Why Convergence between the FASB and IASB May Be Impossible

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Abstract

The objective of this study is to present not only the similarities, but differences in the organization structure, standard setting process and political/business environments between the FASB and IASB. This exposition provides a partial explanation of why convergence between these two regulatory bodies may be impossible. We show how these differences and the influence of their political, business and legal environments impede convergence. Moreover, we provide some examples of how political and regulatory bodies have influenced outcomes of the standard setting process both in the U.S. and in Europe. Accounting practitioners and regulatory bodies may be interested in this study in explaining the barriers to accounting convergence. For example, students of accounting in many instances are not exposed to the political and legal interplay of accounting and how it differs between countries. Others are not aware of how local jurisdictions, political, and legal structures effect the development of accounting standards.

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1. Introduction and outline

The objective of this study is to present not only the similarities, but differences in the organization structure, standard setting process and political/business environment between the FASB and IASB. This may partially explain the convergence issues between these two regulatory bodies. Most studies focus on the empirical results of comparability, usefulness and cost of capital differences in applying U.S. GAAP and IFRS. Other studies find that legal origin, market infrastructure, and culture explain these differences in financial reporting and regulation (Ball, Robin and Wu 2003). Still other studies explain differences in the conceptual frameworks between the FASB and IASB as an explanation for differences in financial reporting (Zeff 2002). We present a commentary on the FASB's and IASB's standard setting, due process and regulatory environments as a partial explanation for why convergence between the IASB and FASB may be impossible.

We believe that accounting practitioners and regulatory bodies may be interested in this study in explaining the impediments to accounting convergence. For example, students of accounting in many instances are not exposed to the political and legal interplay of accounting standard setting and how it differs between countries. Others are not aware of how much influence local jurisdictions or political and legal structures effect the development of accounting standards. We believe that there are many similarities between the FASB's and IASB's organization structure but there are overwhelming differences also. Moreover, we show how these differences hinder the convergence of accounting standards, *de jure and de facto*, between the IASB and FASB. First we present the organization structures of these Boards. Next we present their due process. Finally, we show how dissimilarities in organization structure and due process and the influence of their political, business and legal environments impede convergence.

2. Organization Structure of the IASB

The International Accounting Standards Committee (IASC) was founded in 1973 with the major aim of developing a single set of high quality standards with specific requirements of providing for fewer alternative practices, clarity in its standards[1], and comprehensiveness[2] and transparency of information[3]. These objectives have been undertaken by the International Financial Reporting Standards (IFRS) Foundation since 2001. It is composed by 22 Trustees[4], who are also responsible for safeguarding the independence of the IASB and ensuring the financing of the organization. The IASB is the independent standard-setting body of the IFRS Foundation and since 2012, it is made up of 16 full-time members who are responsible for the development and publication of IFRSs and for approving Interpretations of IFRSs as developed by the IFRS Interpretations Committee (formerly called the IFRIC) (see figure 1[5])

– Insert Figure 1 –

In order to establish its high quality standards, the IASB follows an open and transparent due process based on the publication of consultative documents, such as discussion papers and exposure drafts, for public comment. This approach allows the IASB to take into account comments from stakeholders around the world, including investors, analysts, regulators,

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[1] To avoid difficulties in interpretation.

[2] In order to provide a solution for every kind of operation that a company could face, being able at the same time to provide an effective system to assess new kind of transactions.

[3] That means full disclosure and understandability.

[4] Six of the Trustees must be selected from the Asia/Oceania region, six from Europe, six from North America, one from Africa, one from South America and two from the rest of the world.

[5] Source: http://www.ifrs.org/The-organisation/Documents/2013/Who-We-Are-English-2013.pdf (downloaded 2/25/2013).

business leaders, accounting standard-setters and the accountancy profession. A technical staff, that comprises accounting professionals, supports the IASB in preparing its technical documents and standards.

At the top of Figure 1 in the IASB's organization structure is the IFRS Foundation Monitoring Board. This Board was established to ensure that the Trustees discharge their responsibilities as defined by the IFRS Foundation Constitution, and to approve the appointment or reappointment of IFRS Foundations Trustees. The Monitoring Board is composed of members from the Emerging Markets and Technical Committees of the International Organization of Securities Commissions (IOSCO), the European Commission (EC), the Financial Services Agency of Japan (JFSA), and the U.S. Securities and Exchange Commission (SEC). The Monitoring Board includes as an observer, the Basel Committee on Banking Supervision.

Since 2001 the IFRS Interpretations Committee, composed of 14 voting members appointed by the Trustees and drawn from a variety of countries and professional backgrounds, has taken the place of the former Standing Interpretations Committee in reviewing on a timely basis widespread accounting issues that have arisen within the context of current IFRSs and to provide authoritative guidance (IFRICs) on those issues. The Interpretation Committee meetings adopt the same approach of the IASB in its due process for developing IFRSs.

The IASB Organization Structure has an Advisory Council that provides input/advice on the IASB's agenda, standard setting projects and related matters. Like the IASB, the FASB has an organization structure that is intended to foster independent and transparent standard setting.

3. Organization Structure of the FASB

– Insert Figure 2 –

The Financial Accounting Standards Board's (FASB's) organization structure includes the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB) the Financial Accounting Foundation (FAF), the Financial Accounting Standards Board (FASB), The Financial Accounting Standards Advisory Council (FASAC), the Emerging Issues Task Force, the Private Company Council (PCC) and FASB Staff (see figure 2).

The SEC's mission is to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation" (SEC 2013). The SEC includes five presidentially-appointed commissioners headquartered in Washington, DC. The Securities Act of 1933 requires that investors receive financial reports that fairly represent the companies registered with the SEC. The SEC Act of 1934 empowered the commission to require periodic financial reports of companies with publicly traded securities. The SEC has delegated its accounting regulatory authority to the FASB that is overseen by the FAF.

FAF is an independent, private-sector organization charged with overseeing and appointing FASB board members. They are also responsible for establishing and improving financial accounting standards, educating constituents about the standards, overseeing, administering and financing the FASB's standard setting, and protecting the integrity and independence of standard-setting. It is a charitable, education, scientific and literary non-stock Delaware Corporation and thus has a 501(c)(3) IRS designation. FAF is located in Norwalk Connecticut. While FAF also oversees the Governmental Accounting Standards Board (GASB) this aspect of FAF's structure is beyond the scope of this study.

