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HEEDLESS GLOBALISM: THE SEC'S ROADMAP TO ACCOUNTING CONVERGENCE

William W. Bratton*

The Securities Exchange Commission (SEC) has introduced a "Roadmap" that describes a process leading to mandatory use of International Financial Reporting Standards (IFRS) by domestic issuers by 2014. The SEC justifies this initiative on the grounds that global standardization yields cost savings and an ultimate gain in comparability, facilitating the search for global opportunities by U.S. investors and making U.S. capital markets more attractive to foreign issuers. This Article shows that the offered justification is inadequate. The SEC frames the matter as a choice between two institutional frameworks for standard setting, holding out high quality sets of standards, asking which choice reduces frictions in global securities markets. Global market frictions are not the only stakes on the table. The two systems, Generally Accepted Accounting Principles (GAAP) and IFRS, hold out materially different accounting treatment and the differences matter to domestic reporting companies and domestic users of financial statements. GAAP tends to constrain, where IFRS is flexible. GAAP's constraints reflect normative choices, in particular preferences for conservatism, verifiability and transparent disclosure of current period results. It follows that the Roadmap poses a normative choice. What the SEC presents as an investor-driven initiative in fact abandons an investor-protective institutional arrangement of more than three decades' duration and holds out costs for investors and incidental benefits for corporate managers and auditing firms. This Article concludes the Roadmap should be withdrawn and the SEC should return to the point of departure—the ongoing Financial Accounting Standards Board-International Accounting Standards Board convergence project.

INTRODUCTION

International Financial Reporting Standards (IFRS) swept the globe¹

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

even as Generally Accepted Accounting Principles (GAAP) retained their hold over reporting companies and securities markets in the United States. However, the globalization trend continues to rise and GAAP's days could be numbered as well as those of its generator, the Financial Accounting Standards Board (FASB). The Securities and Exchange Commission (SEC), long the backer and protector of GAAP and the FASB, lately changed course, defecting against them in favor of IFRS and its generator, the International Accounting Standards Board (IASB). The road to defection began when the SEC eliminated the requirement that foreign issuers registered in the U.S. and reporting under IFRS restate their financials to GAAP.² The political and economic logic of globalization took over from there. In 2007, the SEC proposed extending the reporting option under IFRS to U.S. issuers.³ The SEC claimed that option would afford competitive advantages to U.S. issuers with extensive operations abroad.⁴ However, the commentators pushed back,⁵ arguing that the value of global convergence in accounting standards lies in enhanced comparability across the financials of different issuers.⁶ Accordingly, admitting two competing accounting systems into the domestic market would only retard progress toward the goal. The SEC responded in 2008 by admitting the policy salience of comparability and doubling its bet on IFRS: it produced a "Roadmap" that describes a process leading to mandatory use of IFRS by domestic issuers beginning in 2014.⁷ The Roadmap bypasses an alternative, more painstaking route to convergence—a longstanding joint project of the FASB and the IASB directed to the articulation of a common set of accounting standards.⁸

Global Accounting Vision].

2. Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Securities Act Release No. 8879, Exchange Act Release No. 57,026, 73 Fed. Reg. 986 (Jan. 4, 2008).

3. Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards, Securities Act Release No. 8831, Exchange Act Release No. 56,217, 72 Fed. Reg. 45,600 (Aug. 14, 2007) [hereinafter 2007 Concept Release].

4. *Id.* at 45,602–03.

5. For criticism of this position, see Cunningham, *SEC's Global Accounting Vision*, *supra* note 1, at 26–27 (contending that effective competition presupposes full information and that the IASB has a practice of misrepresenting the contents of IFRS and that widespread adoption of IFRS signals a national-level preference for comparability over competition).

6. *See id.* at 27–28.

7. Roadmap for the Potential Use of Financial Statements Prepared in Accordance With International Financial Reporting Standards by U.S. Issuers, Securities Act Release No. 8982, Exchange Act Release No. 58,960, 73 Fed. Reg. 70,816 (proposed Nov. 14, 2008) [hereinafter 2008 Roadmap].

8. *See* IFRS FOUNDATION, A ROADMAP FOR CONVERGENCE BETWEEN IFRS AND US GAAP—2006–2008: MEMORANDUM OF UNDERSTANDING BETWEEN THE FASB AND THE IASB (2006), available at <http://www.iasb.org/NR/rdonlyres/874B63FB-56DB-4B78-B7AF-49BBA18C98D9/0/MoU.pdf>.

The SEC's reports respecting these convergence initiatives talk the globalization talk, extolling the benefits of convergence. They say that standardization yields cost savings⁹ and that a single global set of reporting standards yields an ultimate gain in comparability.¹⁰ Both of which facilitate the search for global opportunities by U.S. investors¹¹ and make U.S. capital markets more attractive to foreign issuers.¹² But, as so often is the case with globalization talk, important points are left out. Two of these points are discussed in this Article.¹³

First, the proposed change is not merely a matter of choosing the institutional framework for standard setting. The accounting treatments themselves are at issue, treatments that for the most part concern domestic reporting companies and domestic users of financial statements. This may seem obvious. But the Roadmap spends only three of its 165 pages comparing IFRS to GAAP.¹⁴ This Article takes the occasion to fill-in some missing details, highlighting some normative implications of a switch to IFRS.

The familiar debate over the relative merits of rules and principles captures many of the matters at stake in the choice of treatments, which leads to this Article's second point. The rules versus principles comparison only has meaning within a specific context, which includes the compliance environment as well as the political and interest group alignments surrounding the standard-setter.¹⁵ These matters tend to be assumed away in recent globalization discussions. The discussants treat standard-setter independence as an accomplished fact on both sides of the Atlantic, an assumption that became widespread after the IASB was reorganized during the last decade to acquire a governance structure that closely resembles the FASB's structure.¹⁶ However, politics does not retreat so easily. To underscore this point, this Article recounts the three decade history of the FASB, showing that the FASB maintained its

9. 2007 Concept Release, *supra* note 3, at 45,604.

