Accounting scholarship and the IAAER
The aftermath of convergence

Midyear meeting of the International Accounting Section, joint with the International Association of Accounting Education and Research (IAAER.org)

February 2019

IAAER
INTERNATIONAL ASSOCIATION FOR ACCOUNTING EDUCATION & RESEARCH

IAAER's mission

… promote excellence in accounting education and research on a worldwide basis and maximize the contribution of accounting academics to the development and maintenance of high quality, globally recognized standards of accounting practice

- This mission pertains to scholarship (E. Boyer, *Scholarship Reconsidered,* 1990)
  - Scholarship of discovery: contribute to the stock of knowledge
  - Scholarship of integration and application: contribute to standard setting
  - Scholarship of teaching: accounting education

Activities to fulfill IAAER's mission

- Contributions to standard setting through scholarship and representation
  - KPMG-IAAER research grants to inform the International Accounting Standards Board, currently in round 6
  - IAAER representation on IFRS Advisory group and IFAC's International Accounting Education Standards Board

- Contributions to scholarship
  - Paper development workshops
    - A forum for emerging scholars to present their work and receive personalized feedback and coaching from senior researchers
    - 2019 workshops will be held in Romania and South Africa
  - Conferences
    - German Academic Association for Business Research (AS-VHB) in Berlin February 2018
    - This conference (joint with IAS)

Activities to fulfill IAAER's mission

- Contributions to scholarship and teaching: KPMG provides access to eIFRS
  - IAAER faculty and student membership **includes** academic access to eIFRS
    - Full text of standards, interpretations and supporting documents
    - Extensive cross-referencing and other annotations
  - Annual IAAER membership (go to **www.iaaer.org**)
    - $US45 faculty, $US30 student
    - University rates start at $US350 (up to 10 faculty)
    - Cost is substantially higher at the IFRS Foundation Shop

Questions to consider in the aftermath of IASB-FASB convergence efforts

- What was the IASB-FASB convergence effort supposed to accomplish?
- What did the IASB-FASB convergence effort accomplish?
- Why weren't all the convergence goals achieved?
  - Conceptual impediments to achieving converged and high quality standards
    - Difficulties with asset and liability definitions
    - Inconsistent application of asset and liability definitions
    - Inconsistent thinking about measurement and presentation

What was convergence supposed to accomplish?

- Original agreement between the FASB and IASB (September 2002; modified 2006, 2008, 2010)
  - Overall goal: A single set of <u>high quality</u> financial reporting standards <u>used</u> on the global capital markets
    - Specific convergence goals:
      - Make existing US GAAP and IFRS standards fully compatible as soon as practical
        - » Do not converge standards with identifiable flaws
        - » Create new converged standards to replace guidance that needs improvement
      - Co-ordinate future standard setting/implementation guidance so as to ensure that compatibility is maintained
      - Complete several “short term” convergence projects in which one Board adopts the other’s solution

How should the goals of convergence be understood?

- What is the meaning of “high quality”?
  - Attributes of a high quality standard (FASB, 1999)
    - Consistent with an underlying conceptual framework
    - Avoid or at least minimize alternatives to increase consistency and comparability (Concepts Statement 8 (2010), part of a joint IASB-FASB project)
    - Understandable
    - Capable of rigorous interpretation

- What is the meaning of “used in the global capital markets”?
  - Does “used” encompass the standards being *required* or is being *permitted as an alternative* sufficient?
  - If the standards are permitted, not required, what is the implication for comparability and consistency?

What projects were part of the convergence effort?

2006 revised convergence agenda—major projects

- Intangible assets—never added to agenda
- Business combinations—completed 2007
- Fair value measurement—completed 2011
- Revenue recognition—completed 2014 (effective now)
- Leases—diverged in some respects (effective now)
- Financial instruments—diverged
- Consolidations—some requirements converged
- Derecognition
- Liability and equity
- Post-retirement benefits
- Financial statement presentation
- Several short-term or narrow convergence projects (some completed)

What didn’t convergence accomplish?

Convergence abandoned or not achieved

- Post-employment benefits
- Consolidation
  - Disagreement on meaning of “control” including whether it refers to ability to perpetuate control
- Financial instruments
  - Disagreement on loan impairment, measurement attribute(s) for financial instruments
- Insurance (not an original convergence project)
- Asset derecognition
  - Confusion between asset/liability and the outcomes of having an asset or liability (risk and reward)
- Distinguishing liability from equity
  - Inability to agree on whether a liability requires the obligor to deliver an asset
- Financial statement presentation
  - Inability to agree on a requirement for a single statement of comprehensive income with no reclassifications

What were (are) some conceptual impediments to convergence?