FAF is governed by a 16-member board of trustees. New trustees are selected by FAF from the American Accounting Association, the American Institute of Certified Public Accountants, the Chartered Financial Analysts Institute, Financial Executives International, the Government Finance Officers Association, the Institute of Management Accountants, the National Association of State Auditors, Comptrollers and Treasurers, and the Securities Industry and Financial Markets Association (Fleckner 2008). FAF is funded through the Public Company Accounting Oversight Board (PCAOB).

The PCAOB secures the majority of funds to operate FAF. Section 109 of the Sarbanes-Oxley Act requires that the FASB is funded by the PCAOB. Annual accounting support fees[6] collected by the PCAOB are allocated to FAF upon review/approval from the SEC of FAF's budget. In 2010 and 2011, 69% and 66%, respectively, of FAF's activities were funded from accounting support fees (FAF 2012). These fees are allocated to the FASB in accordance with the Sarbanes Oxley Act, Section 109. While significant FAF revenues are from PCAOB levied accounting support fees, the FAF continues to be dependent on political influence. For example, FAF in 2004 spent resources, $64,000 (see Denham and Herz 2005), and time on lobbying in Congress.

FASB, established in 1973 in succession to the Committee on Accounting Procedure (1936-1959) and the Accounting Principles Board (1959-1973), is an independent and private standard setting body of seven full time paid members in the accounting profession that promulgate accounting standards, sometimes referred to as U.S. GAAP or Accounting Standards Codifications. These Board members are free of any outside business or professional organization. They are charged, full-time, with establishing and improving financial accounting standards and reporting. They must relinquish all ties with their former

[6] Mandatory accounting fees are imposed on SEC registrants. The budget must be prepared as prescribed in SOX Section 109 and approved by the SEC before any PCAPB collected funds can be allocated to FAF by the Secretary of the Treasury.

employer; and after their FASB term ends they cannot return to their former employer. While much is established to insure the independence of the Board members, they are unable to escape the external pressures from business and political communities (Fleckner 2008; Hail, Leuz and Wysocki 2010).

The Private Company Council (PCC) was created on May 23, 2012, by the FAF Board of Trustees (FAF 2012). All members of the PCC are selected and appointed by the FAF Board of Trustees. The purpose of the PCC is to identify and then vote on exceptions or modifications to existing U.S. GAAP for private companies. Also, the PCC is the primary advisory body to the FASB on technical agenda items for consideration of treatment for private companies. (See FAF Board of Trustees, 2012.) The PCC is to determine, in consultation with FASB and with input from stakeholders, which parts of GAAP should be considered for possible modification, based on a required two-thirds majority PCC voting members. FASB is charged with endorsing PCC decisions. FASB has 60 days to endorse a PCC decision, and if not endorsed, a written reason must be provided. If endorsed by the FASB, then the exception or modification becomes part of U.S. GAAP. While initially the PCC chair was to be a FASB member, this was not endorsed by FAF. Unlike FASB board members, PCC members, 9-12 member board, do not receive compensation. In Figure 2, we have placed the FASB and PCC across from each other and under the authority of FAF as both are responsible for promulgating U.S. GAAP. FAF did create a Private Company Review Committee to oversee the PCC, but only for its first three years of operation (FAF Board of Trustees 2012). After the first three years, FAF will assess whether further changes need to be made to the PCC's organization structure.

The Financial Accounting Standards Advisory Council (FASAC) advises the FASB on matters of concern to the FASB, e.g., technical issues and project priorities. There are approximately 30 members on the FASAC including auditors, preparers and users of financial reports. There is also an Emerging Issues Task Force that is responsible for interpreting standards promulgated by the FASB and publishing its interpretations.

More recently, the FASB has become a member of the newly formed Accounting Standards Advisory Forum (ASAF). The ASAF is composed of 12 national and regional standard setters charged with improving cooperation among standard setters from across the globe and advising the IASB in promulgating IFRS. These members were selected by the IFRS Foundation and include four from Asia-Oceania, four from Europe, three from the Americas and one from Africa. See Tysiac (2013).

While there are many similarities between the FASB's and IASB's organization structure; there are also many dissimilarities. The standard setting boards work under the authority of a board of trustees that select Board members and allocate funds to the Board. Both have an interpretations committee and advisory council. However, the FASB has an objective source of securing operating funds whereas the IASB does not. Moreover, the IASB's members are from across the world whereas the FASB's members are U.S. citizens only. Next we review the due process of the IASB and FASB to present its similarities and differences.

4. IASB Due Process

– Insert Figure 3 –

In order to garner global authoritative support for its standards (Keohane, 2006; Lehman, 2005; Arnold and Sikka, 2001; Ashbaugh and Pincus, 2001), the IASB affirms that the standards are developed through a formal process and a broad consultation (due process) that involves accountants, financial analysts and other users of financial statements, academics and organizations from around the world, and by submitting an exposure draft/discussion paper and collecting comment letters before issuing a final standard.

The due process that leads both to the development of any new standard and revision of existing ones, consists of an international consultation process of interested individuals and organizations from around the world. For the IASB, the due process is articulated in six stages, with the Trustees having the opportunity to ensure compliance at various points throughout[7] (see Figure 3):

1. Setting the agenda. Based mainly on the emerging needs of investors, the IASB evaluates the utility of adding a potential topic to its agenda in order to finally address the demand for better-quality information as a value to all users of financial statements.

2. Planning the project. If the IASB considers a topic to be included in its agenda, it also decides whether to conduct the project alone or jointly with another standard-setter. In both cases a similar due process is followed.

3. Developing and publishing the discussion paper. This stage is optional and the IASB usually publishes it as its first publication on any major new topic. The discussion paper explains the issue and provides possible approaches in addressing the issue. The discussion paper is used to solicit early comments from constituents.