10. *Id.* at 45,606; 2008 Roadmap, *supra* note 7, at 70,823.

11. 2008 Roadmap, *supra* note 7, at 70,818.

12. *Id.* at 70,824 (asserting that a U.S. dual standard "may create challenges in the U.S. capital markets").

13. For discussion of additional points, see Cunningham, *SEC's Global Accounting Vision*, *supra* note 1.

14. 2008 Roadmap, *supra* note 7, at 70,826–27.

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

16. For a discussion of the governance issues and process that led to IASB's reorganization, see David S. Ruder et al., *Creation of World Wide Accounting Standards: Convergence and Independence*, 25 NW. J. INT'L L. & BUS. 513, 526–54 (2005).

independence despite opposition from corporate management. As an independent FASB formulated more standards, management experienced a steady diminution of its zone of financial reporting discretion. The FASB won out only because of consistent protection from the SEC. A switch to IFRS assures no comparable protective structure.

Ironically, a switch to IFRS would also allow management to reclaim some of the lost territory while simultaneously enhancing rents collected by its auditors. Thus the Roadmap sends an implicit political signal: The interest group alignment that protected the FASB, which was comprised of the SEC and investors in the financial markets (termed “users” in accounting contexts), disintegrated. If the SEC chooses mandated IFRS, destroying or materially impairing the FASB, then audit firms and corporate issuers (termed “preparers” in accounting contexts) ultimately will benefit, potentially resulting in negative effects on domestic investors.

Part I of this Article provides the background information, specifically describing the FASB–IASB convergence initiative and the SEC’s Roadmap. Part II analyzes the differences in accounting treatments under GAAP and IFRS, highlighting the two systems’ different normative roots. Part III further describes the context in which GAAP evolved, showing how interest group politics shaped the FASB’s standard setting. Part IV shows that the Roadmap’s shift to the global framework by itself will not denude accounting’s standard-setting of political salience. Accordingly, it follows that the Roadmap makes its global projections on an implausible set of assumptions.

I. ALTERNATE ROUTES TO CONVERGENCE

The SEC Roadmap holds out an expressway to global accounting convergence. A slower road opened in 2002, when the FASB and the IASB coordinated their operations to develop a “compatible” set of standards.¹⁷ Work commenced immediately, but progress slowed. The FASB and the IASB issued a joint progress report in February 2006, termed the “Memorandum of Understanding.” As updated in 2008,¹⁸ it reports completion of joint standards in only one subject matter area: business combinations. Projects in nine other areas were reported as

17. See Press Release, FASB and IASB Agree to Work Together Toward Convergence of Global Accounting Standards (Oct. 29, 2002), available at <http://www.fasb.org/news/nr102902.shtm>.

18. FIN. ACCOUNTING STANDARDS BD. & INT’L ACCOUNTING STANDARDS BD., COMPLETING THE FEBRUARY 2006 MEMORANDUM OF UNDERSTANDING: A PROGRESS REPORT AND TIMETABLE FOR COMPLETION (2008), available at http://www.fasb.org/intl/MOU_09-11-08.pdf.

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ongoing with completion projected for most in either 2010 or 2011.¹⁹ These include financial instruments, financial statement presentation, leases, liabilities and equity distinctions, revenue recognition, consolidation, de-recognition, fair value measurements, and retiree benefits. One other topic, intangible assets, has been dropped entirely. Meanwhile, the 2011 completion target seems more hopeful than realistic.²⁰

Whatever the timetable, the FASB–IASB initiative does not contemplate the emergence of identical standards. “Compatibility” instead means a reduction of distance between the two separate systems. Even so, the distance between the two regimes can be expected to shrink steadily, given an institutionalized working relationship between the two boards. There also could be synergistic benefits from their continued coexistence. By hypothesis, two world–class standard-setters that focus both unilaterally and collaboratively on the entire range of reporting issues could, over time, articulate better sets of standards than would a single agency.

However, long-term prospects for collaborative benefits appeal only to a patient observer. Unfortunately, patience ran out on Chairman Christopher Cox. The Roadmap moots exclusive use of IFRS on a tentative, but rapid timetable. The first key date is 2011, when the SEC is scheduled to decide whether IFRS will be used exclusively. If the SEC affirms IFRS exclusivity, the Roadmap projects that that phase will be completed by 2014 for large filers,²¹ by 2015 for mid-sized filers, and by 2016 for small filers.²² The Roadmap notes that the transition will entail costs, but leaves the matter for later consideration as a factor in the SEC's year or nay decision in 2011.²³

The Roadmap notes a number of residual problems. One is a general lack of familiarity with IFRS among American preparers and auditors.²⁴ For this Article's purpose, a more important problem is the institutional shortcomings at the IASB. Its members are selected by an independent foundation, the International Accounting Standards Committee Foundation (IASCF), which consists of constituents and a monitoring advisory body composed of constituents. Structured in this manner, the

19. *Id.*

20. A review of the reports on these initiatives posted on the FASB website as of December 2009 does not appear to note any significant recent progress toward completion. *See also* Letter from Jack T. Ciesielski, Investors Technical Advisory Comm., to Florence E. Harmon, Acting Sec'y, U.S. Sec. & Exch. Comm'n (Jan. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708.shtml>.

21. 2008 Roadmap, *supra* note 7, at 70,823.

22. *Id.* at 70,824.

23. A study has been commissioned from the Office of the Chief Accountant. *Id.*

24. *Id.* at 70,822–23.

IASB is a carbon copy of the FASB except with a larger cast of characters and geographic distribution requirements.²⁵ Two points of distinction between the two organizations remain—money and public sector oversight.

