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MIND THE GAAP: CULTURAL, POLITICAL, AND LEGISLATIVE ROADBLOCKS TO IFRS INTEGRATION IN THE U.S.

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ABSTRACT: *In October, 2002, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) signed the ground-breaking Norwalk Agreement. This agreement signified the two parties' commitment to the ultimate convergence of United States Generally Accepted Accounting Principles and International Financial Reporting Standards. What appeared at its genesis as a good faith effort to speed convergence between the two respective frameworks seems to have misfired, with an emphasis which now appears to be moving away from convergence, and focused instead on the duality and plurality of co-existing frameworks. The SEC, a governmental entity who had previously issued a clarion call for convergence and had gone so far as to eliminate the required IFRS – GAAP reconciliations for overseas issuers in 2007, appeared in 2011 to do something of a U-turn, and even appeared to retreat from their initial convergence position by suggesting that a US issuer who is in compliance with US GAAP be allowed to state that their financial statements are also in compliance with IFRS. This paper examines the changing attitudes and increasing aversion toward IFRS integration in the US, and attempts to understand some of the reasons; specifically cultural, political, and legislative, which may help to explain this changing of attitudes and direction. There appears to be a litany of prior research relating to US GAAP and IFRS integration, but the research does not tend to focus on specific reasons why convergence has not occurred, and why attitudes toward it have changed. This paper attempts to fill a perceived gap in the research related to the examination of potential political, cultural and legislative drivers of non-convergence. The paper also briefly examines literature related to research conducted which questions whether IFRS has had a positive effect on global capital markets, and whether this positive effect may actually have been caused by the existence of other factors.*

KEYWORDS: US GAAP, IFRS, Convergence, Standard-setters, Harmonization

INTRODUCTION

This article explores the convergence project between US GAAP and IFRS through a study of historical and empirical research and literature. The paper examines prior literature and looks for trends in attitudes toward convergence in the US, and attempts to identify the reasons as political, cultural, or legislative. Attention is also paid to research that has called into question the efficacy of IFRS with respect to global capital markets, and questioned whether positive effects on these capital markets which have been recorded have actually been driven by the implementation of IFRS, or whether there are other variables at play which may be driving these positive changes. The author ultimately concludes, based on the research that it appears that due to the aforementioned categorical differences and evidence of changing attitudes in the US, full convergence of US GAAP and IFRS is unlikely to be achieved. As a corollary to the research conducted in this paper, the author also suggests a possible idea for future research relating to the financial and commercial effects of two co-existing and possibly competing

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frameworks: US GAAP and IFRS, and the resultant effects on information asymmetry, preparatory costs, and costs of capital.

The purpose of the literature review is to examine prior research relative to attitudes toward convergence, and how they may have changed since 2002. The literature review examines prior research in an attempt to understand why attitudes surrounding convergence appear to have changed, and specifically attempts to determine if the catalysts driving the attitudinal change are cultural, political, and regulatory, as opposed to financial.

The landmark Norwalk Agreement was signed jointly between the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) in 2002. The agreement was hailed as historic with respect to convergence efforts between US GAAP and IFRS. What appeared at its inception to be a genuine collaborative effort at acceleration of convergence between the two respective frameworks (Goldberg, Grant, & Stovall, 2006) has waned considerably, with a shifting desire from ultimate convergence, and more toward a duality of frameworks. The Securities and Exchange Commission (SEC), an organization who had publicly and repeatedly supported convergence, and even proactively eliminated IFRS – GAAP reconciliations in 2007 for foreign issuers, issued a bulletin in 2011 which caused commentators to call into question their initial convergence position by publicly taking the position that a US issuer who is in compliance with GAAP be simultaneously allowed to state that the financial statements are also IFRS compliant (Yallapragada, Roe, & Toma, 2014).