4. Developing and publishing the exposure draft. This step sets out a specific proposal in the form of a proposed standard (or amendment to an existing standard) and it is the means to consult with the public. The exposure draft (ED) is independent from the previous publication, the discussion paper. In issuing the ED, the IASB considers inter alia comments received on any discussion paper and suggestions made by the IFRS Advisory Council, working groups and accounting standard-setters, and arising from public education sessions.

5. Developing and publishing the standard. During its meetings, the IASB considers the comments received on the exposure draft and develops the IFRS. In case of particular issues arising from the ED, the IASB could decide to expose its revised proposals for public comment in the form of a second ED.

6. After the standard is issued, the staff and the IASB members are devoted to hold regular meetings with interested parties to help understand unanticipated issues related to the practical implementation and potential impact of its proposals. The IFRS Foundation also fosters educational activities to ensure consistency in the application of IFRS.

[7] Source: http://www.ifrs.org/How-we-develop-standards/Pages/How-we-develop-standards.aspx (downloaded 2/27/2013).

With regard to the due process topic, some authors highlight that the IASB's role is to resolve conflicts among interested groups by trying to find an acceptable solution to various constituencies (Melis 2008; Zeff 2002; Sutton 1984; Zeff 1978). For this reason, an accounting standard setting process is a political lobbying process that offers potential participants several means to influence the IASB's outcome. Moreover, after the spread of IFRS adoption across countries, it is possible to observe that the loss of sovereignty by governments has significant consequences. Every national organization, in fact, will exert its power in the "new" shape of a political lobby toward the international institution. This does not always represent, with certainty, achievement of the main objective that the international institutions have defined. On the contrary, it may lead to the exact opposite, which is, not supporting the stakes of investors and other users (Zeff 1978).

Specifically, the political pressures in the accounting standard setting process could occur in the form of prescribing specific accounting treatments, eliminating alternative treatments, imposing additional disclosure requirements or tightening the allowed interpretations (Zeff 2002). Assuming a nation adopts IFRS *carte blanche*, the more developed a state's national standard setting body, the more the government and accounting profession of that state will lobby the IASB, which in effect reduces its national power of regulating accounting issues (Stoddart 2000). The process of promulgating standards by the IASB is similar to that of the FASB.

5. FASB Standards-Setting Process

– Insert Figure 4 –

The Financial Accounting Foundation (FAF), an independent private sector body, grants the FASB authority to set forth and improve accounting standards according to its "Restated Certificate of Incorporation and By-Laws." (See FAF 2012.) The FASB is a seven-member board that promulgates non-governmental accounting standards, which are to be applied in preparing financial reports. The standard setting process is intended to be comprehensive, independent and open to broad input. The FASB also establishes accounting concepts (FAF 2012), similarly to Financial Accounting Standards. These concepts are to be used in guiding the FASB in setting standards and resolving accounting issues, but are not authoritative. The FASB began establishing and improving accounting standards in 1973. Part of the FASB's mission is to "promote the convergence of accounting standards internationally" (FAF 2012, 3).

The FASB's due process involves open meetings and activities with public participation to support transparency in the standards-setting process. The FASB's Rules of Procedure are quoted below (http://www.fasb.org/facts/ downloaded 2/27/2013) and illustrated in Figure 4.

1. "The Board identifies a financial reporting issues based on requests/ recommendations from stakeholders or through other means.

2. The FASB Chairman decides whether to add a project to the technical agenda, after consultation with FASB Members and others as appropriate, and subject to oversight by the Foundation's Board of Trustees.

3. The Board deliberates at one or more public meetings the various reporting issues identified and analyzed by the staff.

4. The Board issues an Exposure Draft to solicit broad stakeholder input. (In some projects, the Board may issue a Discussion Paper to obtain input in the early stages of a project).

5. The Board holds a public roundtable meeting on the Exposure Draft, if necessary.

6. The staff analyzes comment letters, public roundtable discussion, and any other information obtained through due process activities. The Board redeliberates the proposed provisions, carefully considering the stakeholder input received, at one or more public meetings.

7. The Board issues an Accounting Standards Update describing amendments to the Accounting Standards Codification."

6. Convergence Impediments

a Funding sources of FASB and IASB

Both the FASB and IASB require funding to operate. There are significant difference in how these boards are funded and the enforcement power to obtain funding from the business community.

Funding for FAF comes primarily, about 70%, through the PCAOB, an independent body mandated by the SOX Act of 2002 stating that "annual accounting support fees" are levied on issuers of securities or public corporations in proportion to their "equity market capitalization". These accounting support fees cannot exceed the recoverable expenses of the FASB as provided in the Board's annual budget. Congress sets the budget of the FAF annually. The FAF also receives revenues from subscriptions publications and contributions. In 2010, 69% of its revenues were from accounting support fees and about 28% were from subscriptions to their publications. Finally, the FAF is a non-stock Delaware corporation that operates exclusively for charitable, educational, scientific, and literary purposes.

A large percentage of the IFRS Foundation's funding is from voluntary contributions of companies and accounting firms. Also in practice, the IFRS Foundation is now funded by thousands of bodies either directly or indirectly. The IFRS Foundation, 22 trustees, oversees the work of the IASB, including its structure, and strategy, and has fundraising responsibility. Unlike FAF, the IFRS Foundation does not have authority to require automatic funding from jurisdictions or companies that use IFRS. The IFRS Foundations is a not-for-profit private sector body that raises funds to support the operation of the IASB.

The differences in funding for the FASB and IASB may impede convergence. The IFRS Foundation has no means of enforcing firms across the globe to pay fees to operate IASB. Moreover, the IASB's independence may be mitigated if they have to rely on voluntary contributions from their constituents. That is, firms that make the largest and most significant contributions to the IFRS Foundation may have significant influence on standard setting, more so than firms or jurisdictions that make insignificant or small contributions to the IASB.

b. Environmental Influencers of FASB and IASB

The FASB promulgates financial accounting standards, now referred to as FASB Accounting Standards Codifications. These codifications are part of U.S GAAP. We use the descriptions of the IASB and FASB organization structure and due process along with empirical findings to explain why differences in the standard setting process may impede the convergence of accounting standards between the IASB and FASB. There are differences in how the Boards interact within their political and business environments to affect the due process for standard setting.