As to money, the IASB is funded through voluntary contributions by constituents worldwide, including auditing firms, corporate issuers, international organizations, central banks, and governments.²⁶ Accordingly, questions arise about its independence. The FASB was voluntarily funded for most of its history, but it achieved fiscal independence in 2002 with the enactment of the Sarbanes–Oxley Act (SOX). SOX changed the framework of federal recognition of GAAP, requiring that a recognized standard-setter be wholly funded by fees levied on reporting companies by the federal government.²⁷ The FASB duly applied for recognition and became publicly funded upon the SEC’s approval of the application.²⁸

The Roadmap cautions that mandated IFRS will come only “after the IASC Foundation reaches its goal of securing a stable funding mechanism” that supports independent operation.²⁹ We are not told what such a mechanism might look like. Meanwhile, a look at the budget set out in the IASCF’s 2008 Annual Report confirms the existence of a problem. The IASB’s 2009 budget was projected to be £17 million.³⁰ Of this, the European Commission (EC) donated the largest single sum, £4 million. The next tranche of funds came from twenty-two nationally-based sources, many of them private donors “coordinated” by governments or securities regulators. Of these, the U.S. is the largest, producing £2.4 million from a coalition of uncoordinated private companies. It is followed by Japan at £1.9 million and Germany at £1.2 million, with private but coordinated money in both cases. The cumulated EC and national contributions did

25. See 2007 Concept Release, *supra* note 3, at 45,605; Ruder et al., *supra* note 16, at 519–20; see also INT’L ACCOUNTING STANDARDS BD. & INT’L ACCOUNTING STANDARDS COMM. FOUND., WHO WE ARE AND WHAT WE DO (2010), available at <http://www.iasplus.com/iascf/whoweare.pdf>.

26. See 2008 Roadmap, *supra* note 7, at 70,821.

27. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, § 108, 116 Stat. 745, 768–69 (codified at 15 U.S.C. § 77s (2006)).

28. The IASB does not yet meet the criteria established under the SOX, Pub. L. No. 107-204, §§ 108(b)–109, 116 Stat. 745, 768 (2002) (codified at 15 U.S.C. §§ 77s, 7219 (2006)), for SEC recognition, because it is not funded by congressionally levied fees. For discussion of other possible problems under the requirements, see Cunningham, *SEC’s Global Accounting Vision*, *supra* note 1, at 29–33.

29. 2008 Roadmap, *supra* note 7, at 70,821.

30. INT’L ACCOUNTING STANDARDS COMM. FOUND., ANNUAL REPORT 2008 15 (2009), available at <http://www.ifrs.org/NR/rdonlyres/90CC93BF-581B-44DA-B685-C0503CC24A69/0/IASCFannualreport2008.pdf>.

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not cover the IASB's budget. It made ends meet for 2009 only as the result of a £5.5 million commitment by the Big Four accounting firms.³¹ Red flags unfurl accordingly: accounting standards bear critically on the audit process, and hence, audit firm earnings.

As to public oversight, the IASB also falls short as compared to the FASB. The FASB's parent, the Financial Accounting Foundation (FAF), is overseen by the SEC. Indeed, the FASB itself has long maintained a close working relationship with the SEC's accounting office.³² The IASCF, in contrast, has operated free of government oversight, implying a gap in public accountability. Thus, the IASCF has mooted the formation of an international public sector monitoring group. The SEC Roadmap, in turn, contemplates that the monitoring group will be running by the time of its projected switch to IFRS. The IASB's constitution has been amended to allow for a monitoring board made up of two representatives from the International Organization of Securities Commissions and one from each of the European Union, the SEC, the Japan financial services agency, and the Basel Committee on Banking Supervision. This monitoring board's role is to be determined later. Its present job description is ambiguous: the board will be "linked" to the IASCF, will "participate" in IASCF trustee nominations, and will "advise" the IASCF.³³ The SEC promises to evaluate the effectiveness of this arrangement in the course of its trip down the Roadmap. Whatever the outcome, the IASB will remain several steps further removed from government oversight than has been the FASB.

The SEC implicitly acknowledged the Roadmap's shortcomings in a follow-up report.³⁴ This announced that the staff of the Office of the Chief Accountant will be developing a "Work Plan"³⁵ addressing a number of unsolved problems, in particular levels of knowledge about IFRS, gaps in the coverage of IFRS, human capital readiness, auditability, and comparability.³⁶ The report leaves the 2011 decision date in place even as it moves back the expected initial implantation date from 2014 to 2015 or 2016. It also returns the spotlight to the FASB—

31. *Id.* at 16–18.

32. *See infra* note 94 and accompanying text.

33. *See* INT'L ACCOUNTING STANDARDS COMM. FOUND., CHANGES IN THE CONSTITUTION: REPORT OF THE IASC FOUNDATION TRUSTEES ON PART 1 OF THEIR REVIEW 6–7 (2009), available at <http://www.ifrs.org/NR/rdonlyres/573E48C3-521C-449E-985F-9A7131CDAC17/0/ConstitutionReviewP1May09.pdf>.

34. Commission Statement in Support of Convergence and Global Accounting Standards, Securities Act Release No. 9109, Exchange Act Release No. 61,578, 75 Fed. Reg. 9494 (Mar. 2, 2010), available at <http://www.sec.gov/rules/other/2010/33-9109.pdf>.

35. *Id.* at 9497.

36. *Id.* at 9497–98.

IASB convergence project, on the theory that its successful completion will ameliorate problems with the terms of IFRS.³⁷ This is a step in the right direction. But, as this Article indicates, abandoning the Roadmap entirely remains the better course.

