# Treatment Differences and Political Realities in the GAAP-IFRS Debate

William W. Bratton
*University of Pennsylvania Carey Law School*

Lawrence A. Cunningham
*George Washington University Law School*

# TREATMENT DIFFERENCES AND POLITICAL REALITIES IN THE GAAP-IFRS DEBATE

*William W. Bratton[*] and Lawrence A. Cunningham[**]*

## INTRODUCTION

INTERNATIONAL Financial Reporting Standards ("IFRS") have swept the globe[1] even as Generally Accepted Accounting Principles ("GAAP") have retained their hold over reporting companies and securities markets in the United States. But the globalization wave continues to rise and GAAP's days appear to be numbered, along with those of its generator, the Financial Accounting Standards Board ("FASB"). The Securities and Exchange Commission ("SEC"), long the backer and protector of GAAP and the FASB, lately changed course to defect against them in favor of IFRS and its generator, the International Accounting Standards Board ("IASB"). The road to defection began when the SEC eliminated the requirement that foreign issuers registered in the United States and reporting under IFRS restate their financials to GAAP.[2] The political economic logic of globalization took over from there. In 2007, the SEC proposed to extend the option to report under IFRS to U.S. issuers.[3] That option, said the SEC, would afford competitive advantages to U.S. issuers with extensive opera-

[*] Peter P. Weidenbruch, Jr., Professor of Business Law, Georgetown University Law Center.

[**] Henry St. George Tucker III, Research Professor of Law, The George Washington University Law School. For excellent research assistance, thanks to Chris Davis and Dan Martin.

[1] For an account of this, see Lawrence A. Cunningham, The SEC's Global Accounting Vision: A Realistic Appraisal of a Quixotic Quest, 87 N.C. L. Rev. 1 (2008).

[2] Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Exchange Act Release No. 33-8879, 73 Fed. Reg. 986 (2008), *reprinted in* [2002 to Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 88,032 (Dec. 21, 2007).

[3] Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standard, Exchange Act Release Nos. 33-8831, 72 Fed. Reg. 45,600 (proposed Aug. 14, 2007), *reprinted in* [2002 to Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 87,944 (Aug. 7, 2007) [hereinafter 2007 Concept Release].

tions abroad.[4] But the commentators pushed back.[5] They argued that the value of global convergence in accounting standards lies in enhanced comparability across the financials of different issuers;[6] accordingly, admitting two competing accounting systems into the domestic market would only retard progress toward the goal. The SEC responded by admitting the policy salience of comparability and doubling its bet on IFRS: it has produced a new "Roadmap" that describes a process leading to mandatory use of IFRS by domestic issuers by 2014.[7] The Roadmap bypasses an alternative, more painstaking route to convergence—a longstanding joint project of the FASB and the IASB directed to the articulation of a common set of accounting standards.[8]

Professor Cox accepts the termination of the requirement of GAAP restatements by foreign issuers.[9] We agree, for the reasons he states. We read him to be concerned about an IFRS option for U.S. issuers,[10] and so are we. We read him to be very concerned about the elimination of GAAP,[11] and so are we. We would like to

[4] Id. ¶ 45,601.

[5] One of us has raised the following objections: (1) effective competition presupposes full information and IASB has a practice of misrepresenting the contents of IFRS; and (2) widespread adoption of IFRS signals a national-level preference for comparability over competition. See Cunningham, supra note 1, at 26–27. Numerous accounting scholars expressed opposition to the SEC's ambitions, although for a wide variety of reasons. For a collection and summary, see Posting of David Albrecht to The Summa–Debits and Credits of Accounting Professor David Albrecht, http://profalbrecht.wordpress.com/2008/10/04/publishing-schedule/ (Oct. 4, 2008) (reviewing criticisms by Shyam Sunder (Yale Univ.), Ray Ball (Univ. of Chicago), J. Edward Ketz (Penn State Univ.), Tom Selling (Thunderbird Sch. of Global Mgmt., emeritus), Bob Jensen (Trinity Univ., emeritus), and David Albrecht (Bowling Green State Univ.)).

[6] See Cunningham, supra note 1, at 27–28.

[7] Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers, Exchange Act Release No. 33-8982, 73 Fed. Reg. 70,816 (proposed Nov. 21, 2008), *reprinted in* [2002 to Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 88,409 (Nov. 14, 2008) [hereinafter 2008 Roadmap].

[8] See A Roadmap for Convergence between IFRSs and US GAAP—2006–2008: Memorandum of Understanding between the FASB and the IASB, Feb. 27, 2006, http://www.iasb.org/NR/rdonlyres/874B63FB-56DB-4B78-B7AF-49BBA18C98D9/0/MoU.pdf (last visited Feb. 20, 2009).

[9] James D. Cox, Coping in a Global Marketplace: Survival Strategies for a 75-Year-Old SEC, 95 Va. L. Rev. 941, 985 (2009).

[10] Id. at 985–86.

[11] Id.

take this opportunity to follow up his paper with some amplifying points along similar lines.

The SEC's reports respecting these convergence initiatives talk the globalization talk, extolling the benefits of convergence. We read that standardization yields cost savings[12] and that a single global set of reporting standards yields an ultimate gain in comparability.[13] Both facilitate the search for global opportunities by U.S. investors[14] and make U.S. capital markets more attractive to foreign issuers.[15] But, as so often is the case with globalization talk, things get left out. We discuss two of them here.[16]

First, this is not just a matter of choosing the framework for standard setting. The accounting treatments themselves are at issue, treatments that for the most part concern domestic reporting firms and domestic users of financial statements. This may seem obvious, as a change of standard setter means different standards and the change would extend to domestic companies. But the Roadmap spends only three of its 165 pages comparing IFRS to GAAP.[17] We take the occasion to fill in some missing details, including a treatment-by-treatment comparison of GAAP and IFRS in the Appendix. We go on to discuss the implications of such differences.

The familiar debate over the relative merits rules and principles captures many of the matters at stake, which takes us to our second point of amplification. The rules versus principles comparison only has meaning in context, which includes not only the compliance environment, but also the political and interest group alignments surrounding the standard setter.[18] These matters tend to be assumed away in recent globalization discussions. The discussants treat standard-setter independence as an accomplished fact on both sides of the Atlantic, an assumption that became widespread after the IASB was reorganized during the last decade to acquire a

[12] 2007 Concept Release, supra note 3, ¶ 45,604.

[13] Id. ¶ 45,606; 2008 Roadmap, supra note 7, ¶ 70,823.

[14] 2008 Roadmap, supra note 7, ¶ 70,818.

[15] Id. ¶ 70,824 (asserting that a U.S. dual standard "may create challenges in the U.S. capital markets").

[16] For discussion of additional points, see Cunningham, supra note 1.

[17] 2008 Roadmap, supra note 7, ¶ 70,826–27.

[18] See generally Lawrence A. Cunningham, A Prescription to Retire the Rhetoric of "Principles-Based Systems" in Corporate Law, Securities Regulation, and Accounting, 60 Vand. L. Rev. 1411 (2007).

governance structure that closely resembles the FASB's structure.[19] Politics do not retreat so easily, however. The FASB maintained its independence during its thirty-five-year history in the teeth of opposition from corporate management. As the independent FASB formulated more and more standards, management experienced a steady diminution of its zone of financial reporting discretion. A switch to IFRS would allow management to reclaim some of the lost territory. Thus, the Roadmap sends an implicit political signal. The interest group alignment that protected the FASB, comprised of auditing firms, actors in the financial markets, and the SEC, has disintegrated as U.S. capital market power has waned in the face of international competition. Management is the shift's incidental beneficiary, with possible negative effects for domestic markets.

## I. COMPARING TREATMENTS UNDER GAAP AND IFRS

The Appendix sets out a treatment-by-treatment comparison of cases where GAAP and IFRS establish different standards. We selected the treatments for salience based on our own judgment and experience.[20] If we went treatment by treatment through the list, we

[19] For a discussion of the governance issues and process that led to IASB's reorganization, see David S. Ruder et al., Creation of World Wide Accounting Standards: Convergence and Independence, 25 Nw. J. Int'l L. & Bus. 513, 526–54 (2005).

