Funding of the International Accounting Standards Committee Foundation.
3. Improved ability to use interactive data for IFRS reporting.
4. Improved education and training in the United States.
5. Limited use in a narrow group of companies.
6. SEC to determine in 2011 whether mandatory adoption of IFRS is feasible based on the progress in the first five milestones.
7. Mandatory use. (SEC, 2008).

The roadmap is a step in the direction of solving comparability issues. However, both the IASB and the FASB have noted that the removal of the reconciliation requirement will depend on, among other things, the effective implementation of IFRS's in financial statements across companies and jurisdictions, and measurable progress in addressing priority issues on the IASB-FASB convergence program. Therefore, the ability to meet the objectives set out by the roadmap depends on the efforts and actions of many parties—including companies, auditors, investors, standard setters, and regulators.

The FASB and the IASB also recognized that achieving the reconciliation requirement requires measurable progress on the FASB-IASB convergence program. Consequently, both boards affirmed their commitment to making such progress and indicated agreement on the following guidelines:

- Convergence of accounting standards can best be achieved through the development of high-quality, common standards over time.
- Trying to eliminate differences between two standards that are in need of significant improvement is not the best use of the FASB's and the IASB resources—instead, a new common standard should be developed that improves the financial information reported to investors.
- Serving the needs of investors means that the boards should seek to converge by replacing weaker standards with stronger standards (FASB**,** 2006).

In February, 2000 the Securities and Exchange Commission (SEC) voted to ask U.S. companies to comment on whether it should allow foreign companies to list their securities on U.S. stock exchanges under international accounting rules. Previously, foreign companies seeking to list on a U.S. stock exchange must have recast their financial statements to reflect then-current GAAP. This reconciliation was made by filing Form 20-F with the SEC within six months of the company's fiscal year-end. Previously, only about 1,000 foreign companies were listed on U.S. stock exchanges because of the high cost involved in recasting their financial statements to U.S. GAAP. Formerly, the SEC had consistently taken the position that allowing foreign firms to list using other than U.S. GAAP would result in a loss of investor protection and result in a two-tiered disclosure system, one for domestic registrants and another for foreign registrants.

In 2007, the SEC modified its position on the Form 20-F requirement when it issued *Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to*

*GAAP*. (SEC, 2007b) This rule amends Form 20-F to accept from foreign private issuers in their filings with the SEC financial statements prepared in accordance with IFRS's without reconciliation to U.S. GAAP. The SEC's rationale for this action was to foster the adoption of a set of globally accepted accounting standards. However, the requirements regarding reconciliation to U.S. GAAP do not change for a foreign private issuer that files its financial statements using a basis of accounting other than IFRS's.

The SEC also took another step in the direction of convergence in 2007 when it decided to explore the possibility of allowing U.S. companies to adopt IFRS (SEC, 2007b). In explaining its rationale for this decision, the SEC noted that the movement to IFRS has begun to affect U.S. companies, in particular those with a significant global footprint. That is, under the new rule amending Form 20-F adopted by the SEC, foreign registrants can use either U.S. GAAP or IFRS without reconciling their earnings and shareholders' equity to U.S. GAAP; consequently, it would seem more equitable for U.S. companies, which compete for capital in the same securities market, to also be able to use either U.S. GAAP or IFRS (SEC, 2007b).

In August, 2007 the SEC also published a concept release asking a series of questions on whether U.S. issuers should be allowed to choose, or should be required, to prepare financial statements under IFRS as issued by the IASB (SEC 2007c). The SEC received over 80 comments on that release, which were viewed as both thoughtful and thought-provoking (White, 2008). In order to receive further input on this issue, the SEC held two roundtables in December, 2007 with the participation of over two dozen experts from varying constituencies on the topic of U.S. issuers using IFRS, which were also viewed as thought provoking sessions (White, 2008). And in 2008 Christopher Cox, then SEC Chairman, charged staff members in the Division of Corporation Finance and the Office of the Chief Accountant with developing a roadmap for the Commission's consideration (SEC, 2008).

## INITIAL REACTION TO CONVERGENCE

The move toward convergence was initially hailed as a step forward. For example Robert H. Herz, the previous Chairman of the FASB, commented:

> The FASB is committed to working toward the goal of producing high-quality reporting standards worldwide to support healthy global capital markets. By working with the IASB on the short-term convergence project—as well as on longer-term issues—the chances of success are greatly improved. Our agreement provides a clear path forward for working together to achieve our common goal (FASB, 2009).