II. COMPARING TREATMENTS UNDER GAAP AND IFRS

The Roadmap's policy framework suffers from a fundamental shortcoming. The Roadmap contemplates a choice between two "high quality" standard-setters and two "high quality" systems, viewing the systems themselves as givens and characterizing them only in the most general terms.³⁸ In the Roadmap's thumbnail sketch, IFRS is described as "not as prescriptive as" GAAP and as holding out "a greater amount of options" for issuers while providing "a relatively lesser amount of guidance."³⁹ The SEC notes that this "greater optionality" could detract from consistency and comparability, in addition to making litigation and enforcement outcomes harder to predict.⁴⁰ At the same time, the SEC indicates that relaxed prescription may make it easier for issuers to account for transactions in accordance with their underlying economics.⁴¹

Thus framed, the choice is one between rules and principles, with the SEC taking the occasion to advocate principles.⁴² The Roadmap's framing pre-ordains the bottom line cost-benefit conclusion: Principles are better, therefore, IFRS is cost-beneficial for everybody; throw in additional cost savings from convergence, and the matter can only be decided in favor of IFRS. Essentially, we are told that the choice between two complex regulatory regimes can be decided without reference to their more particular terms.

There must be more to it than that. Some of what is missing is apparent on the Roadmap's face. It tells us that a principles-based approach opens up issuer discretion respecting treatments, which sacrifices comparability across issuers. The Roadmap simultaneously asserts that convergence enhances comparability. Taking the two points together, it would seem to follow that the enhancement of international

37. *Id.* at 9498.

38. *See generally* 2008 Roadmap, *supra* note 7.

39. *Id.* at 70,826.

40. *Id.*

41. *Id.*

42. For a more detailed discussion of SEC pronouncements articulated under previous SEC leadership, see Cunningham, *A Prescription to Retire the Rhetoric of Principles-Based Systems*, *supra* note 15, at 1446-53.

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comparability held out by the Roadmap implies a countervailing sacrifice of comparability in the domestic context as issuers use principles to devise more idiosyncratic treatments. The SEC's stated goal of greater transparency accordingly appears elusive with gains on the one hand, implying losses on the other.⁴³ The comparability problem is compounded if we add a point—IFRS in practice is not a unitary international system, but an international focal point around which a broad range of national systems converge as national regulators adopt IFRS with local carve outs.⁴⁴

Differences of opinion about treatments continue to matter even within the world of IFRS. To get a better handle on the stakes from a U.S. perspective, consider some classic cases where GAAP is famous for rules while IFRS is known for its principles.⁴⁵

Consider first accounting for capital leases—long-term leases that must be booked on the lessee's balance sheet. GAAP uses four defined criteria, including one by-the-numbers test keyed to the useful life of the asset under lease, with the criteria determining the treatment.⁴⁶ IFRS bids the reporting company to look to the economics of the transaction, including eight factors to assist its determination without stipulating results following from their application.⁴⁷ It bears noting that while IFRS is indeed more flexible, the GAAP treatment, founded on a list of factors, does not automatically determine results. American lawyers would describe both treatments as “standards.”

Next, consider accounting consolidation, probably the most often cited case of GAAP as rules and IFRS as principles. Under both GAAP and IFRS, when one firm “controls” another, both report on a

43. See Lawrence A. Cunningham, Editorial, *Beware the Temptation of Global Standards*, FIN. TIMES (London), Sept. 11, 2007, at 11.

44. To see this point in a discussion critical of the Roadmap, see Letter from Kurt N. Schacht, Managing Director, CFA Inst. Ctr. for Fin. Mkt. Integrity, & Gerald I. White, Chairman, CFA Inst., to Florence Harmon, Acting Sec'y, U.S. Sec. & Exch. Comm'n 3 (Apr. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-162.pdf>.

45. For lists of differences between GAAP and IFRS, see, for example, BARRY J. EPSTEIN & EVA K. JERMAKOWICZ, IFRS 2008: INTERPRETATION AND APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS app'x C (2008). Large accounting firms also have compiled booklets describing treatment differences. *E.g.*, ERNST & YOUNG, US GAAP v. IFRS: THE BASICS (2009), available at [http://www.ey.com/Publication/vwLUAssets/IFRS_v_GAAP_basics_Jan09/\\$file/IFRS_v_GAAP_basics_Jan09.pdf](http://www.ey.com/Publication/vwLUAssets/IFRS_v_GAAP_basics_Jan09/$file/IFRS_v_GAAP_basics_Jan09.pdf); DELOITTE, IFRS AND US GAAP: A POCKET COMPARISON (2007), available at <http://www.iasplus.com/dttdpubs/0703ifrsusgaap.pdf>; DELOITTE, IFRS IN YOUR POCKET 2008 (2008), available at <http://www.iasplus.com/dttdpubs/pocket2008.pdf>; PRICEWATERHOUSECOOPERS, SIMILARITIES AND DIFFERENCES: A COMPARISON OF INTERNATIONAL FINANCIAL REPORTING STANDARDS AND US GAAP FOR INVESTMENT FUNDS (2007).

46. William W. Bratton & Lawrence A. Cunningham, *Treatment Differences and Political Realities in the GAAP-IFRS Debate*, 95 VA. L. REV. 989, 1022 (2009).

47. EPSTEIN & JERMAKOWICZ, *supra* note 45, at 533–35.

consolidated basis.⁴⁸ GAAP defines control with a by-the-numbers test. Consolidation follows from ownership of 50% plus one share of the subsidiary's stock, but the inference of control can be rebutted where control actually is not held or is temporary.⁴⁹ IFRS begins with a 50% plus one share test as well, but modifies the zone of control under a standard that variously looks to other arrangements respecting voting shares, contractual arrangements, and regulatory contexts. Application of the standard can cut either way, turning less than 51% ownership into control or rejecting a finding of control given more than 50%.⁵⁰ The rules versus principles distinction is descriptive of the difference. But a caution about the description of GAAP is necessary—the fifty plus one presumption is rebuttable under both systems.

