The IASB and FASB Convergence Process: Current Developments

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Abstract: The importance of harmonization of accounting standards is now widely accepted all over the world. The increased international movement of investments has strongly forces the harmonization of the various national accounting standards in a uniform financial reporting system accepted worldwide. Recently the Securities and Exchange Commission has agreed to remove the requirement of international firms reporting under International Financial Reporting Standards (IFRS) and listed in the U.S to provide reconciliation to U.S. Generally Accepted Accounting Principles (GAAP). This recent move of the Securities and Exchange Commission indicates that U.S. financial reporting is likely to converge with IFRS in the near future. The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) are currently working together so as to converge their existing accounting standards into a common set of international accounting standards. The objective of this paper is to discuss the FASB and IASB convergence process by addressing current developments regarding significant topics that were deemed critical to this convergence. The convergence of GAAP and IFRS seems inevitable. Mixed opinions have been voiced about this convergence process. Many have begun to consider obstacles that is possible to lay ahead as well as the possible costs and benefits of such a move to the IFRS .

Keywords: International accounting; accounting harmonization; principle-based; rule-based standards

JEL Classification: M40; M41

1. Introduction

The variation of the financial reporting systems among countries is caused by many factors that affect the development of accounting system in each country. The type of legal system, type of political system, level of education, the extent of economic development and other environmental factors in addition to the culture of the country are regarded as significant factors that cause this variation of the financial reporting systems among countries. For example, the development of accounting standards in the United States was affected by the Industrial Revolution and the

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need to obtain capital from private sources. As a consequent, users of the financial statements such as investors and creditors required financial accounting information so as to make relevant decisions regarding their investments in the entity. Thus, financial accounting standards in the United States have been developed mainly in the private sector, and the result has been restrictive set of accounting standards. (Schroeder et al. 2009, p. 77). This model of financial reporting is referred to as the Anglo-Saxon financial reporting system. The Anglo-Saxon financial reporting system focuses on the flow of financial information to the financial markets and the relationship between the business and the external users of the financial statements mainly the investors. Thus, the Anglo-Saxon financial reporting approach regards the investor as the main provider of the financial resources of the entity. However, government still uses financial reporting as a means of regulating economic activity. For example, the purpose of the SEC's is to protect the investor and make sure that the securities markets are being run efficiently (Epstein and Jermakowicz, 2010, p. 4).

The other system of financial reporting is 'the continental Europe" or 'the code law' financial reporting system that was evolved primarily in Europe. The 'code law' financial reporting system can be traced back to 1870 after the unification of Germany. The code law model focuses mainly on moving away from market values to historical cost and systematic depreciation. It was used subsequently and mostly in the early twentieth century, by governments for the determination of tax when taxes on business profits started to be introduced (Epstein and Jermakowicz, 2010, p.4).This happened since primary accounting regulation in the European countries was set by the government for the purpose of protecting the economy from bankruptcies.

This variation in the financial reporting systems among countries, may hinder the flows of the capital investments among countries worldwid. In order to be able to evaluate an investment in other country in a proper manner, an investor has to convert or reconcile the financial statements prepared under a foreign set of accounting standards into financial statements in conformity with the national accounting standards of the investor's home country and this may result in substantial differences. For example, in 1993, when German multinational company Daimler-Benz decided to apply for listing on the New York Stock Exchange, the company had to convert its financial statements to be in accordance with US GAAP. At that time, Daimler-Benz reported profit of 615 million German Deutsche Mark under German national accounting standards but a loss of 1839 million German Deutsche Mark under US-GAAP (Hellmann et al. 2010, p.108) . The increased global move of capital has strongly forces the harmonization of the diverse national accounting standards in a global financial reporting standards. It has become common for institutions and individuals to invest outside of their home country. For example, approximately two-thirds of U.S. investors own securities of foreign companies. Similarly, many firms now list on one or more foreign financial markets in addition to listing on the financial markets in their home countries (Erickson et al. 2009, p.531) .

Internationally, the establishment of the International Accounting Standards Committee (IASC) is regarded as a milestone in the move toward accounting harmonization. The IASC was established in 1973 as an independent private sector body whose main goal was to achieve uniformity in accounting principles by developing international accounting standards. The original board members of the IASC was consisted of the professional accounting bodies of nine countries, Canada, Australia, Japan, France, the United Kingdom, Maxico, the Netherland, the United States, and West Germany. (Schroeder et al. 2009. P.82). In 2001, the IASC was restructured and replaced by the International Accounting Standards Board (IASB). The main goals of the IASB are (1) to develop a uniform set of high quality, understandable, enforceable and worldwide accepted international financial reporting standards (IFRSs); (2) to promote the use and application of those set of standards; (3) to take account of the financial reporting requirements of emerging countrys' economies by developing a set of IFRSs for the small and medium-sized entities (SMEs); (4) and to achieve convergence of national accounting standards and IFRSs. (IASB, www.iasb.org). Since 1973 until 2001, the IASB and its predecessor organization (the IASC) have issued 41 accounting standards (12 have subsequently been superseded). These standards were previosly known as International Accounting Standards (IAS) and are now called International Financial Reporting Standards (IFRS). Until now, the IASB has issued 13 IFRSs (IASB, www.iasb.org).