There were great expectations of convergence when the FASB and the IASB jointly signed the Norwalk Agreement in 2002. De Lang & Howieson (2006) postulate that at least some of the impetus for the signing of this agreement was driven by the recent financial debacles of Enron and WorldCom and other large companies in the US. The sheer scale of these financial debacles and the political, regulatory and economic fallout that resulted caused the credibility of GAAP to suffer (Schipper, 2003). Critics decried GAAP's 'check the box' type system, which they believed exposed loopholes which were exploited by firms, and which tied the hands of auditors who otherwise may have been more vocal in speaking out against questionable accounting practices employed at firms like WorldCom, Enron, and others. During this era, GAAP, which had been something of a global standard which other countries aspired to, lost much of its viability and was subject to much criticism pertaining to its rigidity and lack of a principles-based framework (Schipper, 2003). At the same time, IFRS, which was being increasingly used around the world, was the subject of much albeit hypothetical discussion pertaining to its principles-based approach, and whether had the United States already been using these standards, it would have prevented the debacles of Enron and WorldCom (Schipper, 2003).

It is evident that before 2002, convergence was a global hot topic in the realms of accounting and financial reporting. When we consider the increasing sophistication of global capital markets and increasing access to domestic exchanges around the world by foreign issuers, it is not hard to understand why the problem of comparability has continued to grow (Hail, Leuz, & Wysocki, 2010). In response to this, protagonists of a single worldwide set of financial reporting standards have pushed the numerous benefits, for example lower costs of capital for firms because of decreased information asymmetry, reduced costs of information preparation on account of a single framework and the simultaneous elimination of expensive reconciliations. Another obvious benefit to domestic issuers would be considerably easier access to the capital markets of other countries, and an easier listing process on foreign stock exchanges (De Lang & Howieson, 2006). Even throughout these early stages, it is interesting

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to note that detractors of IFRS did exist. Imhoff (2003) posits that US GAAP is likely the most rigorously developed and transparent reporting framework in the world, and further postulates that it was because of these somewhat arduous and comprehensive financial reporting regulations that a large number of accounting discrepancies in the US have been discovered. Further to this, Imhoff (2003) posits whether any other overseas financial reporting framework would have been any more efficacious in detecting the accounting problems at companies like Enron. Imhoff (2003) submits the postulation that GAAP and FASB were "convenient scapegoats" of the 2002 financial reporting debacles, and further posits that due to accounting regulations needing management support and auditor sign-off, if management and auditors decide not to act in the best interest of company shareholders, then it would be relatively simple to bypass either a rules-based or principles-based framework.

In sharp contrast to this, Langmeade and Soroosh (2009) note that the 2003 SEC study report, pursuant to section 108(d) of the Sarbanes-Oxley act determined that convergence was a priority. It's apparent that during this era, detractions of GAAP for being too 'rules-based' and prone to manipulation, and thoughts toward a more 'principles-based' approach were both implicit and replete in the wording of the Sarbanes-Oxley act and the SEC's 2003 report.

In 2005, IFRS arguably received a tangible increase to its viability when the European Union mandated that any issuers listing on an EU exchange use IFRS to report their consolidated financial statements beginning January 1st, 2005 (Gill, 2007). The IASB and FASB had previously signed the Norwalk Agreement in 2002, but the new mandate would help to strengthen and legitimate IFRS as a global financial reporting framework. The new EU mandate would also increase pressure on the FASB and the SEC to speed their convergence efforts (Gill, 2007). In February 2006, the FASB and IASB signed a new memorandum of understanding, which served to reaffirm the 2002 Norwalk Agreement, but also specified certain convergence goals to be achieved by 2008.

In 2007, in a move that not only seemed to accelerate convergence efforts, but also to further signal the position of the SEC with respect to IFRS integration, the same organization eliminated the reconciliation requirement for foreign issuers listing on any US stock exchange under the proviso that issuers used IFRS as set forth by the International Accounting Standards Board (IASB). This appeared to signal a large step toward achieving convergence, and appeared to signify the SEC's ongoing promotion of IFRS as a credible global reporting framework. Erchinger (2007) notes that many foreign issuers were becoming increasingly concerned with the significant human resource, preparation, and implementation costs associated with the reconciliation from IFRS to GAAP; and that numerous foreign issuers were contemplating exiting the US capital markets and deregistering their securities with the SEC as a result. Erchinger (2007) notes that this amendment with respect to the reconciliation requirement likely benefited financial statement users who experienced improved comparability and financial statement issuers who benefited from a decrease in information asymmetry.