It should be noted that IASB does not yet meet the criteria established under the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 108(b)–109, 116 Stat. 745, 768-69 (codified at 15 U.S.C. §§ 77s, 7219 (2006)) for SEC recognition, because it is not funded by Congressionally levied fees. FASB, long supported by private contributions, came to be funded by fees levied on public companies under § 108 of the Sarbanes-Oxley Act. IASB, in contrast, remains privately funded and implicitly beholden to the business and accounting interests that provide the money. For discussion of other possible problems under the requirements, see Cunningham, supra note 1, at 29–33.

The Roadmap discusses the funding problem. To circumvent this problem, IASB is working with the International Organization of Securities Commissions to form an international Monitoring Group made up of representatives of various national regulators. See 2008 Roadmap, supra note 7, ¶ 70,821–22.

[20] More exhaustive lists are available. See, e.g., Barry J. Epstein & Eva K. Jermakowicz, Wiley IFRS 2008: Interpretation and Application of International Financial Reporting Standards app. C at 26–31 (2008). Large accounting firms also have compiled booklets describing treatment differences. See, e.g., Deloitte, IRFSs and US GAAP: A Pocket Comparison (2008), available at http://www.deloitte.com/dtt/cda/doc/content/us_assurance_IFRS_US_comparison2008.pdf; Deloitte, IFRSs in Your Pocket: An IAS Plus Guide (2008), available at http://www.deloitte.com/dtt/cda/doc/content/pocket2008%284%29.pdf; Ernst & Young, US GAAP v. IFRS

would prefer the GAAP treatment in a majority of cases, but also would articulate good reasons to support a number of the IFRS treatments. Whatever the preferences of particular observers respecting particular treatments, a scan of the list reveals a fundamental problem with the current "either/or" policy discussion over the choice of systems. Only the accountants themselves are capable of addressing the matters at stake in an informed way.[21] The policymakers trade in characterizations.

The SEC's characterization, set out in the Roadmap, describes IFRS as "not as prescriptive" as GAAP and as holding out "a greater amount of options" while providing "a relatively lesser amount of guidance."[22] The SEC notes that greater optionality (to borrow its term) could detract from consistency and comparability and make litigation and enforcement outcomes harder to predict.[23] At the same time, it notes that relaxed prescription may make it

The Basics (2008); PriceWaterhouseCoopers, Similarities and Differences: A Comparison of IFRS and US GAAP, available at http://www.pwc.com/gx/eng/about/svcs/corporatereporting/SandD_07.pdf (Oct. 2007).

[21] Accounting experts tend to agree, as an empirical matter, that applying GAAP versus IFRS results in significant bottom line reporting differences. See Cox, supra note 9, at 948. We note that they also disagree on the normative policy implications of the data. Consider literature reviews and policy analysis by two distinguished committees of the American Accounting Association, the preeminent academic accounting body in the United States. Authors of the two studies agree that the empirical evidence indicates that significant differences exist in reported accounting results when applying the two standards, including the bottom line balance sheet and income statement aggregates. Yet the two draw different conclusions, one encouraging competition among multiple standards and the other cautioning that moving the United States to IFRS is premature. Compare Karim Jamal et al., Am. Accounting Ass'n Fin. Accounting Standards Comm., A Perspective on the SEC's Proposal to Accept Financial Statements Prepared in Accordance with International Financial Reporting Standards (IFRS) Without Reconciliation to U.S. GAAP (2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1020408 (finding differences in outcomes but no evidence of relative superiority and therefore concluding that competition among the standards is optimal policy stance), with Patrick E. Hopkins et al., Am. Accounting Ass'n Fin. Reporting Policy Committee, Response to the SEC Release: Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP (2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083679 (finding material differences in outcomes that are relevant to investment decisions and therefore concluding that it is premature for the United States to adopt IFRS).

[22] 2008 Roadmap, supra note 7, ¶ 70,826.

[23] Id.

easier for issuers to account for transactions in accordance with their underlying economics.[24] Thus, the SEC at its bottom line frames the matters at stake within the rules versus principles discourse, taking the occasion to advocate principles.[25] But we also note a tension in the SEC's framework: whatever international comparability enhancement the Roadmap holds out implies a sacrifice of comparability in the domestic context. The SEC's stated goal is inherently elusive.[26]

The Appendix contains some classic exemplars where GAAP is famous for rules while IFRS is known for principles. Consider first accounting for capital leases—long-term leases that must be booked on the lessee's balance sheet (Appendix § VIII). GAAP breaks out four defined criteria, including one by-the-numbers test keyed to the useful life of the asset under lease, with the criteria determining the treatment. IFRS bids the reporting company to look to the economics of the transaction, including eight factors to assist its determination without stipulating results following from their application.[27] It bears noting that while IFRS is indeed more flexible, the GAAP treatment, founded on a list of factors, does not determine results on a stand-alone basis. American lawyers would describe both treatments as "standards."

Now turn to accounting consolidation (Appendix § X), probably the most frequently cited case of GAAP as rules and IFRS as principles. Under both GAAP and IFRS, when one firm "controls" another, both report on a consolidated basis. GAAP largely defines control with a by-the-numbers test: consolidation follows from ownership of fifty percent plus one share of the subsidiary's stock. But, the inference of control can be rebutted where control actually is not held or is temporary.[28] IFRS begins with a fifty percent plus one share test as well, but modifies the zone of control under a standard that variously looks to other arrangements re-

[24] Id.

[25] For a more detailed discussion of SEC pronouncements articulated under previous SEC leadership, see Cunningham, supra note 18, at 1446–53.

[26] See Lawrence A. Cunningham, Editorial, Beware the Temptation of Global Standards, Fin. Times, Sept. 10, 2007, http://www.ft.com/cms/s/0/1d612b96-5fc3-11dc-b0fe-0000779fd2ac.html.

[27] Epstein & Jermakowicz, supra note 20, at 533–35.

[28] Fin. Accounting Standards Bd., Statement of Financial Accounting Standards No. 94: Consolidation of Majority Owned Subsidiaries ¶¶ 10, 13 (1987).

specting voting shares, contractual arrangements, and regulatory contexts. Application of the standard can cut either way, turning less than fifty-one percent ownership into control or rejecting a finding of control given more than fifty percent.[29] The rules/principles distinction once again is descriptive of the difference. But a caution about the description of GAAP once again is in order: the fifty-plus-one presumption is rebuttable under both systems.

IFRS accords reporting companies more elbow room in both of the above cases, but a dispassionate search for economic truth is not its only normative motivation. To get a fuller picture of the issues at stake, compare the treatments for tangible long-lived assets (Appendix § VII). Under GAAP, they are carried on a cost basis. If the asset's value is impaired, the impairment results in a charge to current income. Under IFRS, the asset may be carried at cost or fair value. If the asset's value is impaired, the loss is dealt with by a balance sheet adjustment only. Moreover, if the asset's value recovers after the impairment, the balance sheet adjustment can (and in some circumstances must) be reversed. Here we see that GAAP is motivated by conservatism, the practice of dealing with uncertainty through asymmetric recognition of losses compared to gains.[30] It also favors verifiable numbers, thereby hewing more closely to traditional cost accounting and constraining management's "optionality" respecting balance sheet presentations. IFRS, being more comfortable about extending management discretion to revalue assets, includes a broader range of fair value treatments, introducing subjectivity into the determination of balance sheet amounts. Thus, under GAAP, when a tangible asset is written down, the write-down is forever, while under IFRS, tangible asset values can go up and down with exterior shifts in valuation as management determines.

Note also that in the case of a decline in value, GAAP forces recognition on the income statement, while IFRS lets the company take care of the matter with a balance sheet adjustment.

[29] Epstein & Jermakowicz, supra note 20, at 441–42.

[30] See Sudipta Basu, The Conservatism Principle and the Asymmetric Timeliness of Earnings, 24 J. Acct. & Econ. 3 (1997).

