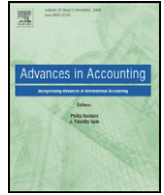




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## The IASB and FASB convergence process and the need for ‘concept-based’ accounting teaching<sup>☆</sup>

Salvador Carmona<sup>a,\*</sup>, Marco Trombetta<sup>b</sup><sup>a</sup> *European Accounting Review, IE Business School, Calle Pinar 15-1, 28006 Madrid, Spain*<sup>b</sup> *IE Business School, Calle Pinar 15-1, 28006 Madrid, Spain*

### A B S T R A C T

The increasing globalization of the U.S. economy drives interest in international accounting standards. In this respect, the convergence process between the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) targets the completion of several major projects by 2011. The importance of the projects under consideration as well as the lack of conclusive theoretical solutions around them suggests that the target of a “common set” of accounting standards will be replaced in the short-medium term by a de facto situation of a “slightly different set” of accounting standards. In this paper, we draw on best available practices to make a specific proposal for the introduction of IFRS into the curriculum of institutions of higher learning in the U.S. Our proposal is driven by the idea that accounting education should move from teaching ever temporary rules to emphasize the economic and strategic underpinnings of accounting transactions.

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### 1. Introduction

The convergence process between the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) targets the completion of several major projects by 2011, and constitutes one of the most ambitious and far reaching efforts in history. Its consequences can hardly be overestimated. As such, the convergence initiative is highly controversial. Nonetheless, it has aligned the agendas of regulators, accounting firms, individual practitioners and academics, who participate in ongoing debates about the optimal nature of standards (rules versus principles), the appropriate standards setting processes and necessary changes to collegiate accounting curricula.

From a U.S. perspective, the increasing globalization of its economy arguably drives interest in international standards. The latest survey of the Bureau of Economic Analysis (BEA) reports that nonbank U.S. multinational companies increased their international operations in 2007 for the fourth consecutive year, as measured by value added, capital expenditures and employment (see Barefoot & Mataloni, 2009). In many if not most of these countries, IFRS is the standard for reporting. Furthermore, IFRS is operating on U.S. soil today; international companies no longer have to reconcile from IFRS

to US GAAP to be registered in the U.S. Under these dynamic conditions, this editorial will elaborate on its implications of the convergence process for accounting education. To do so, a focused review of recent events will be helpful.

Recent surveys conducted by KPMG and the American Accounting Association (AAA) highlight the diverse positions of U.S. accounting scholars regarding the introduction of IFRS in the accounting curriculum (AAA-KPMG, 2008, 2009). The first annual survey was conducted in 2008 and gathered responses from 535 professors. Interestingly, just over 20% of respondents expressed a willingness to make changes in their accounting curriculum, to incorporate IFRS, in the following academic year: 2008–2009. A follow-up survey was conducted during the summer of 2009; this second edition of the survey again collected about 500 responses from U.S. accounting academics. In this case, 75% of the respondents indicated that IFRS should immediately be introduced into the accounting curriculum. Despite this apparent significant, a very small percentage of respondents (8%) considered that their university's accounting faculty was prepared to incorporate IFRS into the curriculum.

The question of whether and when to incorporate international accounting standards into the accounting curriculum is not new. In 1978, the European Economic Community (EEC) issued its Fourth Directive on the annual accounts of certain types of companies. Compliance with provisions of the Fourth Directive required changes in the accounting standards of member states during the 1980s. The adoption of IFRS by the EU in 2005 brought about further adaptation by member states of the current European Union (EU), and required changes in the accounting curriculum. Although these adaptation experiences have not been problem free, they do provide a wealth of knowledge that may be

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\* Corresponding author.

E-mail addresses: [salvador.carmona@ie.edu](mailto:salvador.carmona@ie.edu) (S. Carmona), [marco.trombetta@ie.edu](mailto:marco.trombetta@ie.edu) (M. Trombetta).

transferred to other settings, including the U.S. Drawing on best available practices, we shall make a specific proposal for the introduction of IFRS into the curriculum of institutions of higher learning in the U.S.

As shown by the KPMG-AAA surveys, there is a long way to go in order to get consensus around the introduction of IFRS into the accounting curriculum. We are persuaded that there are two major impediments in this regard. At the core of the discussion is the debate on accrual-based financial accounting, which is an ever-present discussion among accounting academics (see Baxter, 1979). This debate, we submit, has a pervasive impact on several of the specific projects of convergence in accounting standards. Importantly for the purposes of this editorial, there also exists a second and highly interrelated debate about the role of accounting standards in accounting education. In the current editorial, we shall draw on the debate on the first item to outline problems that may be obstructing the actual introduction of IFRS into the curriculum of U.S. universities and business schools.

## 2. The convergence process: a chronology

The beginning of the IASB and FASB convergence project can be traced back to the 2002 Norfolk agreement, where the two regulatory bodies committed to develop a set of high quality “compatible” standards. As noted above, the EU adopted the IFRS in 2004 and made IFRS compulsory for the consolidated accounts of listed companies as of 2005. In turn, this move brought about an active role by national regulatory boards, which were entrusted to issue standards for private companies and for simple accounts. Consequently, the convergence process did not produce a common set of “European” accounting standards across EU state members but rather the cohabitation between a set of “international” standards and a variety of “national” standards. Although national accounting standards have converged in the recent past to IAS/IFRS, they are still not fully equivalent across countries and European accountants have to adapt to this diversity.