In September, 2009, the convergence project received a boost when the leaders of the G20 (the Group of Twenty nations) singularly called on the IASB and the FASB to increase and speed their efforts towards convergence of accounting standards, and ideally achieve full harmonization by June, 2011 (Scanlon & Patch, 2010). Scanlon and Patch (2010) also comment that the SEC noted a concern that the principles-based standards of IFRS could lead to increased audit difficulty due to a greater reliance on professional judgment, and also possibly promote ambiguity with respect to the SEC's enforcement role and responsibilities under the

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new framework. Despite noting these concerns, it does appear that the SEC, at least at the time, was encouraging of integration efforts. A salient point to mention here is that despite the SEC appearing to be supportive, no formal timeline was promulgated, most likely because of the SEC's reservations pertaining to issues such as principles-based accounting, fair value accounting, and questions concerning what exactly the SEC's enforcement role would be under IFRS. Scanlon and Patch (2009) posit that even as early as 2009, there was an increased likelihood of the convergence timeline changing due to both the magnitude and multitude of issues that the SEC faced, which would likely result in some type of deferral.

The continuation of efforts toward, and impetus for convergence of GAAP and IFRS appeared to be in full swing in 2009. The SEC and other agencies with influence on the standard-setting process continued to preach the achievement of convergence as the idealistic goal and thus were vocal in their support of the FASB to redouble its efforts toward this end. At this time, the IASB and FASB continued to work closely on harmonization of certain standards, and convergence efforts appeared to have built a head of steam. Writing in the August, 2010 issue of the CPA Journal, Gannon (2010) summarized the current atmosphere extremely saliently. In describing the "Inevitable Movement" he said "but for most, I think the discussion has now moved to how do we deal with this? In the end, there is no denying the coming changes to financial reporting and the movement toward a single global standard" (Gannon, 2010, p.12).

In 2012, we begin to note some subtle changes in attitudes toward convergence, manifested in SEC and FASB retractions and hints of walk backs from previous positions with respect to harmonization. In a 2012 interview with Accounting Today, FASB Chair Leslie Siedman made some interesting comments on the changing relationship with the IASB, and how moving forward, convergence might look different. These comments appeared to be a portent of things to come, and evidence of the differing dynamic between the two standard-setting agencies. Despite referring to the previous ten years of harmonization efforts as "a success" (Siedman, 2010, p.44), Siedman notes an evolving relationship with the IASB, seemingly distancing the FASB from the previous bilateral approach. When responding to a question about her opinion on whether harmonization efforts were endangered, Siedman answered by saying that "it was important to take a broad look at where this started and where it's gone. It seems to me that there is more than one approach to achieving comparability in accounting standards." (Siedman, 2010, p.44). Siedman also used the interview as an opportunity to refer to the SEC's recent lack of decision on whether or not to incorporate IFRS into the US financial reporting system, which appears to indicate a change in attitude of the SEC, who just four years earlier had abandoned the IFRS-GAAP reconciliation requirement, and had as recently as 2010 continued to aggressively encourage IFRS and direct the FASB to continue as expediently as possible with its efforts toward convergence. Siedman also noted that the term "US GAAP" would very likely remain, and called for standards that were not actually IFRS to be called GAAP; terming it a "truth-in-labelling" issue (Siedman, 2010, p.45). Siedman also made reference to the SEC's more recent "condorsement approach" : a term coined by then Deputy Chief Accountant Paul Beswick, which referred to a suggested path forward that did not ultimately lead to convergence with IFRS. In Beswick's approach, GAAP would continue to be used, and the IASB and FASB would refrain from entering into any new convergence projects. Thus it would seem that in 2012, the first signs of the SEC's changing attitude toward harmonization, and a re-assertion of independence were beginning to metamorphosize.

In their seminal 2010 article: *Global Accounting Convergence and the Potential Adoption of IFRS by the U.S. (Part II*): Political *Factors and Future Scenarios for US Accounting*