This difference also applies more generally. GAAP is income statement oriented because it evolved as a system responsive to the demands of equity holders in U.S. financial markets.[31] When GAAP requires an event to make an impact on the income statement, it in effect flags the event for actors valuing the company. IFRS, with its ties to block-holder regimes, favors the balance sheet, reflecting the greater influence of other constituents, in particular bank creditors and employees.[32]

Now compare the treatments for research and development expenses (Appendix § VIII). Under GAAP, these are expensed in the period incurred, and cash outflows are classified into the operating section of the cash flow statement. Under IFRS, research and development costs are capitalized; that is, the company books the costs as an asset and shows them on its cash flow statement as investment cash flows. A basic policy difference again is manifest: under GAAP, conservatism is a motivating principle, and doubts tend to be resolved by forcing a present deduction on the income statement. IFRS is more liberal and management-friendly, assuming that research and development results in tangible economic value and delaying recognition of its costs for an extended future.

We now turn to revenue recognition (Appendix § IV), once again to see conservatism in action in GAAP. Given a service contract to be performed over multiple reporting periods, IFRS lets a company recognize all the revenue up front upon partial performance. GAAP, taking the idea that revenues should be matched to expenses more seriously, amortizes these contracts over the period of service without up-front recognition. (We note that the IFRS approach bears a more than passing resemblance to the treatment that Enron Corporation received from FASB's Emerging Issues

[31] For more discussion on the evolution of IFRS, see infra text accompanying notes 35–38.

[32] See Cunningham, supra note 1, at 48. There is a parallel dark side to this. In the United States, accounting manipulation generally affects the income statement, with earnings per share being a key factor in the compensation of the corporate insiders responsible. In block-holder countries, manipulation tends to affect the balance sheet, with payoffs to the insiders responsible stemming from the allocation of corporate assets. Id. (citing John C. Coffee, Jr., A Theory of Corporate Scandals: Why the U.S. and Europe Differ, 21 Oxford Rev. Econ. Pol'y 198, 199 (2005); Simon Johnson et al., Tunneling, 90 Am. Econ. Rev. 22 (2000)); see also Vladimir Atanasov et al., Unbundling and Measuring Tunneling (Univ. of Tex. Sch. of Law, Working Paper No. 117, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1030529.

Task force, under which it was permitted to show all gains from its long-term energy contracts up-front.[33]) A similar comparison obtains respecting accounting for pension obligations. Under GAAP, unfunded pension benefit obligations must be shown as liabilities on the balance sheet. IFRS requires no balance sheet disclosure. Once again, conservatism motivates GAAP, while managers get the benefit of the doubt under IFRS.

Finally, we turn to inventory accounting (Appendix § VI), an area where GAAP is the more flexible of the two regimes. For cost accounting purposes, one must make an assumption about the order in which goods are sold. They are either treated as sold in the direct order of production or acquisition (first-in-first-out or FIFO) or as sold in reverse order of production or acquisition (last-in-first-out or LIFO). Given rising prices, FIFO more closely reflects economic reality on the balance sheet, listing inventories close to current values, while LIFO better reflects prevailing economics on the income statement with a figure for cost of goods sold reflecting current prices. GAAP permits companies to choose; IFRS, with its regime of balance sheet primacy, requires FIFO.

The above comparison confirms the SEC's description—GAAP constrains, where IFRS is flexible—but does so with the noted qualifications. The flexibility, as Professor Cox notes, follows in part from the nature of the enterprise.[34] A one-size-fits-all set of global standards of necessity emerges as a big tent so that a range of national practices can be accommodated. We think that comparison also serves to show that there are values at stake—namely, conservatism, verifiability, and transparent disclosure of current period results. None of these is calculated to appeal to managers, nor do they hold out much popular appeal when the stock market is booming. But, right now, in the wake of financial collapse, risk aversion returns to the fore not only in boardrooms, but also in the minds of policymakers. Those pursuing the Roadmap over the next

[33] See Emerging Issues Task Force ("EITF") Issue 02-3: Issues involved in Accounting for Derivative Contracts Held for Trading Purposes and Involved in Energy Trading and Risk Management Activities (Mar. 20, 2003) (discussing the rescission of EITF Issue 98-10: Accounting for Contracts Involved in Energy Trading and Risk Management Activities).

[34] See Cox, supra note 9, at 947.

few years may have a more difficult trip than its progenitors project.

The globe-spanning flexibility of IFRS also reflects differences in corporate governance systems and financial market regulation. IFRS's predecessor systems all developed in small national marketplaces with tight communities of intermediaries and investor populations largely made up of institutions. Tight communities can co-exist with "light touch" regulation, and as between GAAP and IFRS, the latter is the "light[] touch" choice.[35]

But the differences in surrounding regulatory regimes are wrought into the systems. As an example, consider the U.K. requirement that, if necessary for the presentation of a true and fair view of the business, a particular mandated treatment must be overridden.[36] IFRS's stated preference for treatments that follow from the economics of the transaction partakes of the same spirit. Overrides have not been the practice in the United States, even as financials must "fairly present" the company's financial position. Litigation risk is the reason,[37] not GAAP. Litigation risk is a property of the U.S. adversary regulatory system, a system that, unlike that of the United Kingdom, evolved to cope with a dispersed, continent-wide array of financial institutions and investor clients.

In addition, most of the countries in the IFRS fold have blockholder governance systems—the United Kingdom, Australia, and Israel being the exceptions. Blockholders, having control or influence over internal decisionmaking, suffer diminished problems of agency and information asymmetry.[38] Any question arising under a discretionary treatment can be answered by direct inquiry. Accounting principles accordingly matter less than they do given the separation of ownership and control that prevails in the United States.

Thus did GAAP develop into the more constraining system as a result of political and institutional factors unique to U.S. capital

[35] Donald C. Langevoort, U.S. Securities Law and Global Competition, 13, (Georgetown Univ. Law Ctr., Working Paper, 2008), available at http://ssrn.com/abstract=1313133.

[36] See Cunningham, supra note 1, at 41–42.

[37] Id. at 42.

[38] William W. Bratton & Joseph A. McCahery, Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference, 38 Colum. J. Transnat'l L. 213, 226 (1999).

markets. All of these factors remain pertinent in the present policy context, even as potential gains from global convergence introduce a complicating factor. Part II offers a more particular description of the environment in which FASB and GAAP evolved.

## II. THE POLITICS OF GAAP

The FASB came into existence thirty-five years ago as the result of an ad hoc process looking toward the establishment of a viable standard setter under private auspices. The accountants' professional organization, the American Institute of Certified Public Accountants ("AICPA"), took the lead,[39] with input from organizations and individuals representing management and the financial sector.[40] The organizers had a high-powered incentive. They wanted a responsive standard setter without ceding territory to a federal agency,[41] which in those days was associated with domination by progressive, anti-corporate types.[42]

Public legitimacy mattered, so the new standard setter had to be independent, public regarding, and insulated from political pressure,[43] yet simultaneously responsive to constituent interests.[44] The result was a board selected by an independent foundation, itself populated with constituents, along with a monitoring advisory body, also populated with constituents.[45] Today the IASB is a car-

[39] Ronald King & Gregory Waymire, Accounting Standard-Setting Institutions and the Governance of Incomplete Contracts, 9 J. Acct. Auditing & Fin. 579, 583–86 (1994).

[40] Robert Van Riper, Setting Standards for Financial Reporting: FASB and the Struggle for Control of a Critical Process 8–9 (1994); Mohamed Elmuttassim Hussein & J. Edward Ketz, Accounting Standards-Setting in the U.S.: An Analysis of Power and Social Exchange, 10 J. Acct. & Pub. Pol'y 59, 76 (1991).

[41] The federal securities laws directed the SEC to prescribe the form and content of financial statements. See generally, Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1934) (codified as amended 15 U.S.C. § 77, § 77s). For a review of the legislative history, see Sean M. O'Connor, Be Careful What You Wish For: How Accountants and Congress Created the Problem of Auditor Independence, 45 B.C. L. Rev. 741, 789–820 (2004). The SEC then turned the matter over to the AICPA. Van Riper, supra note 40, at 7.

[42] See Van Riper, supra note 40, at 9.

[43] Id.