IFRS affords reporting companies more elbow room in both of the above cases, but a dispassionate search for economic truth is not its only normative motivation. To get a more complete picture of the issues at stake, compare the treatments for tangible long-lived assets.⁵¹ Under GAAP, they are carried on a cost basis. If the asset's value is impaired, the impairment results in a charge to current income. Under IFRS, the asset may be carried at cost or fair value. If the asset's value is impaired, the loss is dealt with by a balance sheet adjustment only. Moreover, if the asset's value recovers ex post the impairment, the balance sheet adjustment can be reversed. Here we see that GAAP can be motivated by conservatism—the practice of dealing with uncertainty through asymmetric recognition of losses compared to gains.⁵² It also favors verifiable numbers, thereby hewing more closely to traditional cost accounting and constraining management's "optionality" respecting balance sheet presentations. IFRS, being more comfortable about extending management discretion to revalue assets, includes a broader range of fair value treatments, introducing subjectivity into the determination of balance sheet amounts. Thus, under GAAP, when a tangible asset is written down, the write down is permanent, while under IFRS, tangible asset values can change with exterior shifts in valuation as management determines.

Note also that in the case of a decline in value, GAAP forces recognition on the income statement, while IFRS lets the company take

48. Bratton & Cunningham, *supra* note 46, at 1020.

49. FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 94: CONSOLIDATION OF ALL MAJORITY-OWNED SUBSIDIARIES §§ 10, 13 (1987).

50. EPSTEIN & JERMAKOWICZ, *supra* note 45, at 441–42.

51. Bratton & Cunningham, *supra* note 46, at 1015.

52. See Sudipta Basu, *The Conservatism Principle and the Asymmetric Timeliness of Earnings*, 24 J. ACCT. & ECON. 3 (1997).

care of the matter with a balance sheet adjustment. This difference also applies more generally. GAAP is income statement oriented because it evolved as a system that is responsive to the demands of equity holders in U.S. financial markets.⁵³ When GAAP requires an event to impact the income statement, it flags the event for actors valuing the company. IFRS, with its ties to blockholder governance regimes, favors the balance sheet, reflecting the greater influence of other constituents, specifically bank creditors and employees.⁵⁴

Next, compare the treatments for research and development expenses.⁵⁵ Under GAAP, these are expensed in the period incurred and cash outflows are classified into the operating section of the cash flow statement. Under IFRS, research and development costs are capitalized; that is, the company books the costs as an asset and shows them on its cash flow statement as investment cash flows. A basic policy difference again is manifest. Under GAAP, conservatism is a motivating principle, and doubts tend to be resolved by forcing a present deduction on the income statement. In contrast, IFRS is more liberal and management-friendly, assuming that research and development results in tangible economic value and delaying recognition of its costs for an extended future.

GAAP conservatism can also be seen in revenue recognition.⁵⁶ When given a service contract to be performed over multiple reporting periods, IFRS lets a company recognize all the revenue up-front upon partial performance. GAAP, taking more seriously the idea that revenues should be matched to expenses, amortizes these contracts over the period of service without up-front recognition. Keep in mind that the IFRS approach bears a more than passing resemblance to the treatment that Enron Corporation received from FASB's Emerging Issues Task Force, under which it was permitted to show all gains from its long-term energy contracts up-front.⁵⁷ A similar comparison obtains respecting

53. See *infra* notes 81-93 and accompanying text.

54. See Cunningham, *SEC's Global Accounting Vision*, *supra* note 1, at 48. There is a parallel, dark side to this. In the U.S., accounting manipulation generally impacts the income statement, earnings per share being a key factor in the compensation of the corporate insiders responsible. In block-holder countries, manipulation tends to impact the balance sheet, payoffs to the insiders responsible stemming from the allocation of corporate assets. *Id.* (citing Simon Johnson et al., *Tunneling*, AM. ECON. REV., May 2000, at 22; John C. Coffee, Jr., *A Theory of Corporate Scandals: Why the U.S. and Europe Differ*, OXFORD REV. ECON. POL'Y, Summer 2005, at 198); see also Vladimir Atanasov et al., *Unbundling and Measuring Tunneling* (Univ. of Tex. Sch. of Law, Working Paper No. 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1030529.

55. Bratton & Cunningham, *supra* note 46, at 1017.

56. *Id.* at 1012.

57. See Emerging Issues Task Force, Fin. Accounting Standards Bd., Issue 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities.

accounting for pension obligations.⁵⁸ Under GAAP, unfunded pension benefit obligations must be shown as liabilities on the balance sheet. IFRS requires no balance sheet disclosure. Once again conservatism motivates GAAP, while managers get the benefit of the doubt under IFRS.

Finally, we turn to inventory accounting,⁵⁹ an area where GAAP is the more flexible regime. For cost accounting purposes, one must make an assumption about the order in which goods are sold. They are either treated as sold in the direct order of production or acquisition—first-in-first-out (FIFO)—or as sold in reverse order of production or acquisition—last-in-first-out (LIFO). Given rising prices, FIFO more closely reflects economic reality on the balance sheet, listing inventories close to current values, while LIFO better reflects prevailing economics on the income statement with a figure for cost of goods sold reflecting current prices. GAAP permits companies to choose; IFRS, with its regime of balance sheet primacy, requires FIFO.

What difference does all of this make at the bottom line? Accounting experts tend to agree that, as an empirical matter, applying GAAP versus IFRS results in significant bottom line reporting differences. One recent study shows that the difference between GAAP and IFRS earnings ranges from minus 84% to plus 14%, with an average of minus 14% for GAAP issuers, with a range of treatments contributing to the differences.⁶⁰

The above comparison and the bottom line empirical results in the end confirm the SEC's description—GAAP constrains, where IFRS is

58. Bratton & Cunningham, *supra* note 46, at 1023.

59. *Id.* at 1014.

60. RISKMETRICS GROUP, THE EARNINGS GAP ACCORDING TO LARGEST ADRS: IFRS VS. US GAAP 1 (2008), available at <http://www.sec.gov/comments/s7-27-08/s72708-55.pdf>.

