

To Converge or Not to Converge?

A question for modern-day standards-setters

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The views contained in this article are those of the authors only and do not necessarily represent the views of any of the FASAB board members or other FASAB staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

What is Convergence?

"Converge" may bring to mind the four-piece band that specializes in hardcore punk and extreme heavy metal music, an atmospheric process in which higher momentum air moves into lower momentum air, or a dynamic object-oriented programming language with compile-time meta-programming facilities. If you have been reading accounting journals lately, you will most likely associate "converge" with the movement toward a global set of accounting standards.

Converging is defined in the dictionary sense as "to come together and unite in a common interest or focus."¹ Many national standards-setters are working "to develop, in the public interest, a single set of high-quality, understandable and enforceable global accounting standards that require high-quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions."²

Sir David Tweedie, chairman of the International Accounting Standards Board (IASB), and Thomas R. Seidenstein, director of operations for the International Accounting Standards Committee (IASC) Foundation, say the goal is to "identify the best in standards around the world and build a body of accounting standards that constitute the 'highest common denominator' of financial reporting... convergence must improve both existing financial reporting and consistency across borders. This is not convergence for convergence's sake."³

This article describes international convergence, the varying degrees of convergence and the potential barriers or obstacles to successful convergence.

Evolution of International Convergence

The IASC was first established in 1973 by Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom, Ireland and the United States to develop international accounting standards.⁴ In the U.S., the private sector move toward convergence of accounting standards started in 1994.⁵ However, momentum really started to build when the IASC Foundation established the IASB in 2001.

At a joint meeting held in September 2002, FASB and IASB published the Norwalk Agreement. The two boards agreed to:

- (a) *Undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, which include International Accounting Standards, IASs);*
- (b) *Remove other differences between IFRSs and U.S. GAAP that will remain at January 1, 2005, through coordination of their future work programs; that is, through the mutual undertaking of discrete, substantial projects which both boards would address concurrently;*
- (c) *Continue progress on the joint projects that they are currently undertaking; and*
- (d) *Encourage their respective interpretative bodies to coordinate their activities.*⁶

In 2005, the FASB and the IASB reaffirmed their commitment to convergence. In an updated memorandum of understanding published in February 2006, the FASB and the IASB 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's 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.⁷

The catalysts for the continued focus on international convergence include:

- A strong desire for the consistent application of accounting standards that would lead to increased comparability of financial statements and more informed decision-making;
- The need for better access to world capital markets, especially for foreign and international investment;
- A response to the financial scandals that came to light starting at the beginning of this decade; and
- The ability to improve reporting conditions for businesses that cross international borders.

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As noted by Consolacion L. Fajardo, DPA, CPA, from the National University in California, "Consistent application of accounting standards that are the same for companies around the world would result to better comparability of financial information resulting in more informed decision-making. For regulators, the confusion associated with needing to understand various accounting standards would be reduced. For auditors, a single set of accounting standards would enable international auditing firms to standardize training and better assure the quality of their work on a global basis."⁸

The Securities and Exchange Commission's proposed decision in June 2007 to permit the use of IFRS for U.S. filings further highlighted the need for and the drive toward a global set of accounting standards.⁹

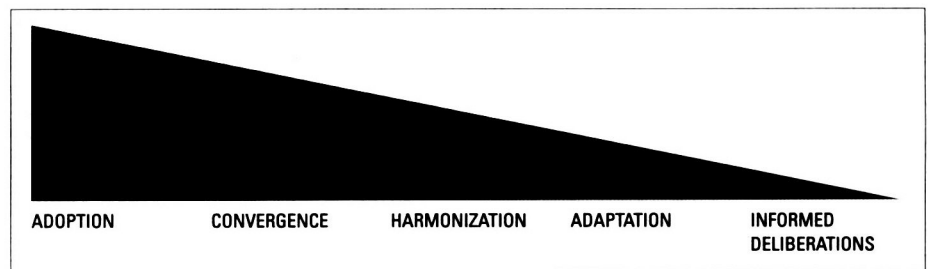
Five Degrees of Convergence

"Convergence" is used to describe a wide array of approaches that can vary significantly in terms of the level of effort and coordination that is involved. In addition, the terminology used may mean different things to different people, especially across different countries, cultures and languages. This section explores and attempts to define the following five major degrees or levels of convergence:

- Adoption
- Convergence
- Harmonization
- Adaptation
- Informed Deliberation

These different degrees or levels can be thought of as being on a spectrum, as seen in *Figure 1*, with adoption being the most complete form and informed deliberation being a form that allows for but does not automatically include a convergence goal. There may be variations that can further complicate discussion.