In 2006, the IASB and FASB signed up a “Memorandum of Understanding” (MoU) which enhanced their commitment from a “compatible” to a “common” set of high quality standards.<sup>1</sup> The MoU, which constituted a definite step forward in the convergence process, listed 11 topics that were deemed critical to convergence: business combinations, consolidation, fair value measurement guidance, liabilities and equities distinction, performance reporting, post-retirement benefits, derecognition, financial instruments, revenue recognition, intangible assets, and leases.

In 2007, the Securities and Exchange Commission (SEC) removed the reconciliation requirement for non U.S. companies reporting under IAS/IFRS in order to register in the U.S. In this manner, the SEC effectively recognized IAS/IFRS as a set of high quality accounting standards which satisfied the information needs of U.S. investors. Ultimately, the SEC granted operations of IAS/IFRS in the U.S., even if only for non-U.S. companies. However the incipient financial crisis exerted a definite impact on the convergence process. In particular, it prompted debates on such fundamental issues as (i) how to report information about financial instruments, (ii) the appropriateness of fair values, and (iii) the perimeter of consolidation in cases of “special purpose” business combinations. These three items were already on the list of the fundamental topics considered in MoU of 2006 and the Boards were under pressures to issue accounting standards on these issues. Inevitably, any new standards, however, would be subject to robust criticism by some segment of stakeholders.

In September 2008, at the peak of the current financial crisis, the IASB and the FASB updated the MoU of 2006. In the new document, the two regulatory bodies reaffirmed the list of 11 fundamental topics that would lead to accounting convergence and stated 2011 as

deadline. In November 2009, the IASB and FASB issued a Joint Statement that restated the convergence process and confirmed 2011 as a deadline. The Joint Statement comprised a detailed status of the convergence process and identified two particularly controversial topics (i) accounting for financial instruments, and (ii) derecognition of assets and liabilities. These items have attracted a considerable portion of the debate around accounting and the current economic downturn; during the pre-crisis period financial innovations focused on structured finance products (e.g., CDOs and CDSs), whose various forms made it difficult their classification and accounting. Importantly, these financial instruments were often used by Structured Investment Vehicles (SIVs) to finance the “acquisition” of pools of other more primary assets from other financial institutions. Therefore, it remained an issue when selling firms had to derecognize these assets or liabilities as a result of the “transfer” to the SIV. As both the IASB and FASB were under pressure to address these issues, there was awareness that issuing significantly different accounting standards on these controversial items would lessen the credibility of the convergence process. Thus, given the importance of these items, we will focus on them in the next section.

## 3. Financial instruments and derecognition of assets and liabilities

Differences between the IASB and FASB concerning derecognition focuses on the basis that should support the decision. As far as the FASB, the decision is based on the “legal isolation” concept meaning that a transferor can derecognize a financial asset only if, after the transfer, there is no way for either the transferor or its creditors to get the assets back even in bankruptcy or receivership. Conversely, for the IASB the decision is based on the concept of “transfer of substantial risks and rewards.” According to this concept, a transferor can derecognize an asset when it transfers the rights to the contractual cash flows and it does not have any longer involvement on it.

With respect to accounting for financial instruments, the IASB issued a new standard in November 2009 (IFRS 9). This new standard modified extant rules to accounting for financial instruments as *assets*, whereas it leaves financial instruments as *liabilities* under the scope of the old IAS 39. The FASB also reached an agreement about many specifics of a new standard on financial instruments although the new standard has not been issued as yet at the time of writing this editorial.<sup>2</sup>

Both Boards moved from a three-category classification model (Held-To-Maturity; Marketable Securities; Available For Sale Securities) to a two-category classification model. In their new framework both Boards used full fair value accounting with changes in the income statement as the default accounting model for securities. They also agreed about allowing debt type securities to be treated differently. However, the Boards disagreed about the accounting model to impose on debt type securities. In IFRS 9 the IASB stated that these securities had to be accounted for at amortized cost with no adjustment to fair value unless in case of impairment for credit losses. Conversely, the FASB advocated fair value adjustments for debt type securities, but with changes in fair value reported in Other Comprehensive Income and not in the Income Statement. Moreover, some other differences between the Boards referred to the calculation of credit losses and accounting treatment for hybrid instruments (see FASB, 2009).<sup>3</sup>

The discussion on the appropriate model to account for financial instruments did not emerge with the current economic downturn. In 2005, the EU endorsed IAS 32 and IAS 39, which became the latest international standards receiving EU support before the official adoption of IAS/IFRS. The promulgation of IAS 32 and IAS 39 was

<sup>1</sup> As noted by some commentators, the adoption of IAS/IFRS by the EU put them in a good position to become a “global” set of standards, and this in turn may have driven this shift in the convergence process (see Whittington, 2005).

<sup>2</sup> A summary of the decisions already reached with respect to the future new standard have been made public in a recent document released by the FASB (2010).

<sup>3</sup> Cf. FASB (2009).

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