[44] See Robert Chatov, Corporate Financial Reporting: Public or Private Control? 232–39 (1975).

[45] Van Riper, supra note 40, at 13–18.

bon copy, but for a larger cast of characters and geographic distribution requirements.[46]

The FASB's governance model, now replicated at the IASB, pursues a middle way that has aroused political objections both on the right and on the left. From the right, public choice commentators have denounced the arrangements surrounding the FASB as a rent-seeking scam. From this point of view, the FASB, which should have operated as a private standard setter subject to free competition, has from the beginning worked instead as a cog in the larger machine of the federal disclosure system, the mandates of which yield rents to auditing firms.[47] Extrapolating, following the Roadmap to substitute the IASB only make matters worse, taking an unsatisfactory domestic arrangement and embedding it on a global basis.

A second set of critics attacked from the progressive, pluralist left. For them, choices of accounting principles have significant allocative consequences; therefore, accounting standard setting is a high stakes game in which the setter has no alternative but to balance interests.[48] Because the setter resolves political rather than technical issues, its legitimacy depends on political responsiveness.[49] The FASB, at its inception, could not provide this because it depended on contributions from the preparers and auditors, groups with high stakes in all of its outcomes.[50] The critics thus contended that the standard setter should be an agency directly responsible to Congress.[51] Substituting the IASB only makes things worse from

[46] See 2007 Concept Release, supra note 3 ¶ 45,605; Ruder et al., supra note 19, at 519–20; see also Intern'l Accounting Standards Bd, IASB and the IASC Foundation: Who We Are and What We Do, available at http://www.iasb.org/NR/rdonlyres/95C54002-7796-4E23A32728D23D2F55EA/0/WhoWeAre_Revise5Feb09.pdf (last visited Mar. 10, 2009).

[47] See Ross L. Watts & Jerold L. Zimmerman, The Demand for and Supply of Accounting Theories: The Market for Excuses, 54 Acct. Rev. 273, 275–81 (1979).

[48] See Van Riper, supra note 40, at 73–74.

[49] See id. at 22–23.

[50] See id. at 14; Staff of Subcomm. on Reports, Accounting & Mgmt., S. Comm. on Gov't Operations, 94th Cong., Staff Study: The Accounting Establishment 1–2 (Comm. Print 1976) [hereinafter The Accounting Establishment].

[51] See Van Riper, supra note 40, at 45 (proposing in particular the General Accounting Office). The obvious choice, the SEC, delegated the standard-setting function to the private sector early in its history. For a critical discussion, see George Mundstock, The Trouble with FASB, 28 N.C. J. Int'l L. & Com. Reg. 813, 825–26, 839–41 (2003).

this point of view as well, because it removes a political subject matter to a distant venue in which U.S. domestic concerns occupy at best a secondary place on the agenda.[52]

The public choice critique has never had much political traction. The progressive attack did have an impact in the FASB's early years and prompted process reforms that strengthened the FASB's public bona fides, particularly in a trend toward ever-increasing distance from the AICPA.[53] It too has lost salience in recent years. But the FASB soon enough encountered a third enemy in the form of the same corporate managers who had been at the table at its inception. This is the one group of critics that would welcome IFRS.

The FASB crossed management when it took up its initial project to articulate generally accepted goals of accounting. The project, eventually called the Conceptual Framework, is a set of principles much derided for its high level of generality.[54] But the Conceptual Framework did lay down at least one outcome determinative point,[55] which lies in a single unprepossessing sentence in Statement of Financial Accounting Concepts No. 1: "Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions."[56] This is called decision usefulness, and it seems to state the obvious. But back in the 1970s it was radical stuff.[57]

Financial reporting in fact serves two purposes: it imports external transparency and also serves as a part of a rational system of internal management.[58] Three decades ago, the prevailing concept of purpose, called "stewardship," encompassed both purposes.[59] It

[52] 2008 Roadmap, supra note 7, at 70,846–47 (recognizing that substitution of IFRS for GAAP implies diminished influence for U.S. interests).

[53] See Van Riper, supra note 40, at 14–15, 46–47, 86–87, 126.

[54] See id. at 80; Stephen A. Zeff, A Perspective on the U.S. Public/Private-Sector Approach to the Regulation of Financial Reporting, 9 Acct. Horizons 52, 52, 60 (1995).

[55] See John C. Burton, A Commentary on the Reflections of Homer Kripke, 4 J. Acct. Auditing & Fin. 79, 80 (1989).

[56] See FASB, Statement of Financial Accounting Concepts No. 1: Objectives of Financial Reporting of Business Enterprises ¶ 34 (1978), available at http://www.fasb.org/pdf/con1.pdf.

[57] See Van Riper, supra note 40, at 20.

[58] See Watts & Zimmerman, supra note 47, at 296–97.

[59] Id. at 296.

meant that corporate managers had a place at the table with market actors as important users of the standards. Indeed, they claimed primacy.[60]

When the FASB elevated the status of outside users of financials with decision usefulness,[61] it broke with history and defected against management. It thereby also succeeded in protecting its own independence, avoiding the pluralist alternative of regulation as mediation in a world of multiple constituents with varied and conflicting preferences.[62] Decision usefulness also imported policy legitimacy, implying a one-size-fits-all theoretical justification for the enterprise as a whole. Back in the 1970s, management was peddling national competitiveness and public welfare to argue for a cost-benefit burden of proof to be met by every new accounting standard[63]—an argument that later would register in the Congress with respect to SEC rulemaking[64] and still registers in today's convergence discussions. The Conceptual Framework's focus on markets let the FASB argue back, first, that information is a public good that will be underprovided absent regulation,[65] and, second, that standards directed to user utility reduce the social costs of information asymmetry, which include high transaction costs and thin capital markets with low liquidity.[66]

Decision usefulness also aligned the FASB's goals with that of its governmental overseer, the SEC, and the SEC's goal of investor protection.[67] The two agencies maintained a cooperative relationship that worked well, at least until recently. The SEC's recent defection against the FASB also amounts to a defection from decision usefulness. A shift to IFRS, with its constituency-responsive

[60] See Van Riper, supra note 40, at 21.

[61] See FASB, supra note 56, ¶¶ 27, 32.

[62] See Baruch Lev, Toward a Theory of Equitable and Efficient Accounting Policy, 63 Acct. Rev. 1, 2, 13 (1988).

[63] See R. K. Mautz & William G. May, Financial Disclosure in a Competitive Economy: Considerations in Establishing Financial Accounting Standards 1–4 (1978) (presenting a project of the Financial Executives Research Foundation).

[64] See National Securities Markets Improvement Act of 1996, § 106(a)(2), 15 U.S.C. § 77b(b) (2006).

[65] See FASB, Statement of Financial Accounting Concepts No. 2: Qualitative Characteristics of Accounting ¶ 135 (1980), available at http://www.fasb.org/pdf/con2.pdf; Lev, supra note 62, at 8–9.

[66] Lev, supra note 62, at 4–9.

[67] See Van Riper, supra note 40, at 141.

stress on balance sheet treatments and de-emphasis of income statement responsiveness, would amount to a move back in the direction of stewardship.

Meanwhile, management has never been happy with GAAP. Because the FASB has independently sets its own agenda, management has seen a classic case of an unresponsive agency promulgating regulations for their own sake.[68] Management voices use the FASB's notice and comment and advisory processes to object but get only occasional concessions as FASB keeps cranking out standards they would just as soon do without.[69] Management also complains of excess complexity, but not when it likes the bottom line result.[70] The managers call the overall result "standards overload,"[71] and recommend shifting agenda control to a new oversight board with power to block agenda items and force revision of existing standards.[72]

Though management's agenda reform proposals have never gone anywhere, it has scored occasional victories in its long battle with the FASB. On occasion, it has used its political muscle to block proposed standards. It also secured two seats on the FASB, and, for a while, a super majority voting regime that made it harder for the FASB to adopt new standards.[73]

Management's complaint of excess complexity collapses into the more serious and widespread complaint that the FASB drafts too many rules, seeking to supply a clear answer to every possible situation, pursuing the objective with detailed statements, bright line tests, and multiple exceptions.[74] This complaint returns us to the SEC Roadmap's justification for doing away with the FASB altogether and so bears importantly in the present context.