Disagreement among the experts on the normative policy implications of the data also is noted. Consider in this regard literature reviews and policy analysis by two committees of the American Accounting Association, the preeminent academic accounting body in the United States. The two authors agree that the empirical evidence indicates that significant differences exist in reported accounting results when applying GAAP and IFRS, including the bottom line balance sheet and income statement aggregates. Yet, the two draw different conclusions, one encouraging competition among multiple standards and the other cautioning that moving the U.S. to IFRS is premature. Compare KARIM JAMAL ET AL., AM. ACCOUNTING ASS'N, A PERSPECTIVE ON THE SEC'S PROPOSAL TO ACCEPT FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) WITHOUT RECONCILIATION TO U.S. GAAP (2007), (finding differences in outcomes but no evidence of relative superiority and, therefore, concluding that competition among the standards is optimal policy stance), with PATRICK E. HOPKINS ET AL., AM. ACCOUNTING ASS'N, RESPONSE TO THE SEC RELEASE: ACCEPTANCE FROM FOREIGN PRIVATE ISSUERS OF FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS WITHOUT RECONCILIATION TO U.S. GAAP (2008) (finding material differences in outcomes that are relevant to investment decisions and therefore concluding that it is premature for the U.S. to adopt IFRS).

flexible. But some important amplifications and qualifications need to be added. Accounting theory certainly plays a role here, but differences of institutional context also matter.

GAAP constraints do not necessarily follow a refractory attachment to detailed drafting at the FASB. There are values at stake, in particular conservatism, verifiability, and transparent disclosure of current period results. Part III's discussion of the FASB's institutional history explains why the FASB pursued these values.

First, some explanatory background respecting IFRS is necessary. IFRS is flexible only partly as a matter of normative preference. Its looseness also follows from the nature of the enterprise.⁶¹ A one-size-fits-all set of global standards of necessity emerges as a big tent accommodating a range of national practices. The globe-spanning flexibility of IFRS also reflects differences in corporate governance systems and financial market regulation. IFRS's predecessor systems all developed in small national marketplaces with tight communities of intermediaries and investor populations largely made up of institutions. Tight communities can coexist with "light touch" regulation,⁶² and as between GAAP and IFRS, the latter is the "light touch" choice.

The differences in surrounding regimes of governance and regulation are wrought into the accounting systems. As an example, consider the United Kingdom (U.K.) requirement that, if necessary for the presentation of a true and fair view of the business, a particular mandated treatment must be overridden.⁶³ IFRS's stated preference for treatments that follow from the economics of the transaction partakes of the same spirit. Overrides have not been the practice in the U.S., even as financials must "fairly present" the company's financial position. Litigation risk is the reason for this,⁶⁴ not GAAP. Litigation risk is a property of the U.S. adversary regulatory system, a system that, unlike that of the U.K., evolved to cope with a dispersed, continent-wide array of financial institutions and investor clients.

It should also be noted that most of the countries in the IFRS fold have blockholder governance systems, although the U.K., Australia, and Israel are exceptions to this general rule. Blockholders, having control or influence over internal decision-making, suffer diminished problems

61. See James D. Cox, *Coping in a Global Marketplace: Survival Strategies for a 75-Year-Old SEC*, 95 VA. L. REV. 941, 947 (2009).

62. Donald C. Langevoort, *U.S. Securities Regulation and Global Competition* 13 (Georgetown Law Faculty Working Papers, Paper No. 89, 2008), available at http://scholarship.law.georgetown.edu/fwps_papers/89/.

63. See Cunningham, *SEC's Global Accounting Vision*, *supra* note 1, at 41–42.

64. *Id.* at 42.

of agency and information asymmetry.⁶⁵ Any question arising under a discretionary treatment can be answered by direct inquiry. Accounting principles accordingly matter less than they do, given the separation of ownership and control that prevails in the U.S.

IFRS, then, follows from institutional and political inputs. GAAP does as well. Part III offers a more particular description of the environment in which GAAP evolved, further sharpening the distinction between the two systems.

III. GAAP'S POLITICAL AND INSTITUTIONAL CONTEXT

The FASB was established in the mid-1970s as the result of an ad hoc process looking toward the establishment of a viable standard-setter under private auspices. The American Institute of Certified Public Accountants (AICPA) took the lead,⁶⁶ with input from organizations and individuals representing management and the financial sector.⁶⁷ The organizers had a high-powered incentive: they wanted a responsive standard-setter without ceding territory to a federal agency,⁶⁸ which in those days was associated with domination by progressive, anti-corporate types.⁶⁹

Public legitimacy mattered, so the new standard-setter had to be independent, public minded, and insulated from political pressure,⁷⁰ yet simultaneously responsive to constituent interests.⁷¹ The result was a board selected by an independent foundation, which is also populated with constituents, along with a monitoring advisory body, also populated with constituents.⁷² As already noted, today's IASB is a carbon copy

65. William W. Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference*, 38 COLUM. J. TRANSNAT'L L. 213, 226 (1999).

66. Ronald King & Gregory Waymire, *Accounting Standard-Setting Institutions and the Governance of Incomplete Contracts*, 9 J. ACCT. AUDITING & FIN. 579, 583-86 (1994).

67. ROBERT VAN RIPER, *SETTING STANDARDS FOR FINANCIAL REPORTING: FASB AND THE STRUGGLE FOR CONTROL OF A CRITICAL PROCESS* 8-9 (1994); Mohamed Elmuttassim Hussein & J. Edward Ketz, *Accounting Standards-Setting in the U.S.: An Analysis of Power and Social Exchange*, 10 J. ACCT. & PUB. POL'Y 59, 76 (1991).

68. The federal securities laws directed the SEC to prescribe the form and content of financial statements. See generally Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1934). For a review of the legislative history, see Sean M. O'Connor, *Be Careful What You Wish For: How Accountants and Congress Created the Problem of Auditor Independence*, 45 B.C. L. REV. 741, 789-820 (2004). The SEC then turned the matter over to the AICPA. VAN RIPER, *supra* note 67, at 7.