Figure 1: Degrees of Convergence



Adoption

In a dictionary sense, adopt means to accept formally and put into effect.¹⁰ In preparing its Reports on the Observance of Standards and Codes, the World Bank found that the adoption of IFRSs could be categorized as:

- full adoption of IFRSs;
- full adoption of IFRSs, but with time lag;
- selective adoption of IFRSs; and
- national standards "based on" IFRSs.

The time lag in adopting the international standards primarily results from the time required to translate the standards.

"True" or full adoption of IFRSs results in the most complete form of convergence. Selective adoption of IFRS and national standards "based on" IFRSs would more closely resemble "adaptation" than "adoption."

Convergence

As defined at the beginning of this article, "converge" is "to come together and unite in a common interest or focus."¹¹ In an ideal scenario, complete convergence would result in "a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions."¹²

Whereas adoption generally involves accepting standards that have been developed and putting them into practice, convergence requires starting with standards that have already been put into practice and gradually making them uniform. This process usually must be approached from the perspective of existing standards as well as new standards that are currently being, or yet to be, developed. From both perspectives (new and existing standards), deliberations and due process proceedings are generally conducted in parallel but may vary based on each board's individual timetables.

Harmonization

The dictionary definition of harmonization is "to bring into consonance or accord."¹³ This term appears very similar to the term convergence; however, convergence and harmonization are actually viewed as two different approaches in practice. For example, the title of the Australian Accounting Standards Board's (AASB) policy statement on convergence is "International Convergence and Harmonisation Policy."¹⁴ If the AASB viewed the two terms interchangeably, the title of its policy statement would be redundant.

In the context of the AASB's policy statement, "international convergence" means working with other standards-setting bodies to develop new or revised standards that will contribute to the development of a single set of accounting standards for worldwide use; "international harmonisation" of Australian accounting

standards refers to a process that leads to these standards being made compatible with the standards of international standard-setting bodies to the extent that this would result in high-quality standards.¹⁵

The process of convergence and harmonization, as defined by the AASB, are neither both required nor mutually exclusive. Convergence involves working together with other standards-setters on a common set of international accounting standards while harmonization involves working individually to bring one's standards in line with either international accounting standards or an alternative best practice. Therefore, one could be working toward convergence and harmonization at the same time or on one but not the other.

Adaptation

Adaptation is "to make fit (as for a specific or new use or situation) often by modification."¹⁶ In terms of convergence, adaptation occurs when a country modifies the original IFRSs or International Public Sector Accounting Standards (IPSASs) to fit a perceived need or difference in its particular country. For example, New Zealand IFRS (NZ IFRS) are an adaptation of IFRS to ensure that the standards applied in New Zealand reflect factors that are unique to public benefit entities or to the New Zealand environment. For example, NZ IFRS adds accounting rules for non-cash generating assets, such as the state highway network, to the existing IFRS for cash-generating assets.¹⁷

Informed Deliberation

Informed deliberation is a commitment by the standards-setter to consider the work of other standards-setters but not to be constrained in developing the best standard. Informed deliberation involves an active effort to review international standards and standards of other domains and countries when developing standards for similar issues; stay abreast of developments by other standards-setters; and include materials on these views and developments in the briefing materials along with the materials for the related issues under deliberation.

This is the degree or level of convergence at which the Federal Accounting Standards Advisory Board (FASAB) has historically operated. For example, during deliberations over the draft Concepts Statement,



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Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements, in addition to reviewing its prior definitions of elements, FASAB reviewed the approach to defining elements and the resulting definitions of other standards-setters, including the IASB, the FASB, the Governmental Accounting Standards Board (GASB), the International Public Sector Accounting Standards Board, and the Australian, Canadian, New Zealand, Swedish and United Kingdom standards-setting authorities. FASAB staff also reviewed the emerging definitions in the joint conceptual framework project of the FASB and the IASB and the reasons for the proposed changes from their current definitions.

FASAB lays out its strategy for developing standards in FASAB's *Strategic Directions: Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting*. FASAB's due process includes monitoring the activities of other standard-setting authorities, such as IPSASB, and seeking their views on proposed concepts and standards (See www.fasab.gov/pdf/stratobjectivesnov2006.pdf). At the September 2007 FASAB meeting, some of the board members expressed an interest in exploring what more FASAB could do in the area of relying on or collaborating with other standards-setters but there was not an immediate interest in pure convergence or adoption due to the barriers and obstacles involved (see section below for a further discussion of these perceived barriers).