Standards, Hail, Leuz, and Wysocki note some of the political challenges that US adoption of IFRS might entail. The current system in the US is that Congress delegates standard setting authority to the SEC, who likewise delegate responsibility to the private sector (the FASB). If standard-setting authority was transferred from these two organizations to the IASB, an international organization, this would likely affect the complex layers of politics and interplay between these organizations (Hail, Leuz, & Wysocki, 2010). If the IASB assumes the role of standard setter in the US, this would create a certain redundancy and overlap between the IASB and the FASB. Hail et al., (2010) also note the US Congress' "innate resistance to give up power to a foreign authority or standard-setting body" (Hail et al., 2010, p. 573) and increasing US resistance against fully adopting and submitting to a framework that could possibly become increasingly dominated by the rapidly growing markets of India and China; one of whom (China) is already a signatory to IFRS, both of whom could influence the issuance of standards detrimental to the interests of US issuers. It is clear to say at this point that any potential switch to IFRS would face significant political challenges within the US. Hail et al., (2010) also discuss the lobbying view of regulation whereby different stakeholders will attempt to influence the outcome of legislation and standards based on their own needs and interests. As one example, multinational companies, many of whom possess powerful lobbies, could lobby in favor of IFRS due to increased comparability, lower preparatory costs, and decreased costs of capital in foreign markets. Similarly, large multinational auditing firms could also lobby in favor of IFRS as they eye the chance to earn additional revenues related to convergence with new standards, especially in the earlier transitional years. On the other hand, smaller, domestically-focused companies and local/regional audit firms might choose to lobby against IFRS due to disproportionately high transitional costs and their lack of capital to cover these costs (Hail et al., 2010). It would appear that careful observance of lobbying activities may provide salient information with respect to the weight of opinion and political climate surrounding IFRS convergence. It now also seems possible that the change in attitude toward convergence evidenced in 2012 is at least partially a result of political concerns about loss of power etc. posited by Hail et al., (2010).

Hussey and Ong (2014) comment that despite early commitments from the FASB relating to harmonization of standards and full adoption of IFRS, this has clearly not occurred, and furthermore there appear to be indicators that this is not likely to happen. Reference is again made to the apparent reticence of the SEC and FASB to relinquish their standard-setting power and role to a supranational organization (Hussey & Ong, 2014). A salient point here also is that when the landmark Norwalk Agreement was signed in 2002, the newly appointed FASB chair, Robert Herz, himself a Chartered Accountant in the United Kingdom who had previously served on the IASB, was keen to instill within the FASB a greater commitment to convergence (Hussey & Ong, 2014). Thus the research here would seem to lend supporting evidence with respect to the importance of politics and culture and its effect on standard-setting and ultimate convergence. Noteworthy here too, at minimum as an area of possible future research, is the effects of changing leadership at key organizations such as the FASB and the SEC, and how these leadership changes promote differing opinions and perspectives on the importance and expediency of IFRS integration.

In their 2017 article *The changing IFRS debate in the USA: a rejoinder* Negash, Holt, and Hathorn (2017) expounded on some of the reasons for uncertainty regarding US adoption of IFRS. Listed among these reasons were high levels of turnover at the executive level at the SEC which might cause a lack of continuity and direction, with newer executives potentially having different views and agendas surrounding convergence, and the importance and urgency

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thereof. A further issue deals with what could be perceived as a potential loss of sovereignty and US aversion to deferring standard-setting authority and to a lesser extent, enforcement power, to a supranational standard-setting body. Also mentioned is weariness among US issuers in certain industries pertaining to litigation surrounding unfamiliarity with a new framework, and the fact that the IFRS framework is more principles-based and leaves substantially more latitude (in the form of judgment) in the hands of management and the auditors. The final issue noted relates to the value attached to the exceptionalism of US institutions, and their tendency to want to remain somewhat isolationist. Interestingly, the authors conclude that the IFRS adoption debate does not center around an alignment of principles of recognition per se, but is more an issue related to change management (Negash et al., 2017). This article would appear to support much of the prior research discussed previously, with having the additional benefit of being much more recent.

Madsen (2013) notes that we have seen examples in other countries of how the decision makers with respect to adoption or non-adoption of IFRS and replacement of national standards are typically ill-equipped to make an educated decision because of a lack of understanding of the framework and associated standards. Madsen (2013) also makes note of how international political forces influence national adoption of IFRS. Interestingly, Madsen proceeds to offer an interesting postulate as to whether the political process that underpins the adoption of new IFRS standards really facilitates the creation and promulgation of efficient standards, and further offers the theory that the new standards are not typically beneficial due to the existing process of creating new standards and what he perceives as a lack of understanding of the material costs and benefits associated with them. Thus, it is possible that standard setters in the US have adopted an increasing aversion to full IFRS integration due to concerns such as these. It is also likely that they have studied other countries that have already adopted IFRS and possibly been dissuaded from full integration by issues these countries have experienced.