Similarly, Sir David Tweedie, then Chairman of the IASB, remarked:

> This underscores another significant step in our partnership with national standard setters to reach a truly global set of accounting standards. While we recognize that there are many challenges ahead, I am extremely confident now that we can eliminate major differences between national and international standards, and by drawing on the best of U.S. GAAP, IFRS's and other national standards, the world's capital markets will have a set of global accounting standards that investors can trust (FASB, 2009).

In 2008 Barak Obama was elected president and some wondered how this would affect the SEC's commitment to one set of global accounting standards **(**Buttell, 2010**).** His newly appointed Chair of the SEC, Mary Schapiro served to allay these concerns in her opening remarks at a SEC 2010 meeting:

> Today's Commission statement reaffirms our support for a single globally accepted standard, describes the issues that need to be further examined and analyzed, and lays out the events that must occur between now and 2011. Specifically, the convergence projects currently underway between the FASB and the International Accounting Standards Board must first be successfully completed. And our staff must gather information to aid the Commission as it evaluates the impact that the use of IFRS by U.S. companies would have on our securities market. To this end, we have asked the staff to develop and execute a work plan ... In 2011, upon conclusion of the fact-gathering and analysis set forth in the work plan – and assuming completion of the convergence projects – the Commission will then be in a position to determine whether to incorporate IFRS into the financial reporting system for U.S. public companies. Until that time, we will expect staff to provide periodic written public reports to the Commission on the progress of its efforts (Schapiro, 2010).

Strong support for adopting IASB standards in the U.S. continues to be voiced. For example, Harvey Goldschmid, an IASB Foundation Trustee recently stated:

> I believe that the best way to protect U.S. stakeholders - -including investors who are increasingly investing globally - - is for the SEC to make an affirmative incorporation decision. Both IFRS and U.S. GAAP now have strengths and weaknesses. A widely shared view is that both are of high quality. But only one - - IFRS - - has the prospect of global acceptance. The U.S. remaining an integral part of the IFRS process will go far toward assuring the continued high quality of international standards. This is what both U.S. and global investors truly need (Goldschmid, 2011).

> Similarly, Hans Hoogerverst the current Chair of the IASB indicated:
>
> I believe that it is important for investor protection in the United States and internationally that the SEC remains at the forefront of determining international financial reporting policymaking. This cannot be done from afar. It is difficult to imagine that, after a decade of investment in convergence, a negative decision could be a possible outcome, or that the United States would intentionally choose to discard international leadership, in something as fundamental as financial reporting. It is also not clear what the alternative would be. IFRS's will continue to evolve. A U.S. commitment to maintaining existing levels of convergence with IFRS's would require the FASB to spend most of its time eliminating new differences. Is this the best use of the FASB's considerable talents, expertise and knowledge of the international environment? If the U.S. chooses not to maintain convergence, it would lead to divergence. That is certainly not what policymakers need as they navigate the ongoing financial crisis. It is for these reasons that I am optimistic about the prospects of a positive decision by the SEC on IFRS's. I believe the direction of travel for IFRS's is established, the momentum unstoppable and the endpoint is clear. Ultimately, there will be a global language and IFRS is the only candidate (Hoogerverst, 2011).
>
> These individuals based their conclusions on the following arguments
>
> 1. Some large U.S. corporations want to switch to IFRS.
> 2. A move to IFRS would restore the public trust in accounting standards.
> 3. U.S. GAAP is not superior to IFRS.
> 4. IFRS is already widely adopted.
> 5. Even though IFRS may not be consistently applied elsewhere, the SEC can enforce compliance with IFRS as it sees fit.
> 6. The costs of conversion to IFRS can be spread out over a long transition period.
> 7. The U.S. will not experience a loss of sovereignty over its ability to set accounting standards.
> 8. Bad things will happen to the rest of the world if the U.S. does not adopt IFRS.
> 9. Bad things will happen to the U.S., if the U.S. does not adopt IFRS.