69. See VAN RIPER, *supra* note 67, at 9.

70. *Id.*

71. See ROBERT CHATOV, *CORPORATE FINANCIAL REPORTING: PUBLIC OR PRIVATE CONTROL?* 232-39 (1975).

72. VAN RIPER, *supra* note 67, at 13-18.

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except with a larger cast of characters and geographic distribution requirements.⁷³

A. Objections on the Right and the Left

The FASB's governance model, now replicated at the IASB, pursues a middle ground that has aroused political objections from the right and the left. From the right, public choice commentators denounced the arrangements surrounding the FASB as a rent-seeking scam. From this point of view, the FASB should have operated as a private standard-setter subject to free competition. It, instead, has worked as a cog in the larger machine of the federal disclosure system, the mandates of which yield rents to auditing firms.⁷⁴ Following the Roadmap to substitute the IASB only makes matters worse, taking an unsatisfactory domestic arrangement and embedding it on a global basis. A prediction follows: The big auditing firms should count among the Roadmap's strong supporters.

A second set of critics attacked from the progressive, pluralist left. For them, choices of accounting principles have significant allocative consequences; therefore, accounting standard setting is a high stakes game in which the setter has no alternative but to balance interests.⁷⁵ Because the setter resolves political rather than technical issues, its legitimacy depends on political responsiveness.⁷⁶ At its inception, the FASB could not provide this because it depended on contributions from the preparers and auditors, groups with high stakes in all of its outcomes.⁷⁷ The critics contended that the standard-setter should be an agency directly responsible to Congress.⁷⁸ Substituting the IASB only makes things worse from this point of view because it removes political subject matter to a distant venue in which U.S. domestic concerns occupy, at best, a secondary place on the agenda⁷⁹ and scraps a publicly-funded standardsetter for one beholden to private interests.

73. See 2007 Concept Release, *supra* note 3, at 45,605; Ruder et al., *supra* note 16, at 519–20; see also INT'L ACCOUNTING STANDARDS BD. & INT'L ACCOUNTING STANDARDS COMM. FOUND., WHO WE ARE AND WHAT WE DO, *supra* note 25.

74. See Ross L. Watts & Jerold A. Zimmerman, *The Demand for and Supply of Accounting Theories: The Market for Excuses*, 54 ACCT. REV. 273, 275–81 (1979).

75. See VAN RIPER, *supra* note 67, at 73–74.

76. See *id.* at 22–23.

77. See *id.* at 14; STAFF OF SUBCOMM. ON REPS., ACCOUNTING & MANAGEMENT, S. COMM. ON GOV'T OPERATIONS, 94TH CONG., THE ACCOUNTING ESTABLISHMENT: A STAFF STUDY 1–2 (Comm. Print 1976).

78. See VAN RIPER, *supra* note 67 at 45.

79. The 2008 Roadmap, *supra* note 7, at 70,827, recognizes that substitution of IFRS for GAAP implies diminished influence for U.S. interests.

The public choice critique has never had much political traction. In contrast, the progressive attack had an impact in the FASB's early years and prompted process reforms that strengthened the FASB's public bona fides, particularly in a trend toward ever-increasing distance from the AICPA.⁸⁰ This critique also has lost salience in recent years, but largely because the FASB, over time, managed to reshape itself to meet the criticisms.

The SEC Roadmap recognizes that accountability concerns retain validity with regard to the IASB. As we have seen, the SEC wants the IASCF to get a new monitoring board, and the IASCF has invented one. But one wonders how well the new oversight setup will serve to meet the public accountability objection. It imports public accountability, but to a diverse internationally distributed oversight panel possessing advisory input without veto authority. Funding may be a bigger problem still. As we also have seen, the FASB has secure funding, thanks to SOX, while the IASB still relies on contributors—32% of its 2009 budget came from the Big Four auditing firms.

Thus, to the extent public accountability matters, a switch to IFRS represents a step backward. The move is doubly disconcerting in view of the FASB's history. Credible and independent private standard-setters do not just pop out of technocratic jack-in-the-boxes. The FASB spent the better part of thirty years pursuing full dress public legitimacy—it formulated, reformulated, tweaked, and re-tweaked itself, and finally, with SOX it was able to get its ducks in a row. The Roadmap would throw away history's lessons in favor of an institution at an earlier, ambiguous stage of evolution. If there were no alternative path to cost savings from convergence, this might loom large as an objection. But, as we have seen, a path exists.

B. The FASB and the Management Interest

The political plot thickens with regard to the history the FASB's relations with its most consistent, most vocal adversaries—corporate managers.

Management, although a major player at the table at the FASB's inception, quickly became an adversary. The FASB crossed management when it undertook its initial project to articulate generally accepted goals of accounting. The project, which came to be called the Conceptual Framework, is a set of principles much derided for its high

80. See VAN RIPER, *supra* note 67, at 14–15, 46–47, 86–87, 126.

level of generality.⁸¹ But the Conceptual Framework did provide at least one outcome determinative point,⁸² which lies in a single unprepossessing sentence in Statement of Financial Accounting Concepts No. 1: “Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.”⁸³ This is called decision usefulness, and it seems to state the obvious, but in the 1970s this was a radical proposition.⁸⁴

Financial reporting serves two purposes: it imports external transparency and it serves as part of a rational system of internal management.⁸⁵ Three decades ago, the prevailing concept of purpose, called “stewardship,” encompassed both.⁸⁶ It meant that corporate managers had a place at the table with market actors as important users of the standards. Indeed, they claimed primacy.⁸⁷

When the FASB elevated the status of outside users of financials with decision usefulness,⁸⁸ it broke with history and defected against management. It thereby succeeded in protecting its own independence, avoiding the pluralist alternative of regulation as mediation in a world of multiple constituents with varied and conflicting preferences.⁸⁹ Decision usefulness also imported policy legitimacy, implying a one-size-fits-all theoretical justification for the enterprise as a whole. Back in the 1970s, management was peddling national competitiveness and public welfare to argue for a cost–benefit burden of proof to be met by every new accounting standard,⁹⁰ an argument that eventually would register in Congress with respect to SEC rulemaking⁹¹ and still registers

81. See Stephen A. Zeff, *A Perspective on the U.S. Public/Private-Sector Approach to the Regulation of Financial Reporting*, ACCT. HORIZONS, Mar. 1995, at 52, 60; VAN RIPER, *supra* note 67, at 80.