The FASB is surrounded by pressures from the SEC, Congress and the business community. A few examples demonstrate the interplay between the FASB and its environment. The FASB is recognized by the SEC as the source of authoritative accounting standards for its registrants. While the FASB is the private sector body that issues accounting standards, the SEC is a governmental agency that has statutory authority to issue accounting standards for publicly held companies under the Securities Exchange Act of 1934. The SEC recognizes the FASB as the standards setting body in the U.S. in its Accounting Series Release No. 150, codified in Financial Reporting Release No. 1, Section 101 and again in its Sarbanes-Oxley Act of 2002. However, should the SEC deem that the FASB ceases to adhere to the provisions of the SEC Act (i.e., standards that do not protect the interests of investors), then the FASB loses its role as a standard setter. The SEC can veto the FASB, but the FASB cannot veto the SEC (Horngren 1985). Hence, the SEC's veto power over the FASB is the link between the FASB and politics.

The FASB's authority and independence has been challenged. For the most part the SEC has accepted the FASB's standards, but in a few instances, has not. The SEC has vetoed the FASB's proposal, suspended a prevailing FASB regulation or at other times issued a superseding regulation. For example, Melumad and Shibano (1994, 6) state that the "FASB-SEC disagreements occurred over standards regarding:

(1) oil and gas (the SEC rejected SFAS No. 19 in 1977),
(2) software costs (the SEC suspended SFAS No. 2 in 1983),
(3) defeasances (the SEC suspended FASB regulations in 1982),
(4) leases (the SEC superseded Opinion No. 31 in 1973),
(5) investment tax credits (the SEC superseded Opinion No. 2 in 1962)
(6) changing price levels (the SEC superseded the FASB Exposure Draft in 1976),
(7) goodwill and intangibles in bank acquisitions (SEC Bulletin 42 superseded the FASB's policy)."

These are just some of the disagreements that have been vetted publicly. Some theorize that when the FASB's position is not close to the SEC's, it affects the standard-setting performance (Melumad and Shibano 1994).

While the FASB is supposed to be an independent standard setter, more recently its independence has been challenged; specifically when making changes on mark-to-market fair value accounting standards in response to political pressure. A disagreement occurred when the SEC expressed enforcement concerns about the FASB's fair-value accounting standard. The SEC and U.S. Congress put strong pressure on the FASB to change its fair value rule (see Laux and Leuz 2009, Wallison 2008, Whalen 2008, Forbes 2009). Bankers put pressure on the FASB as it was concerned that marking assets to market during the financial crisis might have unintended consequences regarding violation of company contracts and debt covenants.

> "The American Bankers Association in its letter to the SEC in September 2008 states:
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> "The problems that exist in today's financial markets can be traced to many different factors. One factor that is recognized as having exacerbated these problems is fair value accounting." Similar concerns were also shared by the U.S. Congress, which put

> strong pressure on the FASB to change the accounting rules. See also, e.g., Wallison (2008), Whalen (2008), and Forbes (2009)" (Laux and Leuz 2009, 826).

FAF has also been challenged by other constituents. The Investors Technical Advisory Committee (ITAC) in 2009 recommended that FAF reverse their decision of 2008 that reduced the size of the FASB from seven to five and further suggested that FAF act as a buffer, "protective shield" for the FASB to enhance the Board's independence. By 2012 FAF's revised due process brought the board size from five members back to the original size of seven members. In FAF's 2004 Annual report they state:

> "While the Trustees of the FAF leave the complex task of accounting standard setting to the experts who make up the FASB and the GASB, the FAF has a responsibility to respond when the independence of the standard-setting process is at risk. This occurred during 2004 when legislative interference was threatened in connection with the share-based payment project. While we respect the right of Congress to set accounting rules if it chooses, we believe that doing so would dangerously compromise the independence of the FASB and, by politicizing standard setting, would compromise the credibility of the resulting accounting standards. Consequently, the Trustees issued a public statement expressing "[their] strong and unanimous opposition to any current or proposed legislation that would undermine the independence of the FASB by pre-empting, overriding, or delaying the FASB's ongoing effort to improve accounting for equity-based compensation or any other topic." Our message was reinforced when individuals and organizations stepped forward to express similar sentiment and to reiterate the message that if special interests are able, through legislation, to overturn expert accounting judgment, necessary and timely improvements in financial reporting will be delayed or denied. Congress has thus far chosen to leave accounting standard setting to an expert process conducted by the FASB and subject to SEC oversight, a choice that we believe is very wise" (FAF, 2005, 3).

Even with this threat to the FASB, the SEC chose to change the date of compliance for the share-based payment standard, see SEC (2005). These examples show that the SEC does at times exercise its statutory power and may continue to do so if IFRS is adopted by the FASB (Hail, Leuz and Wysocki 2010).

There is the influence of not only the SEC, but the business and political environments that have strong-armed the FASB. There was a political battle over stock options during the 1990s (Frontline 2002). Companies had avoided expensing stock options and recording them on their balance sheet in the 1990s. Remember, this was when technology companies were paying their CEOs almost exclusively with stock options. If the FASB finalized its proposed rule requiring expensing of stock options, high-tech companies' profits would have, on average, plunged downward by 60% (see McNamee et al. 2000). In fact, the Senate passed a non-binding resolution to condemn the FASB's proposed recording of stock options. James Hooton, (2002) chief of Andersen's worldwide auditing firm, said that this was the first time the FASB had been so influenced by political and commercial interests. He also commented that moving accounting into politics moves the focus of the FASB from the best standard and instead to commercial interests. Arthur Levitt, then chairman of the SEC, said that never before had so many CEOs come to his office to urge the SEC to prevent the FASB from enacting this proposed rule (Levitt 2002). In fact, Mr. Levitt went to the FASB to urge them not to enact the proposed rule. The result was that although options represent a claim on the company, the proposed FASB rule did not pass and stock options continued to be treated as a footnote disclosure.