10. All nations share the same goals for accounting standards (Selling, 2011).

Despite this support, the SEC has not formally endorsed the use of IASB standards in the U.S. In 2010, Paul A. Beswick (Deputy Chief Accountant, United States Securities Exchange Commission) suggested a possible alternate approach for adoption of IFRS in the United States. He coined the term “condorsement” to refer to a possible hybrid model to adopting IFRS’s in the United States and stated:

> "... While I am a supporter of the objective of a single set of high-quality accounting standards in concept, I have not reached a conclusion on whether, and how, the U.S. capital markets should move to IFRS. So what would be a reasonable approach for the U.S.? In our October update we highlighted that the majority of jurisdictions are following either a convergence or an endorsement approach. In my opinion, if the U.S. were to move to IFRS, somewhere in between could be the right approach. I will call it a "condorsement" approach.... So how would this approach work? Well, to begin, U.S. GAAP would continue to exist. The IASB and the FASB would finish the major projects in their MOU. The FASB would not begin work on any major new projects in the normal course. Rather, a new set of priorities would be established where the FASB would work to converge existing U.S. GAAP to IFRS over a period of time for standards that are not on the IASB's agenda. At the same time, the FASB would have a process where they would consider new standards issued by the IASB for incorporation into U.S. GAAP and then integrate such standards into the U.S. codification. The ideal would be to incorporate such standards as issued by the IASB without modification. However, criteria would need to be established for FASB's consideration of endorsing or incorporating standards (Beswick, 2010).

Later the SEC issued a staff paper that discusses the approaches to IFRS adoption used by various jurisdictions, noting the differences between convergence and endorsement. The paper concludes the "condorsement" approach is in essence an endorsement approach that would share characteristics of IFRS incorporation approaches with other jurisdictions. However, during a transitional period, aspects of the convergence approach would be used to address existing differences between IFRS and U.S. GAAP, including the retention of a U.S. standard setter (FASB), which would facilitate the transition process by incorporating IFRS’s into U.S. GAAP over a defined period of time (e.g. five to seven years). This release indicated that: at the end of [the transitional] period, the objective would be that a U.S. issuer compliant with U.S. GAAP should also be able to represent that it is compliant with IASB standards. Incorporation of IASB standards through the framework would have the objective of achieving the goal of having a single set of high-quality, globally accepted accounting standards, while doing so in a practical manner that could minimize both the cost and effort needed to incorporate IASB standards into the financial reporting system for U.S. issuers. It also would align the United States with other jurisdictions by retaining the national standard setter's authority to establish accounting standards in the United States (SEC, 2011).

The FASB’s role in this process would be to exercise its authority as the national standard setter when it found, based on its experience in the ongoing interpretation or application of IFRS’s incorporated into U.S. GAAP, that supplemental or interpretive guidance was needed for the benefit of U.S. constituents. Under the framework, the FASB should initially address this situation by informing the IASB of the potential gaps in authoritative guidance and providing the IASB a recommended solution to address the practice issues, but ultimately, the FASB could conclude an acceptable solution is not reached or the issue is not being addressed in a timeframe consistent with the needs of the U.S. capital markets.

Accordingly, the FASB could exercise its authority in one or more of the following ways:

1. Adding disclosure requirements to those specified by IFRS, to address U.S. circumstances in a manner consistent with IFRS;

2. Prescribing which of two or more alternative accounting treatments permitted by IFRS on a particular issue should be adopted by U.S. issuers, to achieve greater consistency in U.S. practice; or
3. Setting requirements compatible with IFRS on issues not addressed specifically by IFRS. In particular, the FASB could decide to carry forward certain such requirements that already exist in U.S. GAAP, with any necessary conforming amendments (SEC, 2011).

If the FASB were to exercise this authority, a U.S. "flavor" of IFRS could result. However, U.S.-specific circumstances for which the FASB would consider modifying IFRS should be similar to the circumstances in which the SEC exercises its authority to amend or add to the standards issued by the FASB and, therefore, modifications should be rare and generally avoidable (SEC, 2011).