The efforts of the IASB have resulted in the adoption of IFRS by a large number of countries all over the world. IFRS adapted by more than one hundred countries for compulsory or optional financial reporting by public or private organizations, with many further adoptions scheduled to take place over the next few years. (Epstein and Jermakowicz, 2010, p. vii). Additionally, On November 2007, the Securities and Exchange Commission (SEC) agreed to remove the requirement for non U.S. companies reporting under IFRS to provide reconciliation to U.S Generally Accepted Accounting Principles (GAAP) so as to facilitate listings of international firms (Chen and samı 2008 p15). By the same way, the SEC effectively recognized IFRS as a set of high quality accounting standards which satisfied the information needs of U.S. investors (Carmona and Trombetta, 2010, p.2). The SEC also considers allowing U.S. national firms to choose between IFRS and U.S GAAP in the future. In August 2008, the SEC issued a "Proposed Roadmap" that could result in requiring U.S. accounting setting bodies to use IFRS as issued by the IASB starting from 2014.

The IASB and FASB are currently engaged in several projects in order to attain a uniform set of International accounting standards. The primary objective of this paper is to discuss the convergence process of the IASB and FASB standards by addressing significant current issues on this convergence. The remainder of this paper is organized as follows. The second section introduces principle based and rule based accounting standards. Section three presents the IASB- FASB convergence Project. The fourth section discusses significant current issues on the convergence of the IFRSs and the U.S. GAAP and the last section draws some concluding remark.

2. Principle Based versus Rule Based Standards

According to a widely-held view, it is generally accepted that U.S. accounting standards are more described as 'rules-based standards' and IASB's standards tend to be closer to 'principles-based standards'. Th e U.S. rule-based reporting system is said to be too difficult because there is too much detailed guidance for every set of standard. Schipper, 2003 argued that U.S. financial reporting standards are in general based on principles, which are derived from the FASB's conceptual framework. However, they also include components such as detailed implementation guidance that make them look closer to rules-based. Moreover, a great deal of these details comes from explanations of how to apply the standards an even, sometimes, by illustrating numerical examples. Schipper also indicated that the perceived benefit of the more detailed implementation guidance of accounting standards is greater comparability of financial statements among entities. A good example of a rules-based standard can be noticed in the FASB's Statement of Financial Accounting Standards (SFAS) No. 13, " Accounting for Leases". SFAS 13 determines four criteria that should not be violated if a lease is to be recognized as an operating lease. As a consequence, the leasing entities and lessees attempt to structure lease agreement in order not to violate these four criteria (Schroeder et al. 2009, p. 59). Therefore, companies have been able to structure and interpret lease contracts to avoid capitalization, which tends to present a more favorable picture of a company's overall financial condition. As a result, this rule based standard helps companies to use leasing as a means of off balance sheet financing, in addition to providing justification for this accounting chioce (Shortridge and Myring, 2004).

The FASB provided such a detailed guidance of accounting standards because in the U.S. many external auditors and financial statements preparers are afraid of litigation so they required this. In addition, the FASB have developed rules-based standards in order to meet the demand of the entitys' management and external auditors who need a clear and detailed answers to every accounting issue so as to aviod misunderstanding, by SEC or the public, of the application of the accounting standards. However, The complexity to employ and interpret these set of rules-based standards has increased over time and thus requiring more detailed guidance to be understandable. As these standards are rule-based, it is more costly because it need more efforts for auditors and preparers of thr financial statements to keep up with the continuous developments (Clay, 2007, p.3) .

As a consequence to that in addition to the occurance of series of financial scandals that rocked the business world in 2001-2002 (the most famous case is the collapse of Enron and World Com in the US that was followed by the collapse of their external auditors Arthur Andersen) the US generally accepted accounting standards was subjected to intense criticism. As a response to that the Sarbanese Oxley Act of 2002[1] required the SEC to conduct a study on 'the adoption by the United States financial reporting system of a principles-based accounting system'. The Securities and Exchange Commission (SEC) submitted to congress its study addressing this matter in 2003. The study provided the following recommendations to the Financial Accounting Standards Board (FASB, 2004):

1. The FASB should issue objectives oriented accounting standards,

2. The FASB should address deficiencies in its conceptual framework,

3. The FASB should be the only organization which is responsible for issuing authoritative accounting guidance in the United States,

4. The FASB should continue its convergence efforts,

5. The FASB should work to redefine the GAAP hierarchy,

6. The FASB should increase access to authoritative literature,

7. The FASB should perform a comprehensive review of its literature in order to determine accounting standards that are more rules-based and adopt a transition plan to change those standards.

The FASB responded to the recommendations provided by SEC's study and indicated that number of those recommendations were already being implemented. Tha FASB also noted that it is committed to continuously developing its standard-setting process. The FASB's specific responses to the recommendations of the SEC's study are as follows (FASB, 2004):

1. Issuing objectives oriented accounting standards,

2. Conceptual framework improvements project,

3. One U.S. standards setter,

[1] "Corporate and Auditing Accountability, Responsibility, and Transparancy Act" passed by the US Congress in 2002. Its commonly called the Serbanes Oxley (SOX) Act. The Serbanes Oxley Act formed the Public Company Accounting Oversight Board (BCAOB), which is appointed and overseen by the Securities and Exchange Commission. The responsibility of the PCAOB is to; provide oversight for the auditors of the publicly held companies, set auditing and quality control standards, and perform inspections of the quality controls at auditing firms.

