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## FASB and IASB Add Momentum to Convergence Program

A new FASB-IASB agreement on reducing differences between international standards and U.S. GAAP reflects European and U.S. regulators' desires for progress on convergence sufficient to enable the SEC to eliminate its reconciliation requirement for non-U.S. companies that use IASB standards.<sup>1</sup> The agreement's convergence agenda sets dates for progress through 2008 and provides members of the financial reporting community a useful glimpse into the FASB's standard-setting priorities for the next two years.

### The SEC's "Roadmap"

The SEC staff developed a series of steps, described as a "roadmap," that must be completed before eliminating the requirement for foreign private issuers using International Financial Reporting Standards or IFRS to reconcile their financial statements to U.S. GAAP.<sup>2</sup> One of these steps is significant progress toward eliminating differences between U.S. GAAP and IFRS. Both SEC and European regulators have affirmed their continued commitment to the roadmap.<sup>3</sup> In reaffirming his commitment, SEC Chairman Cox said he would not insist on a particular degree of convergence before eliminating the reconciliation requirement, but did expect "measurable progress in addressing priority issues."

European Union Internal Market Commissioner McCreevy expressed his desire to be able to recognize U.S. GAAP as "substantially equivalent" to IFRS if sufficient progress toward convergence is achieved. This would mean that a reconciliation requirement from U.S. GAAP to IFRS would not be added as a requirement for U.S. companies seeking access to Europe's capital markets and therefore filing with European regulators and securities markets.

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<sup>1</sup> FASB and IASB, A Roadmap for Convergence between IFRSs and US GAAP—2006-2008: Memorandum of Understanding between the FASB and the IASB, February 27, 2006, available at [www.fasb.org/mou\\_02-27-06.pdf](http://www.fasb.org/mou_02-27-06.pdf).

<sup>2</sup> Donald T. Nicolaisen, Chief Accountant, SEC, A Securities Regulator Looks at Convergence, April 2005, available at [www.sec.gov](http://www.sec.gov).

<sup>3</sup> SEC Chairman Cox and EU Commissioner McCreevy Affirm Commitment to Elimination of the Need for Reconciliation Requirements, February 8, 2006; available at [www.sec.gov](http://www.sec.gov).

## The Agreement

The memorandum agreed to by the FASB and IASB reconfirms their commitment to achieving convergence between U.S. and international standards, sets guidelines on how to approach the task, and presents standard-setting goals to be accomplished by the end of 2008.

The guidelines assert that serving the needs of investors means “replacing weaker standards with stronger standards” and that trying to eliminate differences between standards that need significant improvement is inefficient. Implementing these guidelines will mean that for many topics, new common standards will replace existing FASB and IASB requirements.

**Short-term Convergence.** The Boards identified ten areas for short-term convergence, including accounting for income taxes, impairment of long-lived assets, and research and development costs. They intend to determine by 2008 whether major differences in these areas can be resolved through short-term standard-setting projects, and if so, to complete or substantially complete the needed work. The agreement recognizes that limiting the number of short-term projects enables more effort to be devoted to major convergence topics.

**Major Convergence Topics.** The agreement lists 11 other topics that are either already on one or both of the Boards’ agendas or are in the research stage, and it assigns each an

expectation of progress by the end of 2008. The expectation for business combinations, consolidations, and fair-value measurements is to have common standards adopted by the end of 2008. None of the other listed projects, including pensions and other post-retirement benefits, revenue recognition, and leases is expected to yield final standards before the end of 2008. The agreement acknowledges that the time frames were developed with awareness of the measurable-progress criterion in the SEC’s roadmap.

The accompanying table, adapted from tables in the agreement, presents the current status and targeted progress through 2008 for the 11 joint topics.

Status of Convergence Topics				
Topic		Current Status on the FASB Agenda	Current Status on the IASB Agenda	Progress Expected to be Achieved by 2008
1.	Business combinations	On agenda—deliberations in process	On agenda—deliberations in process	To have issued converged standards
2.	Consolidations	On agenda—currently inactive	On agenda—no publication yet	To issue converged standards as a matter of high priority
3.	Fair-value measurement guidance	Completed standard expected in the first half of 2006	On agenda—deliberations in process	To have issued converged guidance
4.	Liabilities and equity distinctions	On agenda—no publication yet	On agenda (will follow FASB’s lead)	To have issued one or more due-process documents
5.	Performance reporting	On agenda—no publication yet	Exposure draft on a first phase	To have issued one or more due-process documents
6.	Post-retirement benefits (including pensions)	On agenda—deliberations underway on the first phase of multi-phase project	Not yet on the agenda	To have issued one or more due-process documents
7.	Revenue recognition	On agenda—no publication yet	On agenda—no publication yet	To have issued one or more due-process documents
8.	Derecognition	Currently in the pre-agenda research phase	On research agenda	To have issued a due-process document on the results of staff research efforts
9.	Financial instruments (replacement of existing standards)	On research agenda and working group established	On research agenda and working group established	To have issued one or more due-process documents
10.	Intangible Assets	Not yet on agenda	On research agenda	To have considered the results of the IASB’s research and made a decision about the scope and timing of a project
11.	Leases	Pre-agenda research underway	On research agenda	To have considered and made a decision about the scope and timing of a project



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**Contributing authors:**

Paul H. Munter  
Steven R. Douglas

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## Other Roadmap Influences on the Agenda

The SEC's roadmap could result in potential additions to the convergence program described above. Later in 2006, the SEC staff will begin to analyze 2005 financial statements filed by foreign registrants that apply IFRS and reconcile to U.S. GAAP. The SEC's review is expected to focus on how faithfully and consistently the standards were applied as well as on the reconciliations to U.S. GAAP. The review could lead the SEC to request that topics be added to the Boards' convergence agenda.

Because the SEC staff will be looking at both the application of IFRS and the reconciliation to U.S. GAAP, the analysis will include an evaluation of the appropriateness of the application of IFRS. According to the SEC staff roadmap, the justification for eliminating the reconciliation requirement includes achieving not only a level of convergence, but also high-quality application of those standards. The SEC staff will consider both in determining whether to recommend that the Commission eliminate the reconciliation requirement.

### FASB Responds to SEC Report on Off-Balance-Sheet Transactions\*

The FASB issued a public response to the SEC staff study on arrangements with off-balance-sheet implications, special purpose entities, and transparency.\*\* The response agreed with the study's recommendations to improve financial reporting and said they were consistent with the FASB's current and planned activities. The study recommended that the FASB:

- Reconsider accounting guidance for leases and for defined-benefit pension and other post-retirement benefits,
- Continue to work on accounting guidance related to consolidation policy, including special-purpose entities,
- Continue work toward requiring all financial instruments to be reported at fair value,
- Develop accounting standards that have a broader, objectives-oriented approach, and
- Develop a disclosure framework to improve communications to investors in the notes to financial statements.

The FASB's response outlined activities that will address the concerns raised by the SEC staff and committed to these broad initiatives: to systematically readdress complex and outdated accounting standards, to improve the understandability, consistency, and accessibility of authoritative accounting literature, largely through a codification of all U.S. accounting requirements, and to develop new accounting standards that take an objectives-oriented approach.

\* FASB Response to SEC Study on Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers, February 16, 2006, available at [www.fasb.org](http://www.fasb.org).

\*\* SEC staff study, Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers, June 15, 2005, available at [www.sec.gov](http://www.sec.gov).

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