Another possible approach was suggested by (SEC)) Commissioner Kathleen L. Casey Giving the keynote address at the Society of Corporate Secretaries and Governance Professionals 65th Annual Conference in Colorado, United States on June 29, 2011, Ms. Casey highlighted the benefits of IFRS adoption including the benefits of a single set of high-quality global accounting standards in increasingly global capital markets, the impacts of more United States entities investing in entities that report in accordance with IFRS's, the United States' influence on IFRS development and cost and other concerns raised by constituents. But she also discussed the possibility of an opt-out for issuers, perhaps on a permanent basis:

> While I believe that the United States must provide for reporting under IFRS by U.S. issuers, I believe that we can and should give some issuers the option to continue to report under U.S. GAAP. One of the concerns that has been expressed since we first issued the "Road Map" in November 2008, from smaller reporting companies and other companies that have no international operations or aspirations, is that the transition to IFRS will be burdensome and impose costs without providing them with any commensurate benefits. I understand these concerns, and it makes sense, in my view, to allow these issuers to opt out of IFRS, at least initially, if not permanently. Providing optionality would preserve the benefits of IFRS, ensure continued U.S. influence in the development and preservation of IFRS, and avoid unnecessary costs for smaller U.S. issuers. Some commentators object to providing optionality on the basis that it would lead to a "two-GAAP" world. My response is that we are already in a two-GAAP world. The Commission already permits foreign private issuers to report using IFRS. Furthermore, in light of the global nature of our capital markets, investors, public accountants and other market participants already need to know both U.S. GAAP and IFRS (Casey, 2011).

**ARGUMENTS AGAINST**

In addition to the advantages expressed by Goldschmidt and Hoogervorst (H & G) (outlined above) proponents of convergence also maintain that convergence will result in improved financial reporting, better corporate governance and stewardship, better informed and therefore more efficient financial markets which will direct capital towards its productive deployment. (Sunder, 2009). However, opponents dispute these contentions; their arguments include the following:

1. H & G have misrepresented reality
2. Convergence would decrease the quality of U.S. financial reporting
3. The lack of accounting standard enforcement mechanisms throughout the world
4. Adoption of IFRS will result in a return to the days of opinion shopping and result in an increase in earnings management

5. IFRS adoption will encounter many of the same problems encountered in SOX-404 adoption
6. The cost burden to smaller companies
7. Proponents stand to reap large benefits from conversion to IFRS
8. IFRS is no more "principles-based" Than U.S. GAAP
9. Research indicates that GAAP is at least as good, if not superior to IFRS
10. GAAP ***is*** better than IFRS
11. IFRS is not compatible with U.S. style corporate governance
12. Loss of U.S. influence over standard setting
13. Radical change is very difficult to implement

With respect to the views expressed H & G on why the U.S. should adopt IASB standards, Selling (2011) maintains that they were: "… synthesized from a mixture of vague generalities, selective use of the facts, cherry picking of academic research, and biased speculations of a doomsday to come if the SEC does not act to adopt IFRS." For example he states that although some large companies do want to adopt IASB standards, there are many more that adamantly oppose a switch to IFRS. He cites summary of the responses of large public companies responding to the SEC's original Roadmap proposals which indicated that that they opposed adoption by 47 to 28; and of the 47 that opposed IFRS adoption, 35, about three-quarters of them, strongly opposed IFRS adoption (Hansen, 2009).

Sunder (2008) rebutted a pair of the SEC's pro convergence claims, that: 1.The move would integrate the world's capital markets by providing a common high-quality accounting language, and 2. Increase confidence and transparency in financial reporting. He maintains that the move will decrease the quality of American financial reporting for the following reasons.

1. IFRS are less enforceable because they provide more room for judgment by managers doing the reporting and by auditing firms. *An American manager might ask, 'Where in IFRS does it say I can't do this,' with unfortunate results.*
2. The characteristic of being of high quality depends upon who is doing the evaluating and what is their set of priorities. *I like pizza, but you might not.*
3. With two standard setters, each can look at the other and learn from the other's experience. In other words, *there is no need to make the same standard setting mistake twice. If the U.S. moves to IFRS, then the U.S. financial reporting environment is doomed to suffer from the mistakes of Europe, a fate that wouldn't occur if only the U.S. had an opportunity learn from Europe's prior (misbegotten) example*.
4. Comparability of financial statements across more than 100 countries is a "pipe dream" because of the interaction between standards and the unique market, financial, governmental, legal, and commerce environment of that country. Such interactions make impossible financial statement comparability. *Since there will never be across border financial statement comparability, there is no reason to cite it as a reason for adopting IFRS.*
5. American business will react to the change in standard setting in unforeseen ways. It simply can't be predicted that the U.S. financial reporting environment will improve with a change in standards (Sunder 2008).