4. International convergence,

5. GAAP hierarchy,

6. Access to authoritative literature,

7. Comprehensive review of literature.

In contrast, as stated earlier, the IASB standards are based more on principles. Principles-based standards provides a conceptual basis that represents principles for preparers of the financial statements to follow instead of issuing a detailed rules (Shortridge and Myring, 2004). For example, IASB has six pronouncements and one interpretation addressing accounting for leases while FASB HAS seventy eight including various interpretations and pronouncements (Shortridge, 2004).

Thus, principles-based accounting standards are regarded as a fundamental understandings and conceptual basis that form transactions and economic events. In the principles-based standards accounting, these fundamental understandings and conceptual basis, dominate any other rule included in the set of standards (Dennis,2008, p.261) . Additionally, principle based standards leave the judgment more to the financial statements preparers and allow different accounting choices. For example in International Accounting Standards (IAS) No. 16 'Property, Plant and Equipment' the IASB allows the companies to use either the cost model or the revaluation model for the purpose of measuring property, plant and equipment after recognition. (IAS, 16/29)

When the rule based standards are employed, focus on detailed rules will result in accounting treatments that comply with the letter of the rules rather than spirit which is seems to be against the 'substance over form' concept of accounting. Therefore, it was described by (Alexander and Jermakwicz (2006) as 'the cookbook approach'. Under the rules-based accounting standards, there are possibilities for entities to manipulate their financial information by concentrating on the form of the accounting treatments rather than substance of the transactions. For example, Enron used special purpose entities in order to present less debt in its financial statements than the company actually had. Enron was able to manipulate the rules so as to show the financial picture of the company in a misleading manner (Schroeder et al. 2009, p.19). Therefore, the principles-based standards, which contain limited interpretive and implementation guidance of the accounting standards, are the perceived solution to problems caused by rules-based standards. The US is among the majority of countries currently employing the rule-based standards of accounting. A shift to international standards of accounting that are based on principles has gained momentum recently. The FASB and the IASB are working together on the convergence of their accounting standards so as to provide a set of accounting standards that are expected to be a solution to the poor financial reportings. This convergence project can be traced back to 2002 when FASB and

IASB signed their agreement in Norwalk. This agreement is now known as the Norwalk Agreement and the two standard setting bodies agreed to converge their accounting standards as quickly as possible. The boards plan to conduct joint project and acknowledged their commitment to the development of high quality, compatible accounting standards (Schroeder et al. 2009, p.63). The FASB and IASB convergence project is discussed in next section

3. The IASB- FASB Convergence Project

The IASB and FASB are currently working together so as to accomplish a single set of International Accounting Standards. Among their efforts are Norwalk Agreement and the Roadmap to Convergence. In October 2002, the FASB and the IASB announced the issuance of a memorandum of understanding, known as Norwalk Agreement, marking a important step toward the convergence of U.S. GAAP and International Accounting Standards. Both standard setting bodies acknowleged their commitment to the development of high –quality compatible accounting standards that can be used nationally and internationally for the purpose of financial reporting. In this regard, the FASB and IASB agreed to:

- Undertake a short-term project for the purpose of removing a the individual differences between U.S. GAAP and IFRSs,
- Working mutually and concurrently on an individual significant projects in order to remove other differences between IFRSs and U.S. GAAP that will remain as of January 1, 2004,
- Continue progress on current joint projects,
- Encourage their respective interpretative bodies to coordinate their activities. (Schroeder et al. 2009, p. 97)

In 2006 the IASB and FASB confirmed their commitment to the convergence process by signing up a 'Memorandum of Understanding' (MoU) and outlined a 'roadmap' for arriving at a unified set of high quality international accounting standards for use in the capital markets worldwide. The MoU, which identified a definite step forward in the convergence process, listed 11 topics that are regarded critical to the convergence process. These topics are, fair value measurement guidance, revenue recognition, consolidation, liabilities and equities distinction, business combinations, performance reporting, post retirement benefits, derecognition, financial instruments, , intangible assets, and leases (Carmona and Trombetta, 2010, p.2).

On November 15, 2007, the Securities and Exchange Commission (SEC) agreed to remove the requirement for non U.S. companies, which are reporting under IFRS and registered in the U.S capital markets, to provide reconciliation to U.S GAAP in order to facilitate listings of the internationa corporations (Chen and Samı, 2008, p15). In this way, the SEC considered IFRS as a set of high quality accounting standards which are satisfactory to the U.S. investors form making relevant decisions. (Carmona S, Trombetta M, 2010, p.2). This has been supported by empirical studies recently which concluded that U.S investors perceive accounting information prepared in conformity with IFRS and U.S. GAAP to have similar quality even though there are differences between the two sets of standards (Kim et al. 2011; Leuz 2003).

Furthermore, the SEC went further to consider allowing U.S. national firms to choose between IFRS and U.S. GAAP in the future (Chen and Samı, 2008, p16). This SEC's important step is welcomed by the IASB, international firms reporting under IFRSs, and major financial markets in U.S. (Kim et al. 2011, p.1). In contrast, some studies concluded that significant differences exist between results reported using IFRS versus U.S. GAAP in spite of the convergence and that the reconciliation from IFRSs to to U.S GAAP provides value-relevant information to investors (Chen and Sami, 2008; Henry et al. 2009).

