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Is Effort to Unify Accounting Regimes Falling Apart?

By Joe Adler

WASHINGTON – For all the talk since the crisis about the need for global accounting standards, the effort to harmonize U.S. accounting rules with those abroad has never been so frayed.

U.S. participation in the one existing multicountry accounting framework, the International Financial Reporting Standards, once seemed inevitable. But recent developments, including U.S. standards-setters' reluctance to approve an international deal on loan-loss provisions, reveal just how far away universal standards are.

"At the end of the day, international harmonization is a worthy goal, but it has to be done very carefully and it is unclear at the moment whether it is in fact workable," said Eugene Ludwig, a former comptroller of the currency and now chief executive of Promontory Financial Group.

Earlier this month the Securities and Exchange Commission threw cold water on the idea with a report that took no position on U.S. adoption of IFRS, thus prolonging the "convergence" policy of the U.S.-based Financial Accounting Standards Board aligning rules piece by piece with the International Accounting Standards Board.

Tension has mounted between the two boards. Echoing banks' concerns that an international model for loss provisioning could possibly result in underreserving, the FASB, at a joint July 18 meeting, held off agreeing with the IASB on the boards' joint impairment proposal.

That did not sit well with IASB Chairman Hans Hoogervorst, who has pushed for greater speed.

Richard D. Levy, executive vice president and controller at Wells Fargo and chairman of the American Bankers Association's accounting committee, said, "There is risk that the convergence of accounting standards worldwide may not fully occur because the boards can't seem to get to agreement."

The magnitude of losses during the crisis was blamed partly on banks' not having had reserved enough in advance. Beforehand, accounting typically had fallen under a so-called incurred-loss model, meaning banks essentially couldn't put money aside to cover losses until loans showed signs of impairment.

While the official standards are still mostly intact, U.S. regulators and banks have since interpreted the rules to allow for much more aggressive reserving.

The FASB and IASB have tentatively agreed on a model allowing reserving for "expected" losses, meaning banks can set aside more if they anticipate a loan will be impaired down the road.

Yet banks and other companies have expressed concerns about the joint proposal. Principally, U.S. firms argue that reserving has been insufficient in other countries, and they fear the plan could result in a less rigorous approach than U.S banks now follow.

"U.S. banks want the 'incurred loss' model wording to change, but we don't want 'impairment light'. One of our concerns is that the joint proposal, as we understand it, could make us reduce our allowances," said Donna Fisher, a senior vice president at the ABA.

Although the two accounting standards boards had come to a tentative agreement in April about the proposal dealing with impairment, which is part of several projects they have undertaken as part of "convergence," the FASB informed the international board it needed more time before approving a draft proposal to clarify issues raised during an outreach effort with U.S. firms. (The overall convergence process has been under way for about a decade.)

"The FASB staff has advised the board that pervasive questions have been raised in the U.S. about the appropriate interpretation of the proposal," Leslie Seidman, the U.S. board's chairman, said in a July 18 statement. "The FASB still strongly desires to achieve a converged standard with the IASB on impairment; however, we believe it is essential that we address the questions that have been raised in the U.S. before moving forward with an Exposure Draft, so that we are confident that the proposal would result in an improvement in financial reporting."

The FASB's decision elicited a cool response from Hoogervorst, who pointed out how long the boards had already been working on a joint plan.

"Both boards have been working on this since the beginning of 2009. Both boards have made three attempts at solving this project, two of which were joint attempts, and we have one lying ahead of us now," he said during the joint meeting, according to a transcript submitted by the IASB. "These were very difficult decisions and we were very happy that we finally reached, on all of the major issues, convergence in May of this year. And I am very worried that what your staff has now just indicated is that the whole thing is going to unravel again."

All sides claim the process is still on track, despite the holdup. A spokesman for the IASB said in an interview that even though "everyone would like certainty early on ... it's not the end of the world if it takes a little longer."