Laurenco and Branco (2015) note that with respect to adoption of IFRS, there are significant gaps in the literature which are offered as further opportunities for future research. For example, there appears to be a void of research and literature that deals with how successful IFRS adoption has been for smaller companies who would typically have fewer resources to spare toward successful implementation of a new standard. The research also notes that with respect to implementation of IFRS, companies within the European Union appear to have fared better than countries outside. Noteworthy also in the study, and of particular importance to the US would be the finding that voluntary adoptions of IFRS have not always shown positive effects. A further reason for the reticence to adopt IFRS might be the emerging body of research which questions the efficacy of IFRS with respect to the capital markets, and posit that its supposed effect on these markets may actually be caused by other factors.

The United States without question has the largest and most sophisticated capital markets in the world. The US has been the clear world leader in this regard for many decades. With such large and well developed capital markets, it makes sense that the framework that has, in essence, regulated the financial reporting aspect of these capital markets would also be extremely robust, sophisticated and well developed. There has been much criticism of US GAAP for being overly rules-based, and we have seen much contention and speculation in the literature about whether or not the financial accounting debacles at Enron, WorldCom, and many other US companies were at least in part caused by GAAP's 'check-the-box' type system. Decriers of US GAAP also point to its voluminous nature (especially in comparison to IFRS) but one should be cognizant of the dangers of this comparison. US GAAP has been a

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developing and evolving set of standards for over a century, whereas IFRS, comparatively speaking, is in it's infancy in this sense, and will no doubt continue to evolve and grow into a much larger set of comprehensive standards. One could make the case that when viewed in the long run, US GAAP has been successful in providing the correct information in a timely manner to various users of the financial statements. We have seen large scale and highly publicized debacles like Enron and WorldCom, whose collapses made news across the world. It should also be pointed out that outside of the US; there have been other large-scale and noteworthy debacles. Take for example the Portuguese bank Banco Espirito Santo who, due to financial irregularities, had to be bailed out by Banco de Portugal (Portugal's Central Bank) to prevent financial collapse. Another example is the Australian retailer Dick Smith, who suddenly collapsed and was placed into receivership in 2016. At the time of collapse, both of these entities were using the IFRS framework. The point here is, although it could be argued that the rigidity of US GAAP contributed to the financial collapses of Enron and WorldCom, it is clearly not an issue confined to the United States. Examples of similar debacles exist in other countries too. There is also a scarcity of research and lack of compelling evidence to support IFRS faring any better in bringing to light the Enron and WorldCom situations before their respective collapses. It is reasonable to at least postulate that from a political and standard-setting perspective, as literature and research surfaces that calls into question issues such as the efficacy of IFRS on global capital markets, and whether one or more other variables could be responsible for the positive increases that have been seen, politicians and standard-setters in the US could reasonably be understood to demonstrate aversion toward convergence. Worthy of consideration here too, and a further factor which could be contributing to US aversion to adopt IFRS may be the seemingly unknown effect of IFRS on small businesses. There are an abundance of small businesses in the US who would clearly be adversely affected by implementation of IFRS with respect to the disproportionate costs of implementation coupled with a lack of resources to properly effect such an implementation. In a similar manner to what large businesses achieve through effective and powerful lobbies, small businesses and cottage industries are able to have their voice heard through their representatives which translate to a national, legislative level.

The United States has a long history of both isolationism and global economic dominance. Thus, one can understand that many in the US would be uncomfortable with a supranational organization taking over responsibility for standard setting as well as, to a lesser extent, enforcement power. In today's current political climate, it would be hard to see a policy endorsing transfer of authority and at least a partial loss of enforcement power overseas as being an overly popular one, and certainly one that would be unlikely to garner any support come election time. It certainly seems as though the SEC, a vocal proponent of IFRS convergence in the early days, is now much less committal with respect to harmonization, and indeed the literature would appear to confirm a move in the contrary direction.