The GASB's Strategic Plan 2005–2009 lays out the GASB's policy in regard to IPSASs.¹⁸ GASB's objective is to participate actively in international public sector accounting standards-setting by influencing the development of international standards and harmonizing with those standards, where appropriate. GASB adopts the following strategies to achieve this objective:

1. *It reviews international standards and standards of other countries when developing GASB standards for similar issues.*
2. *It provides input before due process documents are issued on ongoing projects of the IPSASB that could impact GASB standards and projects.*
3. *It prepares official GASB responses to IPSASB due process documents that address issues relevant to GASB standards and projects.*

Potential Obstacles / Barriers to Successful Convergence

A number of potential obstacles or barriers make the process of convergence extremely difficult, especially when applied in the federal accounting standards-setter environment. Perhaps the following example will be useful in understanding the complexities involved in full convergence:

Imagine that you and your cousin are discussing how fun it would be to take a family vacation to Walt Disney World. The two of you invite your 18 closest cousins and their immediate families to go with you on a family vacation to sunny Orlando, FL. Amazingly, you have all agreed that you want to drive in a convoy. First, you must pick a date and a time to meet up that is agreeable to all (which ends up being three years in the future). Then you must decide which route to take since you and your cousins live in Maryland, Virginia, Pennsylvania, New York or Washington, D.C.

Once you have decided that you are taking Interstate 95, you all hit the roads together. You cannot stop off at one of the exits unless you communicate with all other 19 vehicles, some of which are ahead of you on the road while others are behind you. Since all of the vehicles are varying shapes and sizes, they need to stop for gas at varying times. Rest room breaks must be similarly coordinated. Average speed depends on the individual cars and drivers; some are moving faster than others and it is hard to stay together.

You cannot veer off the path to stop at an outlet mall or a produce stand without losing track of the convoy. The others would wonder where you went and if you are still on the same journey. It is difficult to get everyone to agree where to stop to eat or spend the night because everyone has varying tastes, budgets and lifestyles. The natural leaders in the group want to exert control over all decisions.

Some of the group will want to switch destinations mid-trip and go to Myrtle Beach or Atlanta. They will have to be talked back into agreeing with the master plan of Orlando. Two of your cousins will decide that the trip is taking too long and costing too much money and will turn around and head back. This reminds you of the six cousins that you did not even bother to invite on the trip because they never have enough money and complain about everything along the way.

Once you get to Orlando (with only 11 of your cousins now because five of them decided to stop at varying points along the way and not continue on to Orlando and another one had to head back to tend to a crisis), you realize that you had foolishly assumed that everyone wanted to go to Walt Disney World. You and the one cousin who originally started planning the trip are, in fact, the only ones who want to go to Walt Disney World. While you and your one cousin dutifully stick together in Walt Disney World, each of your 10 other cousins and their families head off to Universal Orlando Resort, SeaWorld Orlando, Universal Studios, Universal's Island of Adventure, Amway Arena, Kennedy Space Center, Central Florida Zoological Park, Orlando Museum of Art, Orlando Science Center, and the Orange County National Golf Center, respectively.

At your next family get-together, you look at everyone's pictures and remark on the differences and similarities among your vacations in the end and how difficult it was to get to Orlando together, only to end up separated because of differing tastes, budgets and lifestyles among the cousins.

Now, translating this example into the environment of a federal standards-setter, one must consider the following regarding convergence with other standards:

- The needs of the federal government's financial statements users. The need for more informed decision-making in world capital markets with more foreign investment choices—a major catalyst for international convergence for listed companies—is not a driver in the federal environment. In fact, because of the differences that arise with tax-driven or public sector entities, many countries are limiting their convergence efforts to listed companies only. The threshold question is whether users of U.S. government financial reports need a global set of accounting standards. If so, an area to explore would be how to ensure adequate due process for U.S. financial statement users in the international arena.
- Federal preparers, auditors, consultants and contractors may not currently have the technical knowledge and training to plan for, implement and audit the results of existing international accounting standards. Implementation (or transition) would be a tremendous undertaking in and of itself. Assuming a user need for global standards is identified, one must then ask whether the need justifies the federal government using taxpayer resources to revise its existing financial reporting process.
- One of the goals of IASB has been to accentuate principles and avoid rules. While there is merit in the principles-oriented approach, this results in a lot of leeway and judgment during implementation. In the federal environment, the more options for implementation there are, the more requests for implementation guidance we receive. Acceptance of international standards could lead to the need

for extensive interpretation and other technical guidance. If individual countries provide extensive implementation guidance, will the overall goal of comparable financial reports be obtained?