These examples show how convergence of the FASB with the IASB may be impossible. The FASB cannot ignore the power of its local business community and the SEC. Further, FASB pay checks are funded by the business community through the PCAOB as mandated in the congressional Sarbanes Oxley Act. The SEC and congress may fear losing control of standard setting if *cart blanche* authority for financial accounting standard setting is given to the IASB. Hence the political and business communities' influence on U.S. GAAP standard setting may preclude convergence of U.S. accounting codifications with IASB international financial reporting standards.

In the U.S. accounting codifications are legally enforceable through the SEC. However, this is not true relative to IFRSs. Below is a description of the endorsement process in the EU for adopting IFRS. This concept of an endorsement is not unique to Europe, but is used here to understand the politics and business environment of adopting IFRS in countries and legal jurisdictions around the world.

In London, home of the IASB, standards must be endorsed by the EU before they are sanctioned by the EU and its member states. The Accounting Regulatory Committee (ARC), composed of representatives from Member States and chaired by the European Commission, was set up by the Commission in accordance with the requirements contained in Article 6 of the IAS Regulation (EC/1606/2002). The Committee has a regulatory function of providing an opinion on Commission proposals to adopt an international accounting standard as stated in Article 3 of the IAS Regulation and comprised of Member State Representatives.

Following the enactment of Regulation no. 1606/2002 on International Accounting Standards, the application of IAS/IFRS by listed companies in the EU from 2005 onwards became subject to EU endorsement. The endorsement procedure in the EU gives them the power to accept, amend or reject newly promulgated IAS/IFRS standards into law. Any decision of the Commission to endorse IAS/IFRS is based upon the opinions of ARC and the technical advice of the European Financial Reporting Advisory Group (EFRAG). EFRAG is a private sector body in Europe known as ‘Member Organizations’. As a technical committee, EFRAG provides the European Commission with technical advice before the Commission endorses any IAS/IFRS. EFRAG participates with the ARC as an official observer[8]. Additionally EFRAG invites the IASB members as observers to its Technical Expert Group meetings and holds joint public meetings with the IASB regularly. EFRAG operates through a Technical Expert Group (EFRAG-TEG), composed of highly qualified experts. EFRAG-TEG assesses whether the standard to be endorsed complies with Community law and in particular, the requirements of Regulation 1606/2002 as including

[8] In March 2006, EFRAG's role was formalized in a Working Arrangement with the European Commission, which states that 'EFRAG will provide advice to the Commission on all issues relating to the application of IFRS in the EU.'

understandability, relevance, reliability and comparability as well as the true and fair principle as set out in the 4th Directive 78/660 and the 7th Directive 83/349. Opinions are issued after a wide consultation of interested parties in the European area, in accordance with its due process[9]. EFRAG also participates in the IASB's due process. Except for the chair, voting members of EFRAG provide their services gratuitously. It appears that the EC has an important role in issuing accounting standards. In fact, although the EC does not issue accounting standards directly, it participates actively in standard issuing by involving EFRAG in IASB's due process and by endorsing IAS/IFRS if they meet the requirements in the European directives.

At the same period of issuing Regulation 1606/2002 (June 2002), EFRAG gave its opinion on the endorsement of all existing IAS/IFRS/SICs. They stated that all existing IAS/IFRS/SICs were not contrary to the 5th Directive and 7th Directive and met the requirements of understandability, relevance, reliability and comparability and the true and fair principle, EFRAG suggested IAS/IFRS endorsement. However, in 2002, EFRAG took note of IAS 39 because of its complexity and effect on hedge accounting standards. They welcomed that the IASB was currently in the process of improving IAS 39.

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[9] EFRAG has established and open and transparent due process, which allows and encourages European constituents to provide input for the consideration of EFRAG. The transparency and independence of EFRAG is mainly achieved by (source: http://www.efrag.org/Front/c1-262/EFRAG-Facts.aspx downloaded 3/26/2013):

- holding all discussions in public meetings, publishing meeting agendas and summaries on the EFRAG website;
- publishing EFRAG preliminary positions, with an open call for comments, regardless of whether these relate to due process documents issued by the IFRS Foundation, the IASB or the draft endorsement advice to support the European endorsement process;
- publishing all comment letters received and of EFRAG's final positions, including presentation of the basis for the EFRAG Technical Expert Group's conclusions for the endorsement advice and reasoned positions for comments to the IASB;
- issuing a public consultation on the EFRAG proactive agenda;
- issuing an invitation for comments on all discussion papers published as part of EFRAG's proactive work.

By July 2003, ARC had voted unanimously, favoring the draft Commission Regulation proposing endorsement of all existing IAS/IFRS/SICs, with the exception of IAS 32 and 39[10]. The ARC Chairman insisted on the IASB and the banking and insurance industries finding an acceptable and prompt solution for IAS 32 and 39.

In fact, European Regulation no. 1725/2003 endorsed all existing IAS/IFRS/SICs with the exception of IAS 32 and IAS 39. Based on EFRAG and ARC recommendations, the Commission decided not to endorse IAS 32 and 39 on financial instruments' disclosure, presentation, recognition and measurement. The EC stated that accounting for financial instruments and derivatives required a high quality standard relevant for the Community capital market. Therefore, they elected not to adopt IAS 32 and 39.

By 2004, EFRAG and ARC had endorsed the IASB's amended standard on financial instruments, IAS 32, but not IAS 39. The failure to endorse IAS 39 became known as the "carve out" of IAS 39. This "carve out" illustrates the strong intervention of third parties, EFRAG, ARC and the EC in the accounting standards endorsement process in the EU. Later in 2004, the IASB using its due process amended IAS 39. EFRAG voted 5 supporting endorsement and 6 opposing endorsement. These voting results failed to meet the two third's majority needed for a non-endorsement advice. EFRAG decided not to issue any advice on whether or not to endorse IAS 39.

The "carve out" of IAS 39 was predicated on two EC concerns. One concern was the possible inappropriate use of the full *fair value option* for all financial assets and liabilities, especially regarding a company's liabilities. A second concern was of European banks, the *hedge accounting* provisions, which presented an issue for banks operating their risk management.

[10] Many Member States regretted the absence of a complete set of IASs and all stressed the importance to consider revised IAS 32 and 39 as soon as possible. Moreover, this "split endorsement" approach proposed was supported by Member States as well as by the private sector.