---

[68] See Dennis R. Beresford, How Should the FASB Be Judged? 9 Acct. Horizons 56, 56–57 (1995).

[69] Van Riper, supra note 40, at 98–99, 118–31, 183; Beresford, supra note 68, at 59.

[70] Van Riper, supra note 40, at 110; Beresford, supra note 68, at 60.

[71] See Van Riper, supra note 40, at 137; Beresford, supra note 68, at 60.

[72] Van Riper, supra note 40, at 119–23; Beresford, supra note 68, at 57.

[73] Van Riper, supra note 40, at 126, 150, 154.

[74] See Sec. Exch. Comm'n, Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System, § I.C (2003) [hereinafter 2003 SEC Report], available at http://www.sec.gov/news/studies/principlesbasedstand.htm (last visited Feb. 1, 2009).

There is no question that GAAP's layers of rules can have perverse effects. Internal inconsistency can result.[75] Comparability also can suffer: reporting entities under the same strict standard can appear comparable on the faces of their financials when their arrangements in fact are dissimilar.[76] Worse, there results a dysfunctional, check-the-box approach to compliance that admits transaction structuring and other strategic behavior, along with rule compliant statements that do not fairly state the reporting company's results or financial position.[77]

Actors at the FASB reply that the rules follow from demands generated by managers and auditors looking for treatment and scope exceptions and "roadmaps" that hold out "guidance."[78] It says it is sorry, but it is just being a responsive regulator and does not exercise total control over outcomes.[79] But this posture of accommodation also has a dark side, for it is here that the public choice critique registers with full force. The securities laws' requirement of an independent audit makes the large audit firms providers of a necessary service, positioning them to collect rents.[80] Complex, rules-based standards aid and abet the rent seeking, generating work,[81] and over time strengthening entry barriers.[82] Moreover, innovations get choked off to the extent that they decrease auditability and expose the firms to legal risk.[83]

All of this is true, but, given the pressures that have come to bear on the FASB, it is difficult to imagine a different evolutionary course for GAAP. In effect, the FASB has had to take our second-best world as it finds it. It is a nasty place where incentive problems

[75] Id. § I.G.

[76] Id.

[77] Id.; Katherine Schipper, Principles-Based Accounting Standards, 17 Acct. Horizons 61, 68 (2003).

[78] See Van Riper, supra note 40, at 105.

[79] See Lawrence W. Smith, The FASB's Efforts Toward Simplification, FASB Rep., Feb. 28, 2005, at 2, 3–4.

[80] See George J. Bentson, The Regulation of Accountants and Public Accounting Before and After Enron, 52 Emory L.J. 1325, 1329–31 (2003).

[81] See Charles R. Plott & Shyam Sunder, A Synthesis, 19 J. Acct. Res. 227, 231 (Supp. 1981).

[82] See Dale Buckmaster et al., Measuring Lobbying Influence Using the Financial Accounting Standards Board *Public Record*, 20 J. Econ. & Soc. Measurement 331, 340 (1994).

[83] See Mundstock, supra note 51, at 817.

impair the auditor-client relationship, auditability does matter, and the standard setter has to worry about scandal prevention.[84] Rules, although not ideal, have advantages because they provide a base of common assumptions and knowledge for preparers, auditors, and users. They decrease differences in measurement; they make non-compliance more evident. And, as room for differences in judgment narrows, transparency and comparability are enhanced.[85] GAAP, then, has followed from defensible tradeoffs.

The institutional conditions that led to the tradeoffs will not magically disappear upon substitution of IFRS. It is therefore hard to predict benefits to domestic statement users from its principles and stress on fair presentation. As to management, however, benefits easily can be predicted.

## III. IMPLICATIONS

So, despite the problems, the FASB put itself on history's winning side with decision usefulness.[86] It thereby aligned itself not only with the SEC but also with the broader economic shift away from managerialism toward capital market governance under the shareholder value norm. The story of GAAP's evolution is thus a story about standard setting in the U.S. markets, where separated ownership and control predominate, and tensions between managers and shareholders are exhaustively worked out in regulation and litigation. The FASB opted for conservatism, verifiability, and rules because it operates in this environment, not because of some refractory, academic commitment to an outmoded approach to standard setting. The IASB, with its shorter history and different regulatory context, has pursued different values. Accordingly, it is not enough to describe it as "independent" and there end the convergence discussion in its favor. Viewed against this background, IFRS must look like an improvement to management, perhaps even if switching costs in the form of higher audit fees turns out to

---

[84] See William W. Bratton, Rules, Principles, and the Accounting Crisis in the United States, 5 Eur. Bus. Org. L. Rev. 7, 14–18 (2004) (describing advantages of rules in the auditing context).

[85] See Schipper, supra note 77, at 68.

[86] For further discussion, see William W. Bratton, Private Standards, Public Governance: A New Look at the Financial Accounting Standards Board, 48 B.C. L. Rev. 5 (2007).

be onerous. This is not because U.S. management can expect to dominate the IASB where it has failed to dominate the FASB. The IASB also has earned a reputation for independence.[87] Moreover, given the IASB's broader, global roster of constituents, any particular demands emanating from a single national interest group or regulator are bound to resound less forcefully than would occur in a domestic standard-setting context. The advantage for management lies in the elbow room imported by a shift to a shorter, less directive stack of standards. A shift to IFRS thus ameliorates the problem of "standards overload" in one swoop. Indeed, given one global standard setter and national governments and interest groups worldwide, it might prove quite difficult for IASB to crank out new standards.

Why, then, this abrupt concession to management after U.S. accounting's three-decade-long history of privileging the user interest? The answer is that the prevailing interest group alignment changed markedly in the post-Sarbanes-Oxley political economy. GAAP has come to be seen as one of the deadweight domestic regulatory costs that make U.S. capital markets unattractive to foreign firms. Thus has the SEC, looking to lighten its touch, abandoned a client that it had long protected. Market intermediaries, long quietly aligned with the FASB,[88] also appear to have crossed over as new listing business has gone to London, Singapore, and Hong Kong. Ominously, the audit firms seem to be lining up against the FASB as well, angling to get new litigation defenses out of the deal[89] and perhaps looking forward to collecting switching fees.

[87] It famously held its ground against the French banks and their government on fair value treatment on macro-hedging. See Ruder et al., supra note 19, at 579–86. More recently, however, IASB's reputation became tarnished when it relented to EU pressure to match U.S. adjustments respecting mark-to-market accounting of distressed debt securities in bank portfolios. See, e.g., Phillip Inman, UK Accounting Watchdog Threatens to Quit over EU Rule Change, Guardian, Nov. 12, 2008, at 26 (describing the resultant threat to resign of Sir David Tweedie, the IASB's chairman).

[88] See Van Riper, supra note 40, at 98.

[89] See U.S. Dept. of Treasury Advisory Comm. on the Auditing Profession, Final Report app. C 3–4 (2008) (appending remarks of U.S. Treasury Secretary Henry Paulson connecting globalization and international financial reporting standards with legal burdens auditors face); id. at VII.23–VII.32 (reviewing disagreement among Committee members on a wide range of litigation defenses and legal protections that auditing firms sought in a comprehensive review of issues facing the profession, in-

We think the SEC is making the classic mistake of a regulator facing its first reversal because of jurisdictional competition. The earlier domination of U.S. equity markets gave the United States the privilege of imposing its own terms on foreign entities.[90] The United States cannot do that anymore and a question is posed: should the United States continue to go its own way or reconstitute its markets so as to catch the at-the-margin consumers now listing securities elsewhere? In addressing such a question, it is important not to panic.[91] The past cannot be recaptured, and something must be sacrificed. And, competition in global securities market not being the same thing as competition in a market for widgets; costs and benefits do not automatically signal catering to the marginal consumer. Protecting domestic markets must be weighed against global market share. Therefore, as between the Roadmap and staying the course with the existing process of letting the FASB and the IASB iron out as many differences as the can, we prefer the latter course.[92]

Finally, opting for IFRS requires defining a framework for relations between the SEC and the IASB. The United States could follow the EU and reserve a right to endorse new IFRS promulgations, standard by standard, or take a more deferential posture toward the IASB.[93] The choice presumably will be influenced by a yet to be determined pattern of relations between IASB, the International Organization of Securities Commissions, and the global roster of participating national governments.