Conclusion/Outlook

While many have argued that achieving the principles of convergence is a worthwhile goal, many contend that there will not be a fairy tale ending to the story of international convergence. While we may think we are heading together to Walt Disney World, we could end up alone at the Kennedy Space Center with great pictures, good memories and a large credit card bill.

Is convergence impossible, even in the federal environment? No. Is it difficult to achieve? Yes. In his presentations on federal financial

management, Sam Mok, CGFM, former chief financial officer at the U.S. Department of Labor and AGA's National President-Elect, has used the example of a frog in a well to describe operations that need fixing. If you are the frog in the well, working hard doing your job, but you have no idea what is going on in the world around you or even where you are in the scheme of things, you could be completely missing opportunities to improve the efficiency and effectiveness of operations.

Standards-setters must jump into the bucket and hoist themselves up to the top of the well to see where they are in the world of accounting standards-setters and what others are doing. At FASAB, we do this through informed deliberations. This ensures that the members have the information they need to make the best decisions they

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can to help achieve the objectives of federal financial reporting.

Beyond informed deliberations, FASAB also looks for opportunities to leverage its resources by partnering with others or building on the hard work others have done. For example, in 2004 FASAB elected to monitor IASB's ongoing project on lease accounting instead of developing its own new approach to lease accounting. More recently, FASAB and GASB are actively considering ways to work together on common projects. One example is the Omnibus AICPA project to incorporate reporting requirements embodied in audit literature in accounting standards. Others relate to the ongoing conceptual framework projects at FASAB and GASB and phases that align well such as the upcoming "measurement attributes" effort.

How much further the board goes in its convergence efforts will depend on the needs of the users of federal financial statements, cost/benefit considerations, and the fit that the board finds between the federal reporting objectives and standards developed entirely by others with possibly different reporting objectives. ■

End Notes

1. Merriam Webster Online at www.m-w.com.

2. International Accounting Standards Committee (IASC) Foundation Constitution available online at www.iasb.org/About+Us/About+the+Foundation/Constitution.htm, accessed August 14, 2007. The International Accounting Standards Board (IASB) is the standard-setting body of the IASC Foundation.

3. Sir David Tweedie, Chairman, IASB, and Thomas R. Seidenstein, Director of Operations, IASC Foundation; "Setting a Global Standard: The Case for Accounting Convergence," *Northwestern Journal of International Law & Business*, Spring 2005, p. 592.

4. The IASC operated from 1973 until 2001 when the IASC Foundation and IASB were formed.

5. Consolacion L. Fajardo, "The Move Towards Convergence of Accounting Standards World Wide," *The Journal of American Academy of Business*, Cambridge, Vol. 12 No. 1, September 2007, pp. 58-59.

6. Source: Financial Accounting Standards Board and International Accounting Standards Board, Memorandum of Understanding, "The Norwalk Agreement," available at www.fasb.org/news/memorandum.pdf, accessed online August 22, 2007.

7. Memorandum of Understanding between the FASB and the IASB—A Roadmap for Convergence between IFRSs and US GAAP—2006-2008, February 27, 2006, available at www.fasb.org/news/nr022706.shtml, accessed online August 22, 2007.

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9. SEC Proposed Rule "Acceptance From Foreign Private Issuers Of Financial Statements Prepared In Accordance With International Financial Reporting Standards Without Reconciliation To U.S. GAAP," Release No. 33-8818, July 2, 2007.

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12. International Accounting Standards Committee (IASC) Foundation Constitution available online at www.iasb.org/About+Us/About+the+Foundation/Constitution.htm, accessed August 14, 2007. The International Accounting Standards Board (IASB) is the standard-setting body of the IASC Foundation.

13. Merriam Webster Online at www.m-w.com.

14. Policy Statement 4 (PS 4), April 2002.

15. PS 4, April 2002, Background, p. 6.

16. Merriam Webster Online at www.m-w.com.

17. These guidelines are also available online at www.asrb.co.nz/documents/Release82004.doc.

18. GASB "Strategic Plan 2005-2009", available at www.gasb.org/strategic_plan/strategicplan.pdf.



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