Another interesting and noteworthy point that surfaced in the literature was the element of redundancy that would exist between the IASB and the FASB should convergence occur. It would seem reasonable to offer the supposition that FASB members may have questioned both their roles and the future of the FASB as a standard-setting organization should the IASB assume command of this function. The possibility at least exists that a certain degree of self-preservation may have been inherent in wanting to ensure the survival of the FASB, which may have at least partially driven the loss of impetus toward convergence. Likewise with the SEC, who would most likely be required to transfer at least some of its enforcement power to the

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IASB. Of course, the SEC has a range of other functions which it could occupy and focus on unlike the FASB, whose circle is far more concentric with the IASB.

Another noteworthy point that speaks to the likelihood of a lack of convergence in the near term is the more recent stances that various countries with key global economies have taken with respect to reaffirming their place and standing in the world. We have seen a wave of patriotism and a nationalistic fervor sweep through many of these counties; typically at the expense of international business and global trade. In the last two years, we have seen Britain exit the European Union and the United States announce a series of aggressive tarries on its allies and major trading partners. The response from these trading partners has typically been retaliatory, which tends to shift the relationship from inclusive to exclusive, from friendly to adversarial. This type of global political posturing and one-upmanship is at best expensive, and at worst, dangerous. It would be hard for one to envision any global convergence effort being successful at present, and it might even be argued that the best chance for convergence now may be for the initiative to lay dormant and attempt to weather the isolationist storm. Hopefully there will be calmer seas and smoother sailing in the future. All of this evidence, coupled with recent world events, would appear to support the idea presented in this paper that political, cultural and legislative roadblocks have proved to be major roadblocks for IFRS integration.

In conclusion, the literature reviewed would suggest evidence of changing attitudes in the US with respect to IFRS convergence. What started as a robust, good-faith effort has been subject to the changing attitudes and opinions of the SEC and FASB which could be attributed to the lack of harmonization of accounting standards and the likely continuation of GAAP as the US accounting framework, perhaps either complimenting or even competing with IFRS. The articles that this paper has examined in a chronological sense from 2002 through the present day would seem to support the conclusion that the two frameworks are unlikely to ever fully merge and become one set of comprehensive standards. As Angeloni (2016) observes, the variance in capital markets, enforcement agencies, and economic environments seem to render adoption of IFRS an unlikely prospect. Building on this, Ong (2018) notes that internationalization isn’t a simple, technical process, but one fraught with political and cultural obstacles, which in the case of the US have caused it to ultimately reject full convergence with IFRS (Ong, 2018). The research also appears to support the theory that, at least in the early years, there was a strong desire in the US shared by the capital markets, politicians, standard-setters and legislators alike to proceed toward integration, but that over time, and especially in the last five years, that desire appears to have hit political, legislative and cultural roadblocks for the reasons enunciated in this article.

At present time, one would have to also conclude that the outlook for GAAP and IFRS convergence is decidedly bleak, especially considering the more isolationist policies recently undertaken by the US in terms of economic sanctions imposed on some countries and tariffs levied on others. Of course the US isn’t the only country to adopt a decidedly more isolationist stance. We’ve also recently seen the United Kingdom vote to exit the European Union; the effects of which will not be known with any surety anytime soon. Thus, at a time when the US has sought to distance itself from its allies and major trading partners, both economically and militarily, and reaffirm its independence and standing in the world, one would struggle to envision any real impetus for convergence surviving at present. It currently appears that we live in a world where countries are attempting to reassert their independence and move towards more isolationist policies, and a nationalistic fervor has taken hold; a fervor which would seem incompatible with IFRS convergence. However that is not to say it may not change. As various

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executives and administrators cycle through the SEC and FASB respectively, each with his or her own agenda and set of priorities, it seems at least possible that the pendulum may swing back in the direction of convergence, however it seems more likely now that a compromise will be reached.

A suggestion for future research would be an examination of whether continuation of US GAAP is likely to compliment or compete with IFRS. The original idea of convergence was to enhance global comparability for financial statement preparers and users through adoption of a single global reporting framework. It would be noteworthy to determine how the simultaneous existence of two well established frameworks would affect global financial markets, costs of capital, and information asymmetry worldwide.

While it might be fair to say that at present, the impetus for full convergence with IFRS has been lost, this is not to say that it may not still happen in the future. It is true to say that we have seen the pendulum swing in the direction of retention of GAAP as the US financial reporting framework, but like any pendulum, regardless of how long it takes, if there is even a little momentum, it is certainly capable of swinging back in the other direction.

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