Whichever choice is made, we predict that conflicts will arise. Given conflicts and an IASB that proves impervious to U.S. inter-

cluding effects of globalization and movement towards international financial reporting standards), available at http://www.ustreas.gov/offices/domestic-finance/acap/docs/final-report.pdf.

[90] See generally, Chris Brummer, Stock Exchanges and the New Market for Securities Law, 75 U. Chi. L. Rev. 1435 (2008).

[91] Cf. William W. Bratton & Joseph A. McCahery, The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World, 86 Geo. L.J. 201, 264–65 (1997) (describing "scare talk" deployments of jurisdictional competition theory).

[92] Perhaps the SEC's ultimate purpose is to give FASB a push to move that process along. But if so, this cannot be a good way to apply pressure. To the extent the GAAP/IASB convergence process entails bargaining, it makes no sense to pull trumps from the national hand.

[93] See Cunningham, supra note 1, at 13, 26–31.

ests, whether articulated by management, users, or the SEC, a new domestic politics of accounting standard setting will emerge. The threshold question will be whether the U.S. national interest counsels departure from IFRS with consequent sacrifice of comparability and increase in compliance costs. In light of the contentious history of GAAP, we predict that the comparability line inevitably will be crossed. Once that happens, U.S. IFRS will begin a long, painful process of reverting to U.S. GAAP.

## APPENDIX

| Topic | GAAP | IFRS |
|---|---|---|

### I. General

| | | |
|---|---|---|
| Departures/ overrides | Allowed in theory; rare in practice[94] | Allowed[95] |

[94] See AICPA, Code of Professional Conduct, Rule 203, available at http://www.aicpa.org/about/code/et_203.html; FASB, Proposal: Principles-Based Approach to U.S. Standard Setting, File Reference No. 1125-001, 7 n.5 (Oct. 21, 2002), available at http://www.fasb.org/proposals/principles-based_approach.pdf.

[95] See IASB, International Accounting Standard ("IAS") 1, Presentation of Financial Statements, ¶¶ 17–22; Principles-Based Approach, supra note 94, 7 n.5.

**II. Income Statements**[96]

| | | |
|---|---|---|
| Classification of "extraordinary items" | *Allowed*[97] | *Prohibited* (unusual items can be segregated)[98] |
| Restructuring costs | Recognized when little discretion to avoid costs exists (mostly when incurred)[99] | Recognized when announced or commenced[100] |

[96] For US GAAP, see generally SEC Regulation S-X, 17 C.F.R. § 210 (2008); FASB, Statement of Financial Accounting Concepts ("CON") 1, Objectives of Financial Reporting by Business Enterprises; CON 2, Qualitative Characteristics of Accounting Information; CON 3, Elements of Financial Statements of Business Enterprises; CON 4, Objectives of Financial Reporting by Nonbusiness Organizations; CON 5, Recognition and Measurement in Financial Statements of Business Enterprises; CON 6, Elements of Financial Statements; CON 7, Using Cash Flow Information and Present Value in Accounting Measurements; FASB, Statement of Financial Accounting Standards ("FAS") 16, Prior Period Adjustments; FAS 52, Foreign Currency Translation; FAS 95, Statement of Cash Flows; FAS 130, Reporting Comprehensive Income; FAS 141, Business Combinations; FAS 154, Accounting Changes and Error Corrections; FASB, Accounting Principles Board Opinion ("APB") 28, Interim Financial Reporting; APB 30, Reporting the Results of Operations–Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions; FASB, Accounting Research Bulletin ("ARB") 43, Restatement and Revision of Accounting Research Bulletins; FASB, FASB Interpretation ("FIN") 39, Offsetting of Amounts Related to Certain Contracts. For IFRS, see generally IAS 1; IAS 7, Cash Flow Statements; IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors; IAS 21, The Effects of Changes in Foreign Exchange Rates; IAS 29, Financial Reporting in Hyperinflationary Economies; IAS 32, Financial Instruments: Presentation.

[97] APB 30, ¶ 1, 10–12.

[98] IAS 8.

[99] See Lawrence A. Cunningham, Law and Accounting: Cases and Materials 306–11 (2005) (excerpting FAS 146, Accounting for Costs Associated with Exit or Disposal Activities).

[100] IAS 37, Provisions, Contingent Liabilities and Contingent Assets, ¶¶ 14–35. IASB is reconsidering its approach to restructuring costs to align the IFRS approach more closely with the US GAAP approach. See IASB Press Summary, IAS 37 Round-table Discussions, available at http://www.iasb.org/NR/rdonlyres/2C92E25A-F831-4399-95F2-A6840DCBFA1F/0/IAS37roundtablespresssummary.pdf. As of February 2009, IASB anticipates adopting a final standard during the first half of 2010. See IASB, Liabilities—Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits* ¶ 5 (2009), available at

**III. Cash Flow Statements**

| | | |
|---|---|---|
| Interest and Dividends | Interest paid and dividends received *must be* classified as operating cash flows; dividends paid *must be* classified as financing cash flows[101] | *Choice allowed* in classifying:<br>1. Dividends and interest paid or received as *operating* cash flows, *or*<br>2. Interest or dividends paid as *financing* cash flows and interest or dividends received as *investing* cash flows[102] |

http://www.iasb.org/NR/rdonlyres/B2EE99F3-C48E-40A1-88275137C92C0EF4/0/ LiabIAS37UpdateFeb09.pdf.

[101] See Cunningham, Law and Accounting, supra note 99, at 48–50 (excerpting SEC Regulation S-X, 17 C.F.R. § 210.3–04 (treatment of dividends) and Accounting Research Bulletin ("ARB") 43, Ch. 3A, ¶ 4).

[102] IAS 7, ¶¶ 31–34.

## IV. Revenue Recognition[103]

| | | |
|---|---|---|
| Service Contracts | Generally, amortize over service period without up-front recognition[104] | Allows up-front recognition when partial performance has occurred[105] |
| Multi-Element Contracts | Defer recognition on delivered portion if non-delivery of remainder triggers a refund[106] | Recognize on delivery of portion even if non-delivery of remainder triggers a refund, so long as delivery probable[107] |
| Long-Term Construction Contracts | Allows percentage of completion method to be approached using either revenue-cost or gross-profit measures<br><br>*Requires* completed contract method in certain circumstances[108] | *Requires* revenue-cost approach to percentage of completion method (unless percentage not reliably estimable, in which case *requires* cost recovery method)<br><br>*Prohibits* completed contract method[109] |

[103] For US GAAP, see generally CON 5; SEC, Staff Accounting Bulletin ("SAB") 104, Revenue Recognition; AICPA, Statement of Position ("SOP") 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts; SOP 97-2, Software Revenue Recognition; FASB, Emerging Issues Task Force Abstract ("EITF") 99-17, Accounting for Advertising Barter Transactions; EITF 00-21, Revenue Arrangements with Multiple Deliverables; FASB, Technical Bulletin ("FTB") 90-1, Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts. For IFRS, see generally IAS 11, Construction Contracts; IAS 18, Revenue; IFRS, International Financial Reporting Interpretations Committee Interpretation ("IFRIC") 13, Customer Loyalty Programmes.

[104] See Cunningham, Law and Accounting, supra note 99, at 118–22 (excerpting SEC, Accounting and Auditing Enforcement Release No. 1454, In re Gunther International, Ltd. (Sept. 25, 2001) and FAS 45, Accounting for Franchise Fee Revenue).

[105] IAS 18.

[106] See Cunningham, Law and Accounting, supra note 99, at 100–01 (excerpting SAB 101, Revenue Recognition in Financial Statements and CON 5 ¶¶ 83(b), 84(a) & 84(d)).

[107] IAS 18, ¶¶ 14–19.

