COMMON LANGUAGE:
Converging Accounting Standards

Big changes in financial reporting are coming soon. FASB representatives outline what you need to know about an international accounting convergence effort that will affect IR.

By Marc A. Siegel and Laura P. Kiernan

A convergence movement is under way in accounting that could significantly change the way your company reports financial information. The goal is to create one set of high-quality accounting standards to be used around the globe. With the IRO's responsibility for explaining financial results, it's crucial that you understand what accounting convergence will mean. Two components are particularly relevant to investor relations:

1. The joint work plan between the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), which will bring financial reporting changes to virtually every U.S. public company during the next several years.
2. The Securities and Exchange Commission work plan to evaluate whether U.S. public companies should report using International Financial Reporting Standards (IFRS) instead of U.S. GAAP.

Why the Need to Converge?

Accounting has often been called the language of investing. Historically, each country independently developed accounting standards for preparing financial reports. As a result, reported financial information differed (often significantly) from country to country. With the world's economies becoming increasingly interconnected and investors seeking to diversify their holdings internationally, there have been calls for a common financial reporting language.

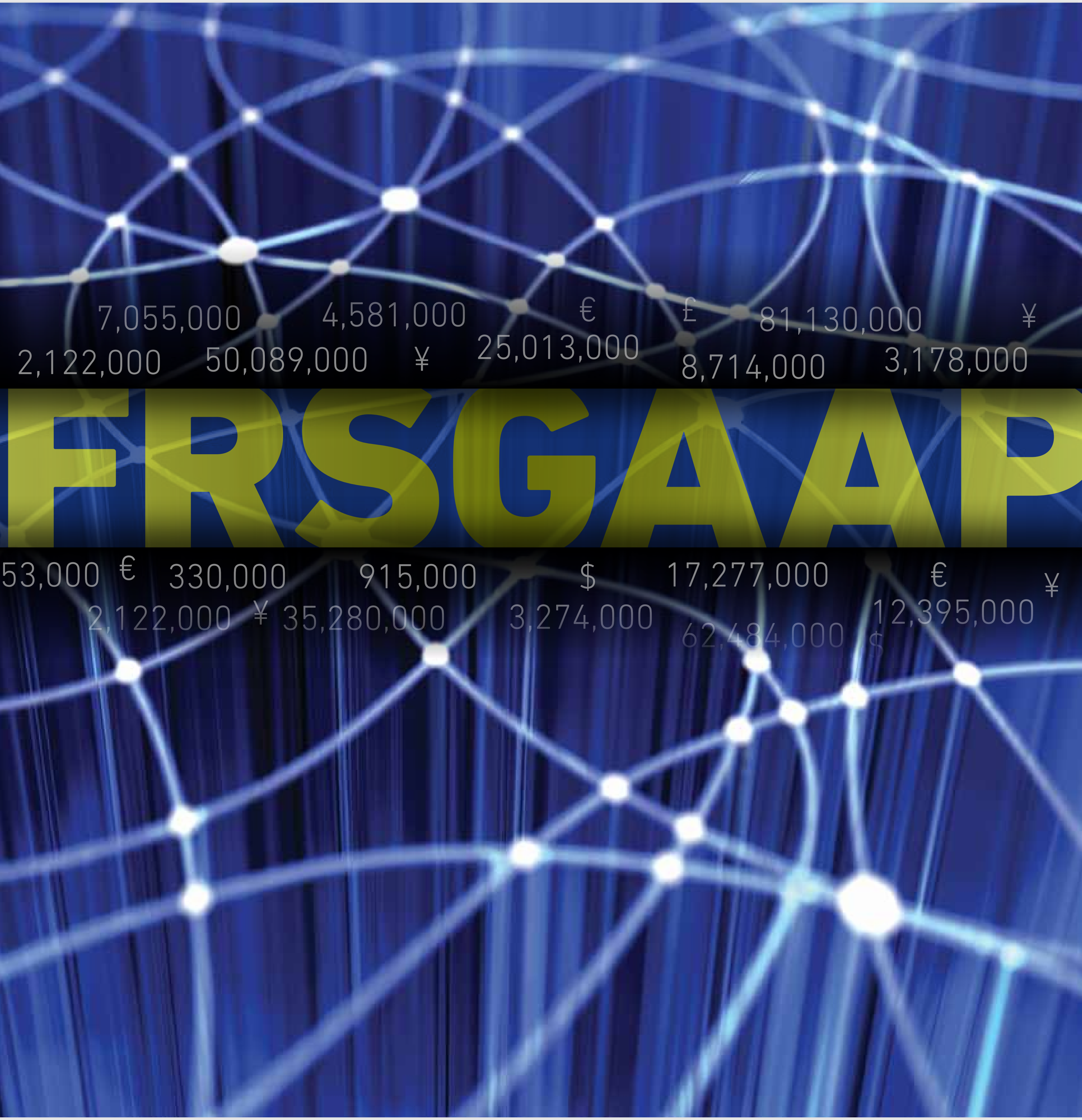
The perceived advantages of a common language include comparability—enabling investors to more easily compare companies worldwide. Another perceived advantage is simplification—providing multinational firms with a common basis of reporting for all operations regardless of where they are located, making it simpler to prepare financial reports.