In August 2008, the SEC issued a 'proposed roadmap' that could result in requiring U.S. standards setters to use IFRS starting from 2014 (SEC, 2008)). The FASB and IASB reconfirmed their commitment to convergence at their October 2009 meeting and agreed to intensify their efforts to complete the major joint projects determined in the MoU. As a further confirmation of that commitment, the boards issued a joint statement describing their plans and milestone targets for accomplishing the aims of completing main MoU projects by mid-2011, and their commitment to providing the public with a periodic reports explaining their progress (FASB, www.fasb.org).

The converged accounting standards -when adopted- will influence different kinds of entities in different ways. For U.S publicly held corporations, the future of financial reporting will certainly be different from the past and present. However, U.S publicly held companies will not be required to adopt current International Financial Reporting Standards (IFRS) since U.S GAAP will be subjected to standard-level convergence instead of set-level convergence. That is, U.S. GAAP and IFRS are converging at the standard level. As a result of the standard-level convergence, both U.S GAAP and IFRS will change significantly as they evolve into a unified set of international standards that will contain some standards from current U.S. GAAP, some standards from current IFRS, and many standards that will be different from those found in existing standards of both FASB and IFRS. In contrast, The countries that have already adopted IFRS (100-plus) have been subjected to a set-level convergence. The set-level convergence takes place when entities in a country adopt an entire existing set of accounting standards that are adopted in other countries. In other words, those countries have replaced their national sets of accounting standards with current IFRS whcih is differnt from the case of U.S GAAP (Pounder, 2008a).

4. Current Development on IASB-FASB Convergence Process

The IASB and FASB have been working on a number of notable projects to accomplish convergence of IFRSs and US GAAP since 2002. The major goals of the two boards are to improve the existing sets of accounting standards through the issuance of high quality worldwide accounting standards and bringing greater convergence between IFRS and US GAAP. This section introduces current development regarding significant topics that were deemed critical to the IFRS and US GAAP convergence process. Therefore, this section includes discussion of FASB and IASB joint conceptual framework project, the IASB -FASB financial statement presentation joint project, the converged standard on fair value and lease accounting joint project.

4.1. FASB and lASB Joint Conceptual Framework Project

The conceptual framework can be defined as 'a coherent system of interrelated objectives and fundamentals that prescribes the nature, function, and limitations of financial reporting' (Johnson, 2004). The first attempt to develop a conceptual framework for accounting is by FASB in the the early 1970s while the first pronouncements started in 1987. Beginning from 1987 until 2010, the FASB's conceptual framework project has resulted in the issuance of eight 'Statement of Financial Accounting Concepts'. The FASB's concept statements established a constitution used by the board and formed a basis to set accounting standards. However, the FASB's conceptual framework has been subjected to criticism to be failure. Solomons (1986) pointed out that the FASB's conceptual framework requires a radical change despite the benefits gained by it. Solomons stated that definitions included in the conceptual framework are vague and unduly used in an unduly way. Solomons also indicated that the board is deferring issuance of statements regarding crucial decisions such as measuring income. Moreover, Johnson (2004) pointed out that the conceptual framework has not kept up with changing times and changing business practices becuase most of the conceptual framework's statements were issued 20 or more years ago (Johnson, 2004a).

In 1989, the International Accounting Standards Committee (IASC) issued its conceptual framework entitled 'Framework for the Preparation and Presentation of Financial Statement'. The IASC pointed out that the the conceptual framework aims at setting out the concepts that underlie the preparation and presentation of financial statements for external users (IASB, conceptual framework). Although there are many similarities between the FASB and IASB conceptual frameworks, the two frameworks have always been distinguishable and separate from each others. The two conceptual frameworks are different on some concepts. The IASB's framework is intended to assist not only standard setters but also preparers of financial statement such as auditors in providing opinions about the fairness of the financial statements and users in interpreting information included in the financial statement. In contrast, the concepts statements contained in the FASB's conceptual frameworks indicated that they do not justify changing in generally accepted accounting and reporting practices or interpreting existing accounting standards based on personal interpretations of the concepts. (Johnson, 2004b). In addition, Camphell et al. (2002) stated that there are several differences between the two frameworks in in general organization, level of details as contained in the concepts statements in addition to other topical differences.

On October 2004, the FASB and the IASB agreed to add to their agenda a new joint project in order to revise their conceptual frameworks for financial accounting and reporting. The purpose of this joint project is to update, improve and converge the existing frameworks of the two boards into a single framework that can be used as a basis in developing new high quality accounting standards or revising the existing ones. The joint conceptual framework project is composed of eight phases which are designated from A to H as follows:

A. Objectives and qualitative characteristics;
B. Definitions of elements, recognition and derecognition;
C. Measurement;
D. Reporting entity concept;
E. Boundaries of financial reporting, and Presentation and Disclosure;
F. Purpose and status of the framework;
G. Application of the framework to not-for-profit entities;

H. Remaining Issues, if any (IASB, www.iasb.org).

As a part of this joint Project, the FASB and the IASB issued a discussion paper titled 'Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information' for phase A In July 2006. In May 2008 the two boards issued an exposure draft entitled 'An Improved Conceptual Framework for Financial Reporting'. The exposure draft was composed of two chapters; the first one presented the objective of financial reporting while second chapter addresses the qualitative characteristics and constraints of decision-useful financial reporting information. (IASB-FASB, Exposure Draft, 2008). The IASB and the FASB issued the final versions of those two chapters later in September 2010. Phases B, C and D of the project are currently still under progress.