Another criticism of convergence relates to the lack of enforcement mechanisms throughout the world. This position was most succinctly expressed by Professor Raymond Ball, o who maintains there will be no uniformity in the enforcement of accounting standards, from country to country, which means that there will be no reason to expect that financial reports will be comparable from companies in different parts of the world.

He goes on to state**:**

> The fundamental reason for being skeptical about uniformity of implementation in practice is that the incentives of preparers (managers) and enforcers (auditors, courts, regulators, boards, block shareholders, politicians, analysts, rating agencies, and the press) remain primarily local (Ball, 2006).

That is, while the increased internationalization of markets and politics might be expected to reduce some of the diversity in accounting practice across nations, nations will continue to display clear and substantial domestic facets in their politics and how their markets are structured, so increased internationalization cannot be expected to eliminate diversity in practice (Albrecht, 2009).

Catanach and Ketz (2011) (C & K) maintain that the move to IFRS will result in a return to the days of opinion shopping and result in an increase in earnings management. They assert that the drive toward IFRS has been remarkable because its support consists primarily of vacuous assertions. That is, advocates claim that principles are better than rules, but nobody has been able to differentiate between principles and rules. For example, if firms should recognize all their liabilities on the balance sheet, is that a rule or a principle? And if a principle, why does off-balance sheet debt still exist in countries that have already adopted IFRS?

C & K go onto point out that the proponents of IFRS argue that uniformity across the world would reduce preparer and investor costs and it would increase transparency. However the world-wide adoption of IFRS has been accompanied with carve-outs, special deals, exceptions, and time-freezes. As a consequence countries are adopting their own national brands of IFRS and here is significantly less uniformity across IFRS-adopters than the advocates of convergence wish to admit.

C & K maintain that it is not enough for principles to be better than rules. Principles-based accounting produces value only when managers and their advisers are principled men and women. IFRS that are supposedly principles-based will not solve the fundamental accounting problems of society until and unless the vast number of managers become principled individuals. Sadly, hundreds and hundreds of restatements and many SEC litigation releases and scores of lawsuits and plenty of criminal cases prove that society does not have enough principled managers to make it work.

(C & K) conclude by noting that today's accounting leaders do not remember much from accounting history. Before the Accounting Principles Board, corporate managers faced mostly toothless or ambiguous accounting rules, if they encountered any accounting or disclosure rules. The great charge that began in the 1960s was the goal to reduce manager's accounting choices in order to reduce the gaming in corporate reports. This goal began in the 1960s, but did not eliminate accounting scandals as attested to by a variety of cases, including National Student Marketing and Equity Funding. But the correct deduction is not to allow managers a free hand in manipulating the accounting; rather, it demonstrated that reducing managerial accounting choices was not sufficient to improve accounting. Other things would be required, such as an improvement in corporate governance.

David Reilly of the *Wall Street Journal* (touched on some of the same issues discussed above and raised several questions about the underpinnings of a set of global accounting standards, including:

1. Even if we can craft a single set of high quality standards, can we consistently enforce them?
2. Any attempt to answer that question leads to a second: who are markets, and by extension accounting standards, ultimately meant to serve? And
3. Finally there is the question of what is driving the move to a global set of standards?

His answer to the first question, in a manner similar to Ball (2006), was that a common accounting system needs a common enforcement system. And having the most intelligently crafted rules means nothing if companies feel they can simply ignore them without fear of any meaningful consequence. He went on to note that there is no global enforcement mechanism. The capability, quality and intent of securities regulators across countries vary wildly. Reilly, (2011) asked: Does anyone think for a moment that rules will be as consistently enforced in Russia as they are in, say, London? And, noted that there isn't even a single securities regulator within the European Union.

In addressing the second question, Reilly (2011) avowed that how accounting standards are enforced, and the way they are set, will be a function of the view each country has toward markets. In other words, who are they meant to serve? He suggested that the answer differs depending on counties economic and political environments. For example, the Anglo-American view advocates the supremacy of investors and while companies are granted importance in this framework, investors are the primary focus of financial reports. On the other hand, there is the corporatist view espoused in much of continental Europe. This view holds that markets exist to help companies, who in turn are often seen as a means to further national policy objectives. Consequently, investors are important, but their views are subordinated and given a backseat to those of the corporation or the state. Finally, there are authoritarian states where markets are tolerated so long as they advance the cause of the ruling party. Under this model, investors are not a real consideration. Reilly (2011) maintained that this provides an unstable basis for forming standards and enforcing them and suggests that it hard to see how countries with such differing views will strive for standards that put investors first or will abide by an accounting outcome if it conflicts with a national objective.