**V. Short-Term Investments & Financial Instruments**[110]

| | | |
|---|---|---|
| Hedging gains/ losses from forecasted transactions and firm commitments | Not included when initially measuring hedged item[111] | Are included when initially measuring hedged item from cash flow hedges[112] |
| Determining hedge effectiveness | Can be assumed in some cases[113] | Must be demonstrable in all cases[114] |
| Macro-hedging | Prohibited[115] | Permitted[116] |
| Reclassifications of investments in *to* the "trading" class | *Required* in some cases (but reclassification *from* trading prohibited)[117] | *Prohibited* (both to or from trading)[118] |

[108] Cunningham, Law and Accounting, supra note 99, at 122–28 (excerpting ARB 45, Long-Term Construction-Type Contracts and SEC, In re Touche Ross & Co. (Nov. 14, 1983)).

[109] IAS 18, ¶¶ 26–28.

[110] For US GAAP, see generally FAS 133, Accounting for Derivative Instruments and Hedging Activities; FAS 137, Deferral of the Effective Date of FASB Statement No. 133; FAS 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities; FAS 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities; FAS 155, Accounting for Certain Hybrid Financial Instruments; EITF D-102, Documentation of the Method Used to Measure Hedge Ineffectiveness under FASB Statement No. 133. For IFRS, see generally IAS 39, Financial Instruments: Recognition and Measurement; IFRS, International Financial Reporting Standard ("IFRS") 7, Financial Instruments: Disclosures; IFRIC 9, Reassessment of Embedded Derivatives.

[111] FAS 133, ¶¶ 29–35; FAS 138, ¶¶ 1–4.

[112] IAS 39, ¶¶ 78, 86, 95, 97; see also Deloitte, Summaries of IFRSs, IAS 39, http://www.iasplus.com/standard/ias39.htm (last visited Feb. 28, 2009).

[113] See Cunningham, Law and Accounting, supra note 99, at 357–60 (excerpting FAS 133).

[114] IAS 39, ¶¶ 71–102 (especially ¶ 81).

[115] FAS 133, ¶¶ 357, 443, 447, 449.

[116] IAS 39, ¶¶ 71–102; see also Deloitte, IAS 39, supra note 112.

[117] See FAS 159, The Fair Value Option for Financial Assets and Financial Liabilities, ¶ 29; see also id. at A51–52 (noting that continuing differences in accounting for financial instruments between GAAP and IFRS exist, "principally [as] to disclosures, scope exceptions, and whether certain eligibility criteria must be met to elect the fair value option").

[118] IAS 39, ¶¶ 50–54.

## VI. Inventory

| | | |
|---|---|---|
| Methods | *Allows* LIFO or FIFO (and others)[119] | *Prohibits* LIFO[120] |
| Measurement | Lower of cost or *market*[121] | Lower of cost or *net realizable value* ("NRV")[122] |
| Adjustments | Lower of cost or market adjustments *cannot be reversed*[123] | Lower of cost or NRV *must be reversed* in some cases[124] |

[119] See Cunningham, Law and Accounting, supra note 99, at 187–88 (excerpting ARB 43, Ch. 4, Stmts. 4 & 8), 190–91 (excerpting In re Arthur Andersen & Co. (FIFO)), 194–97 (excerpting United States v. Ingredient Technology Corp. (LIFO)).
[120] IAS 2, Inventories, ¶ 25.
[121] See Cunningham, Law and Accounting, supra note 99, at 205–06 (excerpting ARB 43, Ch. 4, Stmts. 5–6).
[122] IAS 2, ¶ 9.
[123] See Cunningham, Law and Accounting, supra note 99, at 205–06 (excerpting ARB 43, Ch. 4, Stmts. 5–6); see also SEC, Codification of Staff Accounting Bulletins, Topic 5: Miscellaneous Accounting Topics, Section BB. Inventory Valuation Allowances, http://www.sec.gov/interps/account/sabcodet5.htm (last visited Mar. 26, 2009).
[124] IAS 2, ¶ 33.

**VII. Tangible Long-Lived Assets**[125]

| | | |
|---|---|---|
| Measurement | *Requires* cost basis[126] | *Allows* cost basis or fair value[127] |
| Impairment Tests | Impairment suggested when book value exceeds *gross expected future cash flows*; second step measures amount of impairment using discounted cash flow analysis[128] | Impairment suggested when book value exceeds *greater of value in use (discounted cash flows)* or *fair value less cost to sell*[129] |
| Impairment Effects | Recognized in current income[130] | If cost method used, impairments recognized in income; if revaluation used, impairment usually treated as balance sheet adjustment[131] |
| Impairment Reversals | Impairments, once recognized, *cannot be reversed* [132] | Recognized impairments *reversed* in certain cases[133] |
| Investment Property | Required to be at depreciated cost[134] | Allowed at depreciated cost *or* fair value[135] |

[125] For US GAAP, see generally FAS 34, Capitalization of Interest Cost; FAS 143, Accounting for Asset Retirement Obligations; FAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets; FAS 154; ARB 43, Restatement and Revision of Accounting Research Bulletins; APB 6, Status of Accounting Research Bulletins; FIN 47, Accounting for Conditional Asset Retirement Obligations. For IFRS see generally IAS 16, Property, Plant and Equipment; IAS 23, Borrowing Costs; IAS 36, Impairment of Assets.

[126] See Cunningham, Law and Accounting, supra note 99, at 148–50 (excerpting CON 5 ¶ 67a and In re Harlan & Boettger, LLP).

[127] IAS 16, ¶¶ 29–31; IAS 36, ¶¶ 18–57.

[128] See Cunningham, Law and Accounting, supra note 99, at 165–67 (excerpting SFAS 144, ¶¶ 7, 23).

[129] IAS 36, ¶ 6 (providing relevant definitions) and ¶¶ 7–17 (discussing test).

[130] See Cunningham, Law and Accounting, supra note 99, at 167 (excerpting SFAS 144, ¶ 25).

[131] IAS 36, ¶¶ 58–64.

[132] See Cunningham, Law and Accounting, supra note 99, at 165–68 (excerpting FAS 142, Goodwill and Other Intangible Assets, ¶ 15 and FAS 144); FAS 144 ¶ B53.

[133] See IAS 36, ¶¶ 110–124 (addressing reversal of impairment); see also Deloitte, Summaries of IFRSs, IAS 36, http://www.iasplus.com/standard/ias36.htm (last visited Feb. 22, 2009).

| | | |
|---|---|---|
| Costs of Major Overhauls | Generally expensed[136] | Capitalized[137] |

[134] See Ernst & Young, US GAAP vs. IFRS, at 15 (2009), available at http://www.ey.com/Global/assets.nsf/International/IFRS_v_GAAP_basics_Jan09/$file/IFRS_v_GAAP_basics_Jan09.pdf (stating that investment property is not a separately defined classification in US GAAP).

[135] IAS 40, Investment Property, ¶ 30; see also Deloitte, Summaries of IFRSs, IAS 40, http://www.iasplus.com/standard/ias40.htm (last visited Feb. 22, 2009). Initial measurement is at cost. See IAS 40, ¶¶ 20, 23; IASC Foundation, Technical Summary, IAS 40, available at http://www.iasb.org/NR/rdonlyres/0E7AB953-8BE4-4799-97BC-A3BDE0B01A3E/0/IAS40.pdf.

[136] See FASB, Board Meeting Handout: Planned Major Maintenance Activities 3 (Mar. 8, 2006) (noting intent to issue an FSP to require direct expensing of all maintenance activities), available at http://72.3.243.42/board_handouts/03-08-06.pdf.

[137] IAS 16, ¶ 13.