The FASB and IASB indicated that a common aim of two boards is to develope sets of accounting standards based on principles. The conceptual framework joint project is currently being conducted in parallel to several significant joint projects to converge the boards accounting standards. In spite that the conceptual framework project was launched in 2004, the two boards have just finished the first phase of it (phase A) in september 2010. The boards were criticised by many to be going slowly for accomplishing such a significant project which is regarded as a fundamental concepts of financial reporting. Colleen Cunningham the member of FASB's Financial Accounting Standards Advisory Committee (FASAC) and IFRS Standards Advisory Committee stated that;

"I still believe that this project should be a priority; particularly as the big ticket convergence projects are tackled, wouldn't it be easier to agree on standards if the conceptual frameworks were the same for both boards? If anything, I think that the financial crisis brought a sharper focus on some of the fundamental issues and limitations of financial reporting that need to be addressed before more complex standards are issued" (Cunningham, 2010)

4.2. The IASB -FASB Financial Statement Presentation Joint Project

A joint project on financial statement presentation was launched by the IASB and the FASB in April 2004. The goal of this project is to develope a standard that will guide the organization and presentation of accounting information in the financial statements. The boards issued their joint discussion paper entitled "Preliminary View on Financial Statement Presentation" in October 2008 as a part of their efforts to conduct the project. The new proposal is regarded as a radical change to the way in which financial information is presented in the balance sheet and, to some extent, in the statement of comprehensive income. This suggested presentation method requires an entity to present information about the way it creates value (its business activities) separately from information about the way it finances those business activities (its financing activities) (FASB, Discussion Paper, 2008). According to this proposal, each financial statement consisted of the following four major sections:

A. Business: in this section an entity presents information about its business activities. This section will be divided into operating and investing subsections,
B. Financing: in this section an entity presents information about the financing of its business activities separately depending on the source of that financing or funds. More specifically, information about sources of finance provided by non owner with its related changes should be presented separately from financial resources contributed by owners together with its related changes,
C. Discontinued operations,
D. Income taxes: in the statement of comprehensive income, an entity presents separately information about its income tax expense (benefit) which is related to the following:

1. Income from continuing operations (the total of its income or loss from business and financing activities)
2. Discontinued operations
3. Other comprehensive income items.

The proposed classification model for the four financial statement is illustrated as follows in table 1:

Table 1 the proposed classification scheme for the financial statements

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business • Operating assets and liabilities • Investing assets and liabilities	**Business** • Operating income and expenses • Investment income and expenses	**Business** • Operating cash flows • Investing cash flows
Financing • Financing assets • Financing liabilities	**Financing** • Financing asset income • Financing liability expenses	**Financing** • Financing asset cash flows • Financing liability cash flows
Income taxes	**Income taxes** on continuing operations (business and financing)	**Income taxes**
Discontinued operations	**Discontinued operations,** net of tax	**Discontinued operations**
	Other comprehensive income, net of tax	
Equity		**Equity**

Source: Financial Accounting Standards Board, (2008). Discussion Paper, Preliminary Views on Financial Statement Presentation, Retrieved from: http://www.fasb.org/DP_Financial_Statement_Presentation.pdf , 08. 27. 2011

As indicated in the joint discussion paper of IASB and FASB, the proposed model has adopted the followings core financial statement presentation principles:

1. Cohesiveness: this principle states that an entity has to present accounting information in its financial statements in a way that reflects a cohesive financial picture of its activities. That is, each financial statement should contain the same sections and categories. In this manner, clear relationship between the statements will be portrayed. In addition, the financial statement will be viewed as complementing each others. This way of presentation also facilitate analysis of financial statements.

2. Disaggregation principle which dictates that an entity should disaggregate information in its financial statements in a way that makes it useful in the evaluation of the amount, timing, and uncertainty of its future cash flows. To achieve this purpose, categories with essentially similar economic characteristics will be grouped and presenting categories that do not have similar economic characteristics as distinct line items.

3. Liquidity and financial flexibility principle which means that an entity should present information in its financial statements in a manner that helps users to evaluate the entity's ability to meet its financial obligations as they mature and to decide with or not to invest in different business opportunities.

The proposed classification and format of the financial statement is as follows:

- Statement of Financial Position: the statement of financial position is the most influenced statement by proposed financial statements presentation model. As can be seen from table 1 above, the statement of financial position is presented by major activities which are operating, investing and financing rather than by assets, liabilities and equity as in the existing presentation model. In each section, an entity would present both assets and liabilities with net asset subtotals being shown for each item. Additionally, an entity may choose to present totals for assets and liabilities and subtotals for short-term and long-term assets and liabilities.

- The Statement of Comprehensive Income: an entity should present comprehensive income and its components in a separate statement of comprehensive income. This statement separates business activities from financing ones. In addition, operating snd investing activities are presented as subtitles under business activities. Discontinued operations are disclosed in a separate category, but extraordinary activities would no longer be presented. Thus, the statement of comprehensive income comprises two main parts; net profit or loss and other comprehensive income. Comprehensive income will be disclosed as bottom line of the statement. The comprehensive income and other comprehensive income items would be no longer disclosed in a statement of changes in stockholder's equity. This new presentation way is different from the existing presentation requirement under both IFRSs and U.S. GAAP. The existing presentation model allows several alternative formats for presenting comprehensive income and its components. The IASB and FASB pointed out that presenting a single statement of comprehensive income will improve the comparability of financial statements among companies as all entities will present the comprehensive income and its components in a similar way in the same financial statement.