In addressing the third question, Reilly (2011) observed that while consideration of international standards has been underway for a long time in the U.S., it really picked up speed under former SEC Chairman Christopher Cox. That initiative came at a time when there was much debate about the competitiveness of U.S. capital markets. The argument was that burdensome regulation was going to push capital markets activity to London and Hong Kong. To counter that threat, the argument went; we needed to embrace more principles-based regulation and standards setting of the IASB. The passage of time has proven this view wrong. The lack of regulation and regulatory power, not too much of it, was a large contributor to the financial crisis that brought our economy and markets down. Reilly (2011) also suggested that politically there does not seem to be a desire to place oversight of financial reporting in the hands of what could come to be seen as a UN-style body.

Tom Selling (2010), (with apologies to David Letterman) provided a list of the top 10 reasons why the adoption of IFRS would be a bad idea. Among his reasons were:[ii]

**IFRS adoption will encounter many of the same problems encountered in SOX-404 adoption.** The costs of conversion to IFRS could be in the billions of dollars. Therefore, IFRS conversion costs could similar to those of Section 404 of Sarbanes-Oxley[iii] and result in uncertain cost and unquantifiable benefits, as well as the problems of justifying the costs for smaller companies.

**Proponents stand to reap large benefits from conversion to IFRS**. Many of the people promoting a change to IFRS stand to benefit from the change.

**IFRS Is No More "Principles-Based" Than U.S. GAAP**. Selling argues that fuzzy lines in accounting standards have come to be exalted as 'principles-based' and bright lines are disparaged as 'rules-based.

**Research indicates that GAAP is at least as good, if not superior to IFRS**. In her testimony before Congress, Teri Yohn of Indiana University (2007) cited about 25 academic research studies comparing IFRS to U.S. GAAP. Her testimony indicated that investors appear to prefer U.S. GAAP over IFRS, and that IFRS has provided greater opportunities for earnings management.

**GAAP *is* better than IFRS.** In 1999, the FASB concluded, in its extensive report on the similarities and differences between IFRS (technically IAS at the time) and U.S. GAAP, that IFRS was lower quality than GAAP.

**IFRS Is Not Compatible with U.S.-Style Corporate Governance**. The corporate scandals taking place in Europe are fundamentally different from those in the U.S., due to significant differences in ownership structure.

**Loss of U.S. influence over standard setting.** If IFRS are adopted, the risk of near total loss of U.S. influence over accounting standards is a possibility.

**Radical change is very difficult to implement.** There is an approach to business policy known as "logical incrementalism." It is based on the premise that business processes in large corporations are so complex that it is usually too risky to undertake radical change. A more effective approach is to make smaller adjustments over time.

Finally, Reilly (2011) also discussed the condorsement approach to adopting IFRS. He noted, that under this approach, the U.S. would essentially sign on to adopt IFRS, but take its time getting there. Meanwhile, the U.S. would keep the FASB in place and require it to endorse new international standards or change them if necessary before they would take effect in the U.S. Reilly (2011) found some merit to this approach in that it gives the SEC a way to ease the transition to IFRS, and perhaps lower the costs of transition and market disruption. Consequently, the U.S. might be prevented from being excluded from the international standards process, which would probably occur if the SEC decided not to adopt IFRS, and as a result, the SEC might play a major role in determining how international standards are implemented. Never-the-less, Reilly (2011) noted several problems. For example, the notion that the U.S. might be able to mold future international standards to suit our own needs is similar to what the European Union has in some cases done – and been criticized for. Additionally, when it dropped the 20-F reconciliation requirement in 2007 for non-GAAP IFRS users, the SEC required that this stipulation would only apply if companies used IFRS "as promulgated by the IASB", in other words, not national variants of IFRS. The condorsement approach would be a reversal of this requirement. Finally, Reilly (2011) maintained that the condorsement approach would be an attempt by the SEC to say to the international community "We're on board" – while making it seem otherwise at home in hope of allaying a domestic political uproar should it proclaim a hard-and-fast switchover date. This would be a mistake that investors, companies and markets deserve to have clarity on the issue. They also need to know if the SEC believes that IFRS should truly be a single language, which could result in a set of negotiated, and possibly watered down, consensus standards. Or, would it be a language with many different dialects, U.S. IFRS being one of them. Reilly (2011) suggested that the latter is the more likely outcome. If so, are the costs of changing to IFRS, even if through a condorsed, approach worth it. Meanwhile we still haven't determined how we can make a global system work in a world of national enforcement and often conflicting views of the role of markets.