After these concerns were debated and comments from the ARC and EFRAG were considered, the EC considered the "carve out" as a best alternative for endorsing IAS 39. In September, 2004, the EC presented a draft Regulation of IAS 39 with the exception of the full fair value and portfolio hedging of core deposits. In October 2004, ARC expressed its opinion in favor of this draft even after considering some of EFRAG's[11] concerns. Finally, the EC issued Regulation no. 2086/2004 endorsing the "carve out" version of IAS 39[12]. A year later, EFRAG and ARC gave support of the IAS 39 "carve out" version. By the end of 2005, the EC endorsed and the EFRAG and ARC expressed positive opinions on Regulation no. 2016/2005, that is, the "carve out" version of IAS 39.

While the Commission confirmed that it had no intention of becoming an accounting standard setter, its actions regarding IAS 39 demonstrate its strong influence on standard setting. In fact, the IASB agreed to discuss with the European Banking Federation its proposals on a new hedging method and to revise IAS 39 regarding the full fair value option and to consider concerns expressed by *inter alia* the European Central Bank and the Basel Committee of banking regulators.

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[11] "*In relation to the carve-out of the fair value option for liabilities the concerns are that the carve-out will create artificial volatility for many entities in Europe and the effect may be serious for those entities and countries affected*" and "*In relation to hedge accounting the effect of the carve-outs is not just to allow fair value hedging of core deposits on a portfolio basis but to extend the range of items that can be designated as hedged items and to relax the effectiveness test requirements for all hedges*".
(Source: http://ec.europa.eu/internal_market/accounting/docs/efrag/20040926_ias39_carveout_en.pdf downloaded 3/11/2013).

[12] The Commission had also adopted a political declaration stating that it expected the International Accounting Standards Board (IASB) to bring forward the necessary amendments to the full fair value option by December 2004 and to the provisions on hedge accounting by September 2005. Commissioner Frits Bolkestein said: "*IAS 39 has been very controversial. I am glad that we have found a solution. The two 'carve outs' are purely temporary because the Commission expects the IASB to remedy the outstanding problems quickly. The Commission is not a standard setter and cannot resolve them on its own*." (source: http://europa.eu/rapid/press-release_IP-04-1385_en.htm downloaded 3/20/2013).

During the financial crisis of 2007 the EC again intervened on the IASB standard setting process. Specifically the EC was concerned about fair value accounting of financial instruments as issued in IAS 39 and in the more recent IFRS 7-*Financial Instruments: Disclosures "Reclassification of Financial Assets"*[13]. Initially, the IASB issued an amendment to IAS 39 and IFRS 7 that permitted an entity to "reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition (also referred at as the fair value option)) out of fair value through the profit or loss category in specific circumstances." This amendment was issued without the normal due process of the IASB, that is, no exposure draft was published. EFRAG endorsed this amendment without following its usual due process and the EC issued the Regulation no. 1004/2008 to endorse the above amendment[14]. These swift leaps to action were in response to the urgency of the financial crisis.

After a meeting with European stakeholders, the EC voiced to the IASB an urgent need for more guidance on the application of fair value in inactive markets. Given the global nature of the financial crisis, the EC preferred a globally coordinated solution. This ongoing financial crisis further exacerbated the EC's concern for urgency on this guidance. The IASB's reaction should have been an appropriate due process. On October 31, the IASB published a document setting forth guidance which stated that transaction prices and broker or pricing service quotes could be inputs when measuring fair value if an active market did not exist.

[13] IFRS 7 has been issued by the IASB in 2005 in order to replace some of the requirements in IAS 32 and to require entities to provide disclosures in their financial statements that enable users to evaluate: (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date, and how the entity manages them. It has been endorsed by EC with the Regulation 108/2006 with the favorable opinions of ARC and EFRAG.

[14] Referring to the *Reclassification of Financial Assets* option of the amendment, the Regulation's text highlights that "the current financial crisis is considered to be such a rare circumstance which would justify the use of this possibility by companies".

This clarification was acceptable to European companies, that is, to apply internal models to calculate the value of financial instruments of inactive markets. This same clarification was issued by the FASB and SEC. Moreover, during this financial crisis, several issues emerged resulting in the IASB's commitment to work with the FASB to effect globally consistent solutions. Together, the IASB and the FASB established a process for the rapid consideration of issues raised by the EC and by other stakeholders. The push for global convergence of standards setting is not limited to Europe.

c. *Global pressures to converge FASB and IASB*

Political representations of world nations, in responding to the financial crisis, have urged the IASB and the FASB to convergence. At the G-20s April 2009 meeting, they concluded that: "*Standard-setters should make significant progress toward a single set of high quality global accounting standards*." In June, the U.S. Treasury made the same recommendation[15]: "*We recommend that the accounting standard setters make substantial progress by the end of 2009 toward development of a single set of high quality global accounting standards*." These cries for convergence have been fully supported by the Financial Crisis Advisory Group (FCAG)[16]. FCAG expressed that while the maintenance and enhancing of high quality accounting standards is of utmost importance, and difficult issues remain to be resolved in the convergence process, they shared the sense of urgency expressed by the G-20 and U.S. Treasury.

FCAG did however disagree with any attempts on the part of a national, regional or global basis to amend any standards of the IASB as had occurred. They stated the following.

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[15] Financial Regulatory Reform A New Foundation: Rebuilding Financial Supervision and Regulation (06/2009). Available at www.treasury.gov.

[16] It was formed to advise the International Accounting Standards Board (the "IASB") and the US Financial Accounting Standards Board (the "FASB") about the standard-setting implications of the financial crisis and potential changes in the global regulatory environment.