- Statement of Cash Flows: the proposed statement of cash flows will have the same sections and categories as the statement of financial position and the statement of comprehensive income. However, the new proposal suggests a minor change to the presentation of this statement's categories. According to the suggested model cash flows resulted from operating and investing activities are grouped under the business section whereas these two items are presented in separate sections under the existing practice. In addition, the two boards require the use of direct method to present information about cash flows from operating because under this method the statement of cash flows will be more understandable by users of financial statement. Moreover, the boards indicated that the direct method provides insight into entity's cash flows. The existing practice for reporting of cash flows from operations under IFRS and U.S. GAAP permits either the direct or indirect method.

- The Statement of Changes in Equity: this statements will not be changed under the proposed model and will continue to be required as part of the set of financial statements.

The IASB and FASB boards indicated that the major purpose of this joint project is to improve the usefulness of the information presented in an entity's financial statements so as to help financial statements users make relevant decisions in their capacity as providers of financial resources. Moreover, the proposed changes as suggested by the new model will contribute in removing differences between the presentation formats used by companies that reporting under IFRSs and those reporting according to U.S. GAAP. However, some argued that this new presentation model will be accompanied by impacts on the financial statements users. For example, Henry. Et el, (2008), have argued "whether changes to the format of the financial statements will help users to better understand an entity's financial position and to better assess the entity's future cash flows and whether the benefits of change will outweigh the costs". They also pointed out that more sophisticated financial statement users would likely gain temporary advantage over less sophisticated users since they can understand and analyze the new format of the financial statements more quickly than others. In addition to that, the American Accounting Association's (AAA) Financial Accounting Standards Committee (FASC) have discussed several potential problems related to this proposed project. Many of the problems discussed by the AAA are related to potential learning impediments for the financial statements users to adapt to the new model of financial statements presentation. Among these problems discussed by the AAA is the improper timing of the proposal. The AAA pointed out that this proposal seems to contain an implicit conceptual framework whereas a joint and comprehensive conceptual framework is being under progress by the FASB and IASB (AAA FASC, 2010).

The new proposed presentation of the financial statements contains new format and contents which seems to be 'financial statement unlike any you've seen' as stated by Bruce Pounder, president of accounting education firm Leveraged Logic. Pounder stated that

> " … to the extent that the boards can convince their constituents of the benefits of changing the contents and formats of the financial statements, we may soon find ourselves entering a new era of financial reporting under truly global standards" (Pounder, 2008b).

4.3. The Converged Standard on Fair Value: Would it Quell Debate?

Fair value is regarded as a compex and a controversial issue in accounting and accordingly has resulted in substantial research efforts. The fair value concept of accounting may be regarded new by the majority of the financial statements users. However, the principle of fair value has existed since the 1930s that was referred to as mark to market accounting and has became a significant part of financial accounting In addition to that, fair value accounting (FVA) was not developed or enforced by FASB or IASB (or its predecessor IASC) or any other standard setting bodied (Cascini and DelFavero, 2011, p.1). In the international arena, fair value was introduced into accounting standards in 1975 (IAS 2 –1975). This was an introduction for integrating the fair value concept as an altenative reporting model to historical cost. Subsequently, the use of fair value in international accounting standards was introduced and expanded into Property, Plant, and Equipment (IAS 16); Leases (IAS 17); Revenues (IAS 18); Employee Benefits (IAS 19); Accounting and Reporting by Retirement Benefit Plans (IAS 26); Impairment of Assets (IAS 36); Financial Instruments; Recognition and Measurement (IAS 39); Investment Property (IAS 40) (Shanklin et al., 2011, p.24).

The fair value concept was introduced by FASB into accounting standards in 1993. At that time, the U.S GAAP standards required that all debt and equity investments classified as trading securities or available-for-sale securities must be recognized and reported in the financial statements at their fair values. Further pronouncements have been issued subsequently in order to provide guidance on recognizing, measuring, and reporting of other issues such as financial instruments, hedges, and other assets and liabilities at fair value (Cascini and DelFavero, 2011) . However, the US. GAAP accounting standards that are mainly regarded to be the fair value standards today are SFAS 157 "Fair Value Measurements" and SFAS 159 "The Fair Value Option for Financial Assets and Financial Liabilities". SFAS 157 defines fair value as the exit price or "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date". SFAS 157 identified three different categories of valuation criteria for assets and liabilities breaks them them down into three levels as below:

1. Level one: unadjusted quoted prices in active market for identical assets and liabilities,

2. Level two: observable inputs other than quoted prices for the asset or liability that include quoted prices for similar assets or liabilities in active markets or quoted prices for similar assets or liabilities in markets that are not active,

3. Level three: Unobservable input based on the reporting entity's assessment of market participant assumptions, based on the information available in the circumstances.