## CONCLUSIONS

In the preceding paragraphs we examined the perceived advantages and disadvantages of adopting IFRS in the U.S. In theory, global accounting standards make sense for both investors, who will have greater comparability, and companies, who might see their cost of capital fall. That was certainly true in Europe where the adoption of IFRS replaced more than two dozen different, national accounting systems. However, in the U.S., many companies enjoy a lower cost of capital than in other parts of the world. Therefore, it is not clear that eliminating GAAP in favor of IFRS will result in lowering companies' cost of capital; additionally, the costs of switching to IFRS will be high.

After reviewing the arguments, we have concluded that adopting IFRS in the U.S. would not be in the best interests of investors at this time. Specifically, we do not agree with the contention that adopting IFRS will create a more efficient global capital market. Those favoring the adoption of IFRS ignore the fact that the U.S. has enforcement powers and capabilities that are much stronger than those elsewhere. Without similar enforcement powers everywhere for all users, common standards, even good ones, will not be uniformly applied.

We also do not agree with the contention that establishing uniform international standards will increase intercompany comparability. The Financial Accounting Standards Board's Conceptual Framework maintains that the consistent use of accounting methods, whether from one period to another within a single firm, or within a single period across firms, is a necessary but not sufficient condition of comparability. Uniformity is an input quality; comparability, relates to the quality of outputs. For example, uniformly writing off R and D costs isn't useful because it doesn't distinguish successful efforts from the unsuccessful. If two companies own real estate with the same cost but different values, uniformly reporting them at cost doesn't allow users to detect their dissimilar future cash-flow potentials. Therefore; comparability exists only when statement users can identify real similarities and differences (Miller and Bahnson, 2011).

We are also troubled by the apparent inconsistent application of IFRS in different countries. A recent SEC staff study found that while foreign country financial statements generally appeared to comply with IFRS requirements, certain differences were noted. Lacking the ability to obtain clarifying information, the Staff was unable to determine whether such differences were material departures from IFRS. (SEC, 2011). The overall analysis suggested a level of diversity in applying IFRS across various territories. This diversity may result from options contained in IFRS or the practice of utilizing previous home country or regulatory guidance. Such practices increase comparability within a territory, but decrease consistency on a global level.

We also do not favor the condorsement approach to adopting IFRS. We believe that at a minimum this would result in short-term confusion in the application of accounting standards.

We agree that adopting global accounting standards is a worthy objective; however, achieving this object by utilizing what is, in our view, a set of inferior standards is not in the best interests of U.S. investors. Rather, we suggest that the FASB and IASB continue and complete their convergence project so that GAAP and IFRS become one uniform set of standards. This recommendation is similar to a recent Financial Accounting Foundation comment letter which stated:

> The Trustees are recommending an IFRS incorporation approach that embraces the concepts of the SEC staff's Condorsement framework while addressing concerns raised by various U.S. stakeholders. The recommended approach is premised on the belief that although the pursuit of a single set of global accounting standards is a worthy objective, a more practical goal for the foreseeable future is to achieve highly comparable (but not necessarily identical) financial reporting standards among the most developed capital markets that are *based on* a common set of international standards. (FAF, 2011)

Under this model the FASB and IASB would finish their current joint projects, the IASB would engage in standard setting that improves IFRS (with significant FASB input), and the FASB would address the remaining differences between IFRS and U.S. GAAP. We suggest that such an approach would improve or maintain the quality of U.S. GAAP while moving financial reporting forward toward globally comparable standards.

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**Endnotes**

[i] The IASC’s standards were called *International Accounting Standards* (IAS), the IASB’s standards are termed *International Financial Reporting Standards* (IFRS).

[ii] Unfortunately, he could only come up with 9.

[iii] Section 404 of Sarbanes-Oxley requires auditors to assess the effectiveness of internal control over financial reporting as of the end of the most recent fiscal year. Bhamornsiri, et al (2009) found that external audit fees increased 65% during the first year of implementing Sarbanes-Oxley primarily due to this requirement.