> "with any attempts on a national or regional basis, such as occurred in 2005 and again in late 2008 and early 2009, "*to allow either "carve-ins" or "carve-outs" from full IFRS* [we disagree]. *Any retreat from IFRS as issued by the IASB to national or regional standards would have serious consequences for the global financial system. First, it would limit the ability of financial market participants, prudential regulators, and others to compare the economic performance and condition of financial institutions and industrial companies operating similar businesses but based in different jurisdictions. Second, it would reinstate impediments to cross-border capital-raising and, in particular, the flow of capital to developing countries. Third, it would subject non-US companies that are SEC registrants that do not follow IFRS as issued by the IASB to US GAAP reconciliation. Finally, and perhaps irretrievably, it would dissuade countries on the verge of adopting or converging with IFRS from doing so, and it would halt the momentum that has been created for convergence between IFRS and US GAAP and, potentially, for adoption of IFRS in the United States.*"[17]

By March 2008, the IASB and FASB had published a discussion paper, *Reducing Complexity in Reporting Financial Instruments*. Subsequently, the IASB decided to reconsider accounting for financial instruments in three phases: (1) classification and measurement; (2) impairment methodology; and (3) hedge accounting.

The first phase of this project IFRS 9, which partially replaced IAS 39, was issued in November 2009. In December 2011, the IASB amended IFRS 9 to make the effective date as annual periods beginning on or after January 1, 2015 and to not require the restatement of comparative-period financial statements upon initial application. Then on November 28, 2012, the IASB issued an Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)).

For the second phase of this project, the IASB issued the supplementary document *Financial Instruments: Impairment,* published in January 2011. The comment period closed on April 1, 2011, but redeliberations are on-going. For the third phase of this project, the IASB published on September 7, 2012, a draft of the forthcoming general hedge accounting requirements to be added to IFRS 9: Financial Instruments.

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[17] Report of the Financial Crisis Advisory Group, July 2009. (Available at http://www.ifrs.org/News/Press-Releases/Documents/FCAGReportJuly2009.pdf downloaded 2/28/2013).

Financial instruments came to the attention of the IASB and FASB at about the same time. However, the FASB took a different approach to modifying its *Accounting Standards Codification* (ASC) Topics 825, *Financial Instruments* and 815, *Derivatives and Hedging*, in using a single solution. This represented a non-linear progression between the IASB FASB due processes.

By examining the above case as an example of convergence, it appears that the two Boards are working toward convergence but it seems that the convergence process is going on in a non-linear trend where there are some stalls as well as accelerations. The financial crisis represented a strong acceleration (Mala and Chand 2012) and it requested the intervention of world political leaders to push toward the convergence by considering it to be the only way to eliminate the lack of trust across world investors and overcome the difficult contingency. In other words, regional and country specific demands should be descended for the global higher interest.

6. Conclusions

In this study we find that the due process and organization structures of the FASB and IASB have many similarities. They have open meetings, seek the comments of its constituents before promulgating standards, and have an advisory council and interpretations committee and a foundation as its overseer. However, differences in the due process and organization structure as well as differences in business and political influencers of these standard setters may cause pause, coming to the realization that the adoption of one set of high quality accounting standards applicable across the world may be impossible. The organization structure of the FASB includes a major source of funding that is legislatively enacted to provide independent funding to the board. The IASB lacks an independent source of funding. The result is that the IASB may be influenced by the largest of donors at the risk of not developing high quality global accounting standards.

The FASB is strongly influenced by its legal environment, including the SEC. At times the SEC has challenged, suspended or superseded FASB's regulations. The EC is strongly influenced by its environment including EFRAG, ARC, FCAG and business constituents in endorsing IFRSs. Moreover, both the FASB and IASB have been pressured by world leaders, including the G-20 to develop, timely, one set of global accounting standards. This effort on the part of the IASB to develop one set of globally accepted high quality accounting standards has failed. We believe that it is time to face the reality that the efforts of the IASB are noble and continue to require global support with the understanding that the more developed reporting regimes, including Europe and the U.S., will probably never adopt all of the IASB standards as published for its domestic companies.

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Figure 1
IASB Organization Structure