In spite of this extensive efforts, IASB and FASB fair value standards have been criticised and described to have many shortcomings. As stated earlier, the IASC introduces the fair value as a measurement base in 1975 through IAS 2 and followed by fair value requirements by other standards. However, IASB have not specify any guidance or methodology to be regarded as a appropriate basis for determining fair value. Moreover, the IASB did not specify any authoritative definition for fair value until September 2009 in an exposure titled Fair Value Measurement (Shanklin et al., 2011, p. 24). In addition, the SFAS 157 treatment of the fair value accounting was also criticised by many. For example, Benston (2011) have summarised the following shortcomings of SFAS 157:

1. Many of the illustrative examples for determining fair value involve calculations of value in use or entrance values even though the FASB has defined fair value as the exit price,
2. Fair values for inventories, other than finished goods, and fixed assets that may be included in business combinations form problems which are not recognized,
3. The determination of fair values other than level 1 difficult to verify and could be manipulated,
4. The determination and verification of fair values which are not based on actual market prices are costly,
5. Although transaction costs must not be used as stated in SFAC 157, they often are not excluded.

Additionally, several differences exist between IFRS and U.S. GAAP standards of fair value accounting in regard to the followings:

- Fair value definition;
- Methods for measuring fair value;
- The specific balance sheet items that are required or allowed to be measured at fair value;
- The disclosures that a entity must make in respect to its measurements of fair values (Pounder, 2011).

As a result to that, the FASB and the IASB agreed to develop common fair value measurement guidance on their meetings in October 2009. The objective of this joint project was to to develop common guidance that is used as basis for fair value measurement for IFRSs and U.S. GAAP. The two boards pointed out that having common requirements for fair value measurement and disclosure would improve the comparability of financial statements prepared under IFRSs and U.S. GAAP. Additionally, this may participate in reducing discrepancy in the application of fair value measurement requirements and simplifying financial reporting (FASB, Ed, 2011 p.169). As a result of this joint project, the IASB and the FASB issued separate pronouncements that represent the changes to IFRS and U.S. GAAP fair value accounting. The IASB issued IFRS 13 'Fair Value Measurement' and the FASB issued Accounting Standards Update (ASU) No. 2011-04 titled "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs".

In its new standard (IFRS 13) makes more substantial changes to fair value accounting. The IFRS 13 introduce new definition of fair value which is identical to the existing definition of fair value under U.S. GAAP in SFAC 157. The IASB indicated that fair values should be exit prices and defines it as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date" (Pounder, 2011). Furthermore, the the IASB includes a the same three-level hierarchy described in SFAS No:157 for the purpose of fair value measurement (Ernst & Young, 2011)

FASB's Accounting Standards Update (ASU) contains some clarifications for how to apply existing fair value measurement in addition to some additional disclosure requirements. For example, the FASB's ASA indicated that the concepts of "highest and best use[1] " and "valuation premise[2]" in a fair value measurement must only be employed when measuring the fair value of nonfinancial assets. In addition, according to the new FASB's ASU the reporting entity is required for the discloser of quantitative information about the unobservable inputs when measuring fair value at level 3 on the fair value hierarchy (FASB, Ed, 2011).

The new converged fair value standards is the culmination of more than five years extensive efforts made by IASB and FASB in order to harmonize and improve fair value measurement and its disclosure requirements. This new standard is considered as an important step towards converging accounting standards for fair

[1] The use of a nonfinancial asset by market participants that would maximize the value of the asset or the group of assets and liabilities (for example, a business) within which the asset would be used.

[2] The highest and best use of a nonfinancial asset establishes the valuation premise used to measure the fair value of the asset. When determining the highest and best use for non-financial assets, such as property interests, it is important to determine whether the highest and best use of that property interest is within a group, or on a stand-alone basis. The fair value of an asset that has a highest and best use in combination with other assets is determined on the basis of the use of the asset together with those other complementary assets, even if the asset is aggregated or disaggregated at a different level. In contrast, the fair value of a property interest that provides maximum value on a stand-alone basis is measured based on the price that would be received to sell that property interest on a stand-alone basis

value measurement. However, if we look to this converged standards on the whole we can notice that they are are more closer to previous FASB's standard than they are to previous IASB's one. The new FASB's ASU supersedes much of the requirements in the existing FASB standards. The new ASU is said to be just a clarification of existing fair value accounting and include wording modifications for the purpose of harmonizing it with IFRS 13. In other word, the new FASB's standards do not seem to have substantial modifications for the measurement of fair values that would end or resolve controversial issues in the existing ones. As stated earlier, many argued that fair values other than level one are likely to be manipulated by overoptimistic managers and difficult to be verified by auditors. (Benston 2011 and Benston 2006). For example, Benston, 2006 pointed out that Enron extensively used level three estimates and in some situations level two estimates fair value hierarchies for energy contracts and was able to manipulate revenue and net income and thus overstated its assets to a wide range. Inspite of that, the new converged standards on fair value do not include any changes in respect to the three different levels of valuation criteria for assets and liabilities.

4.4. Rewriting Lease Accounting

Leasing is regarded as an important source of finance. Recently, leases has become a common method of acquiring long term assets so as to be used by different entities. The World Leasing Yearbook stated that that leasing activities in 2008 are estimated to be US $640 billion in 2010. (IASB Snapshot, 2010). Companies use leasing as a mean of financing its acquisition of property planta and equipments becuase it has the following advantages:

1. It offers 100 percent financing,
2. It offers protection against obsolescence,
3. It is frequently less costly than other forms of financing the cost of the acquisition of fixed assets,
4. If the lessee qualified as an operating lease, it does not add debt to the balance sheet (Schroeder et al. 2009, p. 444).