- *Impediment 1:* Problems with asset and liability definitions
- *Impediment 2:* Inconsistent application of asset and liability definitions
    - Asset (US GAAP): Probable future economic benefit obtained or controlled by an entity because of a past event or transaction
        - Some (nearly) certain future cash inflows are not assets
        - Future benefit might be zero
        - Past event might be difficult (or impossible) to identify
        - Disagreement about “control”
    - Liability (US GAAP: Probable future sacrifice of economic benefits arising from a present obligation of an entity to transfer assets or provide services to other entities in the future because of a past event or transaction
        - Some (nearly) certain future cash payments are not liabilities
        - Future sacrifice might be zero
        - Implies a share-settled obligation cannot be a liability
        - Past event might be difficult (or impossible) to identify
- *Impediment 3:* Confusion between having a right or obligation and the outcome of having a right or obligation

Conceptual impediments to convergence

- *Impediment 4:* Inconsistent thinking about asset and liability measurement
    - Some reported amounts can (best) be described as the result of a calculation, not as a measurement
        - Reported amount of an equity method investment
        - “Best estimate”
        - Present value of cash flows, without specifying the discount rate
    - Some disputes about measurement are really disputes about:
        - When (under what circumstances) to remeasure
            - *Example :* Asymmetric recognition criteria for unrealized gains vs unrealized losses
        - How to display the effects of remeasurement (presentation)
- *Impediment 5:* Inconsistent thinking about presentation
    - What subtotals if any should be *defined* and *required* in a statement of comprehensive income?
    - Should the way an item is measured affect presentation?
    - Why is the same amount presented twice (reclassified or recycled)?

Conceptual impediments to convergence

- *Example 1:* Post-employment benefits
  - Applying the definition of a liability
    - Does an unvested obligation meet the definition of a liability?
    - Does a projected benefit obligation (based on future work and future salary increases) meet the definition of a liability?
  - Measurement
    - When if ever should liabilities be discounted using an asset-return rate?
  - Applying consolidation guidance
    - Is a defined benefit pension plan an example of a special purpose entity that is controlled by the plan sponsor?
    - If yes, why isn't the defined benefit plan consolidated (assets and liabilities shown gross, not net)?

Conceptual impediments to convergence

- *Example 2:* Consolidation
    - What does “control” mean, in the context of an entity, not an asset?
    - Is it necessary or appropriate to have two approaches to consolidation depending on how control is exercised?
        - IFRS: one approach based on a qualitative definition
        - US GAAP: two approaches based on whether control is exercised using voting interests or in other ways (VIEs)
    - Does having a forward contract to obtain control or an option to obtain control imply that control exists?
    - Does control *necessarily* imply the ability to perpetuate control?
        - *Example:* Owner of 40% of shares can currently elect entire governing board but may not be able to do so in indefinitely

Conceptual impediments to convergence

- *Example 3:* Distinguishing liability from equity
  - Should a liability *require* the delivery of the entity's own assets or performance of services?
  - If yes, then any share-settled arrangement would be equity not liability
    - *Possible example:* Agreement to settle accounts payable by transferring shares
  - If yes, why does existing guidance distinguish between obligations to deliver a fixed number of shares (equity) versus a variable number of shares (often, liability)
  - How should derivatives on an entity's own shares be accounted for?
    - Option to acquire own shares
    - Forward to acquire own shares
    - Puttable shares

Aftermath of convergence

- No additional formal efforts (joint projects) to achieve converged standards
  - Hans Hoogervorst, various speeches, described the joint IASB-FASB convergence efforts
  - The FASB may choose to “stay with US GAAP;” the IASB “has a large part of the world to take care of”
  - Convergence was a “limited scope project,” with substantial success
  - Convergence effort had a “structural fault” involving two independent boards with “different imperatives”

Aftermath of convergence

- Separate IASB conceptual framework project completed 2018
    - Reintroduced “stewardship” and “prudence” [conservatism], not part of the converged portions of the IASB’s and FASB’s conceptual frameworks (2010)
    - Conceptual justification for the use of separate measurement attributes on the balance sheet and income statement
    - Changes to asset and liability definitions
    - What are the implications if IASB Board members use a non-converged conceptual framework to analyze issues and reach decisions, including decisions to revisit existing standards?
- No substantial formal arrangements to converge implementation guidance
    - – The FASB’s EITF and the IASB’s IFRIC operate independently
- No SEC plans to require IFRS for US SEC registrants
    - Since 2007, non-US SEC registrants may file using IFRS without reconciliation

Aftermath of convergence: questions to consider

- Actual effectiveness of convergence efforts
  - How many converged standards represent new solutions generated jointly by the FASB and IASB, as opposed to solutions adapted from US GAAP?
  - What are the likely effects if the IASB bases decisions on a conceptual framework that (appears to) differ from the FASB's conceptual framework?
- Will implementations of nominally-converged standards (for example, share based payment; revenue recognition; business combinations) begin to diverge over time?
- Several hundred large non-US SEC registrants file using IFRS without reconciliation; does this create noncomparability in the US capital markets?
  - Would an SEC decision to *permit* US registrants to provide IFRS reports aid or impair comparability?
- How much of the failure to complete major convergence projects can be attributed to a failure to apply concepts rigorously and consistently?