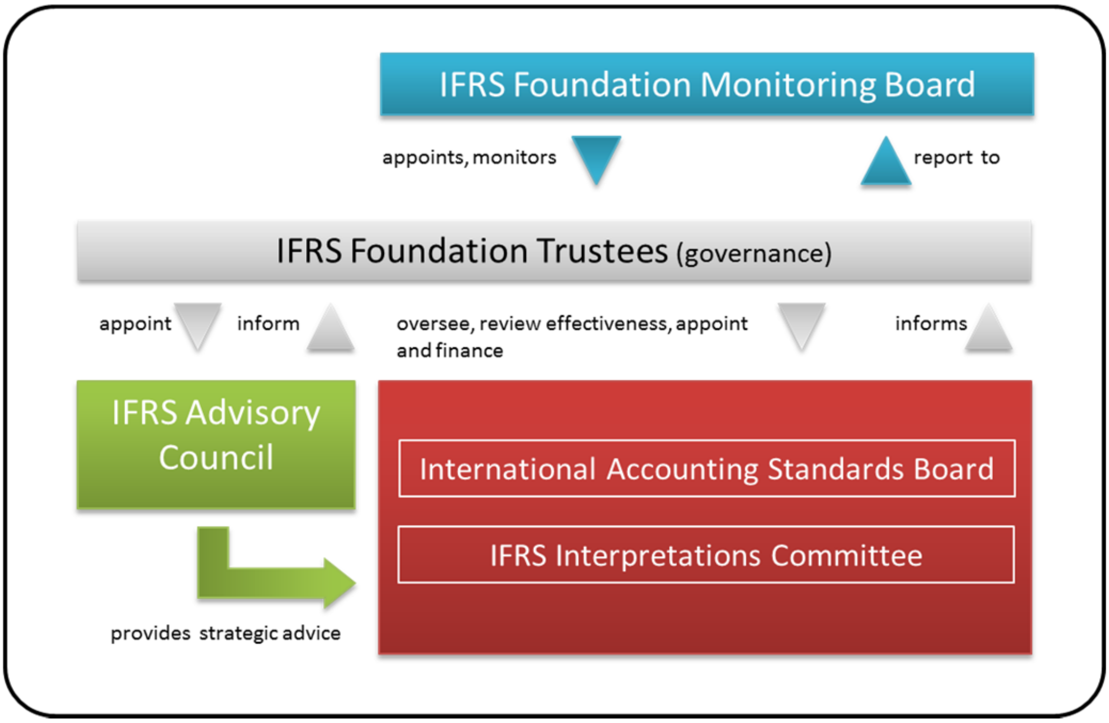

Figure 2
FASB Organization Structure

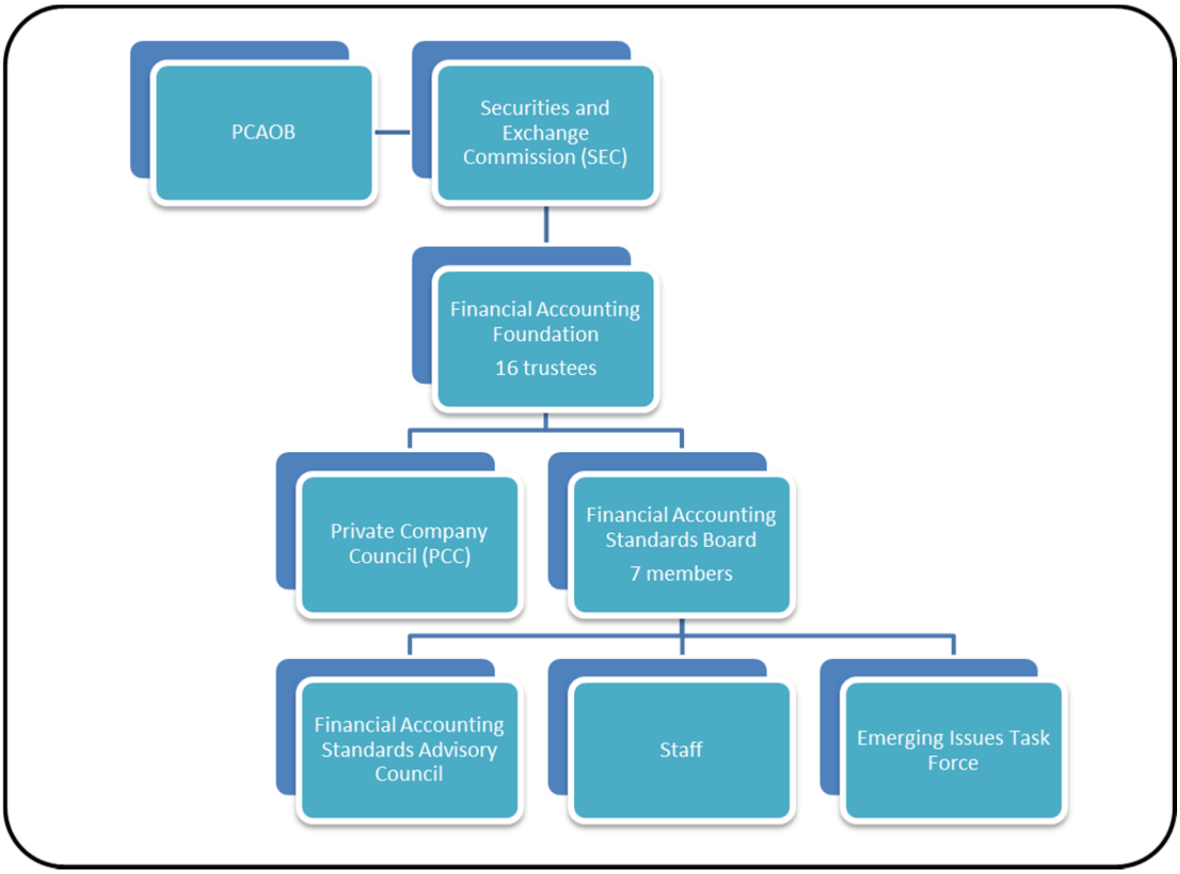

Figure 3
IASB Due Process

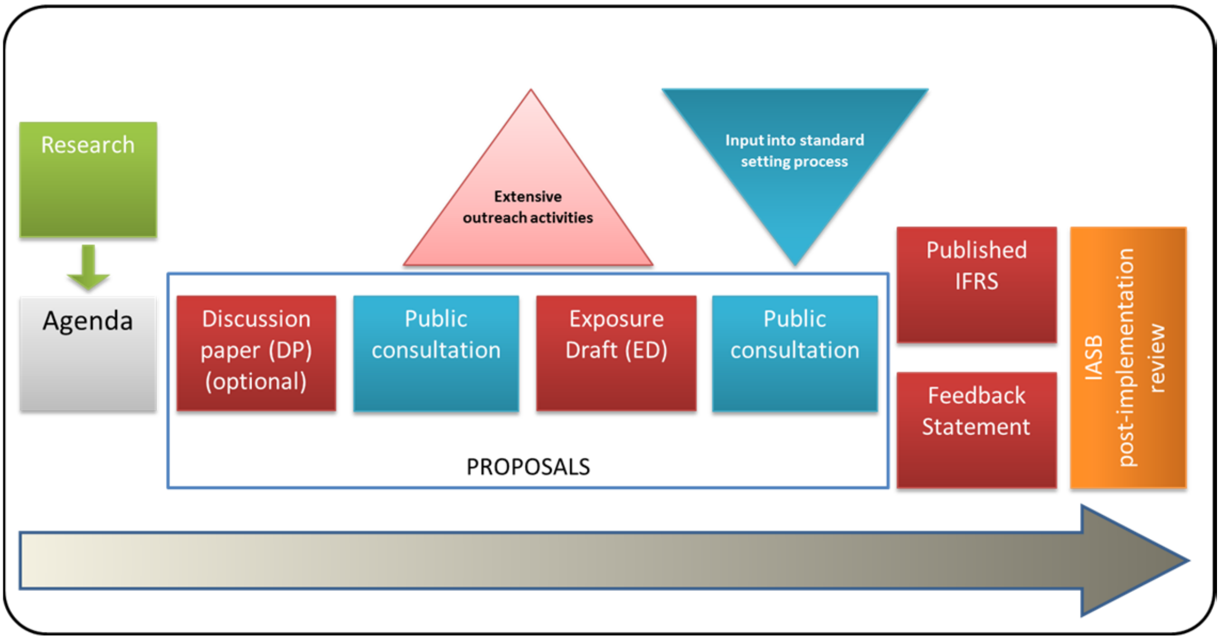

Figure 4
FASB Due Process