It is important that lease accounting should provide financial statements users with a complete and understandable picture of the firms' leasing activities. In SFAS 13 "Accounting for Leases" and IAS No. 17 "Leases", both US GAAP and IASB identified specific criteria for classifying leases as either finance leases (the term capital leases is used in U.S GAAP) or operating leases. According to the two set of standards, payments of leases deemed to be operating are treated as expenses and reported in the income statement and, thus, they will not result in asset or liability reflected in the balance sheet. On the other hand, if the lease is classified as a finance one, it will be treated like the acquisition of an asset, giving rise to an asset and a liability that will be reported in the balance sheet. However, both U.S

GAAP and IFRS existing lease standards have subjected to criticisms by many. Among these criticisms are the followings:

- There are different accounting models for the treatment of leases (finance and operating);
- Existing guidance effectively allows the structuring of lease agreements to accomplish certain accounting treatment;
- Operating lease accounting fails to recognize a contractual liability and the related acquisition of assets;
- Operating lease disclosures do not provide financial statement users with adequate information enabling them to determine the amount of related assets and liabilities (Kuczborski, 2010).

The significant criticism among the others is that lessees do not recognise all lease obligations on their balance sheets. The current distinction between a finance leases and the operating lease is considered to be arbitrary so that it enables many entities to structure lease contracts in ways that produce the desired financial reporting pictures and gained benefits from this capital structure. For example, FASB and IASB have estimated annual leasing volume in 2007 at $760 billion. However, many of those lease transactions are structured to be classified as operating leses and thus are not reflected on balance sheets (Whitehouse, 200).

A a consequent to that, the FASB and the IASB decide to add a lease accounting as a joint project to their agenda in July 2006. The primary objective of the project is to develop a new lease accounting model in order to improve the transparency of leasing transactions as reported in financial statements. The Boards concluded that the existing lease accounting standards for both IASB and FASB fail to meet the needs financial statements users because they do not provide a transparent reporting of leasing transactions in the financial statements.

The FASB and IASB issued a discussion paper in March 2009 that introduces the Boards' preliminary views of a new model for leasing accounting. In Augest 2010 the boards issued Exposure Draft (ED) addressing their proposed new model of lease accounting. The new leases model indicates that assets and liabilities arising under leases transactions should be recognized in the statement of financial position. Under the proposed model, employed the " right-of-use" model for leases accounting. The right-of-us model states that an asset representing the right to use the leased property over the lease term should be recognized. In addition, the future rent payments expected to be made over the life of the lease represents a liability obligation to pay rentals that must be recognized (FASB, Ed, 2011).

Thus, the major point of the Boards' proposal is to remove the distinction between the finance and operating lease and consequently removing the off-balance sheet treatments for operating leases. The IASB and FASB pointed out that no matter of the many special provisions and variations in lease arrangements, the most significant is the focus on economic substance of the leases transactions. Specifically, they have concluded that a lessee's right to use leased asset meets the definition of an asset, like other rights that are commonly recognized as assets such as patents and franchises. In the same manner, the boards have also indicated that a lessee's obligation to make rental payments to the lessor made over the life of the lease meets the definition of a liability. (Pounder, 2009)

The Boards' proposed model will have impacts on company's financial statement. The lessees that currently classify leases as operating leases would certainly recognize more assets and liabilities on their balance sheets than is the under either U.S. GAAP or IFRS existing standards (Pounder, 2009). Therefore, the new leases model will result in material influences on financial statements metrics of the firms. For example, as debt will go up, the debt-to-equity ratio will increase, but equity is going to remain unchanged. That leads to immediate concerns about the amount of leverage companies will suddenly see arising into their balance sheets. Furthermore, according to the proposed model, there will no longer be rent expense for long-term leases. Instead, the "right-of-use" leased asset will be reported in the form of interest expense and amortization. This accounting model will result in improved earnings before interest, taxes, depreciation and amortization (EBITDA) for entities because rent expense is deducted in arriving at EBITDA while interest and depreciation are not (Hardy, 2010, p. 20). At the same time, the lessee's net income is likely to decrease to the extent that interest, depreciation, and executory cost expenses in total exceed the present rent expense. This reduction in net income accompanied by an increase in leased assets on lessees' balance sheets may leas to the reduction to return on assets (ROA) calculated by lessees. The effects of such a change in lease accounting would be significant for both managers and external auditors in terms of the need for substantial transition efforts. Thus, questions have been raised about the complication of the reporting process the financial statements disclosure requirements after the application of the new leases model and and whether the new lease model will result in substantive benefits the justify the significant increases in accounting costs. (Pounder, 2009)

5. Conclusion

IFRSs have been adopted or adapted by more than one hundred countries. The convergence of U.S GAAP and IFRS seems to be inevitable. Proponents of this convergence process highlight the potential to improve comparability of financial statements for companies from different countries. They argue that the use of a single set of high quality International Accounting Standards will facilitate the movement of investments across countries and will help companies and capital markets compete all over the world. However, others argue that the shift to IFRS will be accompanied with additional costs related to educating market participants regarding differences in accounting standards, and companies' preparation of employees and computer systems for this transition (Erickson et al. 2009, p 537). The Converged standards -when adopted- will contain some standards from current U.S. GAAP, some standards from current IFRS, and many standards that will be different from those found in either today as the (GAAP) and IFRS are converging at the standard level. The next few years are expected to result in extensive modifications of the reporting environments both in the U.S. and worldwide and we will likely find ourselves entering a new era of financial reporting.

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