**VIII. Intangible Long-Lived Assets**

| | | |
|---|---|---|
| Research Development Costs | *Expensed* as incurred; included in *operating* cash flows[138] | Research costs expensed as incurred; development costs *capitalized and amortized*; portion capitalized included in *investing* cash flows[139] |
| Estimated residual value | Present value of expected disposal proceeds[140] | Current net selling price, assuming asset is in expected age/condition as at end of useful life[141] |
| General Impairment Tests | Fair value[142] | Higher of *use value or fair value less costs to sell*[143] |
| Goodwill Impairment Test | Special test compares fair value of cash generating unit to book value, then compares good-will to carrying value[144] | No special test (use one similar to other long-lived assets, a single-step computation)[145] |
| Impairment Reversals | *Prohibited* [146] | *Permitted* in some cases[147] |
| Revaluations | *Prohibited* [148] | *Permitted* in some cases[149] |

[138] See Cunningham, Law and Accounting, supra note 99, at 144–45 (excerpting FAS No. 142 ¶ 10).

[139] IAS 38, Intangible Assets, ¶¶ 51–71; see also IASC Foundation, Technical Summary, IAS 38, http://www.iasb.org/NR/rdonlyres/149D67E2-6769-4E8F-976D-6BABEB783D90/0/IAS38.pdf.

[140] FAS 142, ¶ 13.

[141] IAS 38, ¶¶ 100–03; see also IASC Foundation, supra note 139.

[142] FAS 144, ¶ 7; see also id. ¶ 5 (noting that the standard does not apply to a variety of accounting measurements, such as goodwill or certain other intangible assets).

[143] IAS 36, ¶ 18.

[144] FAS 142, ¶¶ 18–22.

[145] IAS 36, ¶¶ 80–99; see also IASC Foundation, Technical Summary, IAS 36, http://www.iasb.org/NR/rdonlyres/A288C781-7D39-4988-BA71-9AB77A263BA0/0/IAS36.pdf.

[146] See Cunningham, Law and Accounting, supra note 99, at 165–68 (excerpting FAS 142, ¶ 15 and FAS 144); FAS 144, ¶ B53; see also supra note 128.

[147] IAS 36, ¶¶ 109–25.

[148] See Cunningham, Law and Accounting, supra note 99, at 168 (excerpting FAS 142 ¶ 17).

| | | |
|---|---|---|
| Asset Retirement Obligations | *Not usually recomputed* after initial computation[150] | *Recomputed* at each balance sheet date[151] |

[149] IAS 38, ¶¶ 75–87.
[150] See Cunningham, Law and Accounting, supra note 99, at 180–81 (excerpting FAS 143 ¶¶ 3–11).
[151] IAS 37, ¶ 59.

## IX. Long-Term Investments

| | | |
|---|---|---|
| Classification | Only securities are classified as trading, available-for-sale, or held-to-maturity[152] | All financial investments, including securities, are classified as trading, available-for-sale, or held-to-maturity[153] |
| Investee Positions | Equity method | Equity method, cost, or fair value |
| Unlisted securities | Cost | Cost or fair value if reliable measure available[154] |
| De-recognition | Based on surrendering control; diminishes reliance on *risks-and-rewards analysis*<br><br>Prohibits partial de-recognition[155] | Based on *risks-and-rewards and control analyses*<br><br>Allows partial de-recognition[156] |
| Investment Property | *Must be* accounted for by cost (and depreciation) method[157] | *Can be* accounted for by cost (and depreciation) method, or by fair value method with changes reported in income[158] |

[152] FAS 115, Accounting for Certain Investments in Debt and Equity Securities, ¶ 4.
[153] IAS 39, ¶ 2.
[154] Id. ¶¶ 43–70 (especially ¶ 46).
[155] FAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, ¶¶ 125–140.
[156] IAS 39, ¶¶ 14–42.
[157] APB 6, ¶ 17.
[158] IAS 40, ¶ 30.

**X. Business Combinations and Consolidated Financial Statements**

| | | |
|---|---|---|
| Consolidation Test | Based on *majority ownership*<br><br>*Closing date* generally used for recognizing acquisitions[159] | Based on *control*<br><br>*Control date* used for recognizing acquisitions[160] |
| Consolidation | Required as to majority owned subsidiaries unless parent does not exercise control[161] | Required as to controlled entities unless except for interests in acquired subsidiaries classifiable as "held for sale" [162] |
| Parent-Sub Accounting Policies Conformity | Not necessary to conform[163] | Must conform[164] |
| Post-Acquisition Obligations | Recognize only for existing activities begun before acquisition, to be completed in one year[165] | Recognize only for provisions that had been recognized by acquired entity |
| Restructuring Reserves | Can be recognized if post-acquisition restructuring of acquired entity planned | Generally not allowed, unless acquired entity had recorded contingent liability before transaction |

[159] See Cunningham, Law and Accounting, supra note 99, at 267–72 (excerpting FAS 94, Consolidation of All Majority-Owned Subsidiaries and ARB 51, Consolidated Financial Statements); FAS 141, ¶¶ 10–11.

[160] IAS 27, Consolidated and Separate Financial Statements, ¶¶ 1, 4, 21.

[161] See Cunningham, Law and Accounting, supra note 99, at 267–92 (excerpting FAS 94; ARB 51, Consolidated Financial Statements; FAS 141).

[162] IAS 27. A prior standard stated an exception in terms of temporary control. See Deloitte, IAS 39, supra note 112.

[163] FAS 141, ¶¶ 60–66 (discussing subsequent accounting practices); see Deloitte, IFRSs and US GAAP: A Pocket Comparison 31 (2008) (noting as to different accounting policies of parents and subsidiaries that IFRS requires them to be conformed whereas US GAAP has no specific requirements).

[164] IAS 27, ¶¶ 28–29.

[165] FAS 141, ¶¶ 51–56.

**XI. Contingencies**

| | | |
|---|---|---|
| Contingent Gains | Not recognized[166] | Can sometimes be recognized in narrow circumstances[167] |

**XII. Long-Term Liabilities**

| | | |
|---|---|---|
| Convertible Debt | Classified as a liability[168] | Classified as both a liability and equity based on relative fair values[169] |
| Defaulted Debt | Classifiable as long-term if waiver of default obtained before *financial statements are issued* | Classifiable as long-term if waiver of default obtained before *balance sheet date* |

[166] FAS 5, Accounting for Contingencies, ¶ 17.

[167] These narrow circumstances include recognition of gains in connection with uncertain tax positions and by interpretation and application of provisions dealing with contingent assets and contingent liabilities. See IAS 37.

[168] APB 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants, ¶ 12.

[169] IAS 32, ¶¶ 28–32.

**XIII. Leases**

| | | |
|---|---|---|
| Capital Leases[170] | Based on presence of any one of *four defined criteria*[171] | Based on examination of *risks and rewardstransferred*[172] |
| Third-Party Support | *Excluded* from minimum lease payments analysis of capital lease classification decision[173] | *Included* in minimum lease payments analysis of capital lease classification decision |
| Output Contracts | Classified as leases | Not classified as leases |

[170] GAAP uses the term capital leases; IFRS uses the term finance leases.
[171] FAS 13, Accounting for Leases, ¶¶ 6–7.
[172] IAS 17, Leases, ¶¶ 7–8.
[173] FAS 13, ¶¶ 20–22.

**XIV. Pensions / Postretirement Benefits**

| | | |
|---|---|---|
| Past Service Costs | Amortized over service period or life expectancy of workers[174] | Expensed[175] |
| Minimum Liability | At least the unfunded accumulated pension benefit obligation appears in the balance sheet as a minimum liability[176] | No minimum liability reported in the balance sheet[177] |
| Pension Assets | No limitation on recognition of pension assets[178] | Some limitation on recognition of pension assets[179] |
| Legal Changes | May not be anticipated in variables used in making calculation | Should be anticipated in variables used in making calculation |
| Termination Benefits | Expensed when employees accept and amount can be estimated; recognize contractual benefits when it is probable that employees will accept[180] | Expensed when employer is committed to pay[181] |

[174] FAS 87, Employers' Accounting for Pensions, ¶¶ 162–67.
[175] IAS 19, Employee Benefits, ¶ 10.
[176] FAS 87, ¶¶ 144–56.
[177] IAS 19, ¶¶ 49–60.
[178] FAS 87 ¶¶ 117–23.
[179] IAS 19, ¶¶ 102–04.
[180] FAS 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, ¶ 15.
[181] IAS 19, ¶ 133.