Different methods exist for achieving the goal of one global financial reporting language. One approach is collaboration—standards setters working together to improve the quality of financial reporting while eliminating differences between their existing national standards. Another approach is by fiat—the decision by governments to adopt international accounting standards.

The FASB and its counterparts internationally have been working on convergence using the first approach—collaboration—since the 1980s. In the early 2000s, the convergence movement took a significant step forward with the creation of the independently structured IASB and the subsequent decision by Europe and more than 100 countries outside of Europe to either require or permit the use of IFRS instead of their national standards (the fiat approach). At the same time, the FASB and the Accounting Standards Board of Japan embarked on collaborative work programs with the IASB to improve both standards and eliminate differences between them. During the past eight years, progress toward the goal of a high-quality and global reporting language accelerated through a combination of both approaches.

Changes Coming Soon

The FASB and IASB convergence program will soon improve financial reporting by virtually every U.S. public company. The progress stems from a strong partnership dating back to 2002. At that time, the FASB and the IASB committed to work together toward the goal of a common set of high-quality, compatible accounting standards. The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collaboration began with a focus on two important areas: business combinations and accounting for stock compensation. The collaboration quickly expanded, however, to include all major new standards under development.

In 2006, the FASB and the IASB set specific convergence goals for both the accounting issues they would tackle together and progress milestones in a document called the Memorandum of Understanding (MoU). The shared objective was to improve the quality of financial reporting worldwide and to converge IFRS and U.S. GAAP. The boards agreed to concentrate efforts on the areas where both U.S. GAAP and IFRS were most in need of improvement, which include accounting for financial instruments, revenue recognition and leases.

The boards have set a near-term target of issuing improved and converged standards in those areas in 2011. Those new standards, if finalized as proposed this past summer, would change the financial reports of most companies. They may also affect how your investors analyze your company. For example:

- The proposed financial instruments standard would primarily affect financial institutions; financial assets and liabilities would be reported at fair value in the balance sheet, and impairment losses would be measured in new ways.
- The revenue recognition standard would affect nearly all industries, especially the construction, technology and real estate industries. It would replace the existing U.S. GAAP patchwork of various industry- and transaction-specific requirements with a consistent method of accounting for revenue across all industries and transactions.
- The proposed new leasing standard would also affect nearly all industries, especially the retail, health care, and transportation and warehousing industries. It would require lessees to recognize all leases on the balance sheet, including what are presently considered operating leases. While a lessee's leverage would typically increase under the proposed accounting, the lessee's calculation of non-GAAP EBITDA also would increase because of the reclassification of rent expense as interest expense and amortization expense on the income statement.

The draft standards, even if finalized in 2011, are not expected to change financial reporting *immediately*. Companies, auditors and financial statement users (i.e., your investors) will be provided with time to learn about and adapt to the new requirements. Be on the lookout during the first half of next year for announcements about when those new requirements will become effective. In the meantime, due to the significance of these reporting changes, IROs are urged to begin a dialogue with finance colleagues to fully understand the implications for their companies. By doing so, you can proactively help management craft strategies for communicating these potentially significant changes.

The SEC's Evaluation of IFRS

The SEC has long supported the goal of convergence and the collaborative efforts of the FASB and the IASB. While those efforts will improve and converge important aspects of U.S. GAAP and IFRS, many differences between them will remain. Some have suggested that the time may be right for the United States to consider the adoption of IFRS as a means to achieving full convergence.

In 2007, the SEC began to actively consider the role IFRS might play in the U.S. financial reporting system. For example, the SEC issued a concepts release (2007) and a rules proposal (2008) asking whether some or all U.S. public companies should have the option of preparing financial statements using IFRS instead of U.S. GAAP.

In late 2009, after considering the input received on those releases, the SEC issued a statement describing its plans to consider whether, how and when IFRS might be incorporated in the U.S. financial reporting system. The SEC has said that completion of its work plan and progress on U.S. GAAP and IFRS convergence should position it to make a decision in 2011 about the role IFRS might play in the U.S. reporting system.

Because of the significant implications that the SEC's decision has for reporting by U.S. companies, IROs should closely monitor this project. All IROs are urged to read an SEC interim progress report on the work plan, available at http://www.sec.gov/news/press/2010/2010-207.htm.

Resources for IROs

The FASB believes in the convergence goal of a common set of high-quality international standards and it is committed to working collaboratively and intensively with the IASB to improve standards and reduce the differences. Available at www.fasb.org are summary documents to help you better understand the proposed changes. The documents include high-level summaries for each project (titled FASB in Focus), podcasts, webcasts and webinars. You may also sign up for Action Alerts at www.fasb.org for real-time updates. If you have questions or comments, please contact Laura Kiernan at lpkiernan@fasb.org or (203) 956-3451. IRU

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