"Up to date this has been a joint project. Both boards have worked together. They've deliberated together. They've done outreach together. They've definitely gone hand in hand. ... I think they will come together," said James Kendrick, a vice president at the Independent Community Bankers of America. "My understanding is the project is substantially complete. I don't get the impression that anything is jeopardy."

Some observers said unified accounting standards around the world are still likely at some date, it is just unclear when.

"This is just yet another twist in a long, drawn-out story, that has had a lot of twists and turns in it when this all started back in 2008 with a very hopeful tone right before the bottom fell out on the capital markets, and things continued to evolve," said Joel Osnoss, global leader in Deloitte & Touche's IFRS group.

"Over the last few years momentum has certainly slowed in the process," Osnoss said. "There are fits and starts. There are setbacks along the way. My feeling is that global standards are an inevitable concept. It's just a question of how long it's going to take to get there."

But both the delay in the impairment proposal, and the SEC's reticence about the U.S. adopting IFRS, indicate a long road ahead.

The SEC's July 13 staff report underlined that the intent of the study was not to come down one way or another on full adoption.

"The Commission believes it is important to make clear that publication of the Staff Report at this time does not imply – and should not be construed to imply – that the Commission has made any policy decision as to whether International Financial Reporting Standards should be incorporated into the financial reporting system for U.S. issuers, or how any such incorporation, if it were to occur, should be implemented," the report said.

The report further stated that generally accepted accounting principles – the FASB's official standard – are still preferred by U.S. firms over International Financial Reporting Standards.

"The standards that are issued by the IASB are generally perceived to be high quality by the global financial reporting community," it said. "However, there continue to be areas that are underdeveloped. ... By comparison, U.S. GAAP also contains areas for which guidance is in need of continued development ... but the perception among U.S. constituents is that the 'gap' in IFRS is greater."

But a statement by Hoogervorst following release of the SEC's report suggested the IASB's patience is waning.

"We are at a pivotal moment for our organization. The IASB has started working on a new agenda. The era of convergence is coming to an end," he said. "We are revamping our institutional infrastructure to provide for a more inclusive approach to international standard setting. This is the right timing to come on board and participate in shaping the future of global accounting."

Still, bankers and other observers say some vast disparities between the U.S. and Europe, both in how their respective industries are structured and how regulators in different countries write rules, must be bridged before joint standards can be reached.

"We have different systems. We just have to make sure it's going to work and enhance investor understanding, not impede it. It's not that IFRS and the IASB would do that, or intend to do that, but they are built for different cultural realities," Ludwig said.

Observers say international standards are perceived to be principles-based, whereas the sheer size of the U.S. banking industry, for example, calls for more specific rules so institutions with distinguishing characteristics can understand how standards apply specifically to them.

"There are things that are done differently in the United States versus the way they're done in Europe. Loan losses is a very big one, which we do more conservatively here in the U.S," said Raj Mehra, chief financial officer of the $1.2 billion-asset Middleburg Bank in Virginia.

"They don't have too many community banks in Europe. The whole concept of community banking is more of a factor in the United States. When European standards setters are developing these proposals they really are doing so with an eye to the larger banks. In the United States, we do have to take into account all the banks. That is where, I think, convergence is running into some obstacles."

Wells' Levy said the joint proposal on impairment would bring international firms closer to the more conservative reserving U.S. banks have undertaken since the crisis. But he said U.S. companies would need to ensure that joining an international framework provides value over what they are already doing.

He noted that while larger banks may be more ready to incorporate international accounting rules after having been through the process of implementing capital rules in the global Basel framework, the accounting standards need to be better tailored for the thousands of community banks in the United States.

"The proposal on loan losses would bring the rest of the world more in line with current U.S. practice and would result in a larger level of reserving," he said. "But that doesn't really enhance the U.S. process, and will actually confuse the U.S. process because it introduces concepts that are foreign to non-Basel III banks.

"There is pressure on the boards to move forward. But by the same token, quite frankly U.S. banks don't want to see a ready-fire-aim approach to new accounting standards. We want to make sure that the standard is a good standard, and that any revision represents an enhancement."