82. See John C. Burton, *A Commentary on the Reflections of Homer Kripke*, 4 J. ACCT. AUDITING & FIN. 79, 80 (1989).

83. See FIN. ACCOUNTING STANDARDS BD., Statement of Fin. Accounting Concepts No. 1: Objectives of Financial Reporting by Business Enterprises § 34 (1978), available at <http://www.fasb.org/pdf/con1.pdf> [hereafter FASB, SFAC No. 1].

84. See VAN RIPER, *supra* note 67, at 20.

85. See Watts & Zimmerman, *supra* note 74, at 296–97.

86. *Id.* at 296.

87. See VAN RIPER, *supra* note 67, at 21.

88. See FASB, SFAC No. 1, *supra* note 83, §§ 27, 32.

89. See Baruch Lev, *Toward a Theory of Equitable and Efficient Accounting Policy*, 63 ACCT. REV. 1, 2, 13 (1988).

90. See R. K. MAUTZ & WILLIAM G. MAY, FINANCIAL DISCLOSURE IN A COMPETITIVE ECONOMY: CONSIDERATIONS IN ESTABLISHING FINANCIAL ACCOUNTING STANDARDS 1–4 (1978) (presenting a project of the Financial Executives Research Foundation).

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

in today's convergence discussions. The Conceptual Framework's focus on markets let the FASB argue first, that information is a public good that will be underprovided absent regulation,⁹² and second, that standards directed to user utility reduce the social costs of information asymmetry, which include high transaction costs and thin capital markets with low liquidity.⁹³

Decision usefulness also aligned the FASB's goals with that of its governmental overseer, the SEC, and the SEC's goal of investor protection.⁹⁴ The two agencies maintained a cooperative relationship that has worked well. The SEC's recent defection against the FASB also amounts to a defection from decision usefulness. A shift to IFRS, with its constituency-responsive stress on balance sheet treatments and de-emphasis of income statement responsiveness, would amount to a retreat in the direction of stewardship.

Meanwhile, management has never been entirely happy with GAAP. As the FASB has independently set its own agenda, management has seen a classic case of an unresponsive regulatory agency promulgating regulations for their own sake.⁹⁵ Management also complains of excess complexity, but not when it likes the bottom line result.⁹⁶ Management voices use the FASB's notice and comment and advisory processes to object, but only get occasional concessions as the FASB keeps cranking out standards it would just as soon do without.⁹⁷

The managers call the result "standards overload."⁹⁸ Back in the 1980s, their representatives recommended an organizational overhaul to address the problem. This would have shifted agenda control at the FASB to a new oversight board with power to block agenda items and force revision of existing standards.⁹⁹ Such drastic reform proposals have never gone anywhere, even as management has scored occasional victories in its long battle with the FASB. It has used its political muscle to block proposed standards. It also secured two seats on the FASB, and for a while, had a super majority voting regime that made it

92. See FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FIN. ACCOUNTING CONCEPTS NO. 2: QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION § 135 (1980), available at <http://www.fasb.org/pdf/con2.pdf> [hereinafter FASB, SFAC No. 2]; Lev, *supra* note 89, at 8–9.

93. Lev, *supra* note 89, at 4–9.

94. See VAN RIPER, *supra* note 67, at 141.

95. See Dennis R. Beresford, *How Should the FASB Be Judged?*, ACCT. HORIZONS, June 1995, at 56, 57.

96. *Id.* at 60; VAN RIPER, *supra* note 67, at 110.

97. Beresford, *supra* note 95, at 59; VAN RIPER, *supra* note 67, at 98–99, 118–31, 183.

98. VAN RIPER, *supra* note 67, at 137; Beresford, *supra* note 95, at 60.

99. Beresford, *supra* note 95, at 57; VAN RIPER, *supra* note 67, at 119–23.

harder for the FASB to adopt new standards.¹⁰⁰

Meanwhile, management's complaint of excess complexity collapses into the more serious complaint that the FASB drafts too many rules, seeking to supply a clear answer to every possible situation, pursuing the objective with detailed statements, bright-line tests, and multiple exceptions.¹⁰¹ This complaint returns us to the Roadmap's justification for doing away with the FASB altogether and so bears importantly on the present discussion.

There is no question that GAAP's layers of rules can have perverse effects. Internal inconsistency can result.¹⁰² Comparability also can suffer as reporting entities under the same strict standard can appear comparable on the faces of their financials when their arrangements in fact are dissimilar.¹⁰³ Worse is the resulting dysfunctional, check-the-box approach to compliance that admits transaction structuring and other strategic behavior, along with rule compliant statements that do not fairly state the reporting company's results or financial position.¹⁰⁴

Actors at the FASB reply that the rules follow from demands generated by managers and auditors looking for treatment exceptions, scope exceptions, and "roadmaps" that hold out "guidance."¹⁰⁵ It apologizes, but it is just being a responsive regulator and does not exercise total control over outcomes.¹⁰⁶ However, this posture of accommodation also has a dark side, for it is here that the public choice critique registers with full force. The securities laws' requirement of an independent audit makes the large audit firms providers of a necessary service, positioning them to collect rents.¹⁰⁷ The critics allege that complex, rules-based standards aid and abet the rent seeking, generating work¹⁰⁸ and over time strengthening entry barriers.¹⁰⁹ Moreover,

100. VAN RIPER, *supra* note 67, at 126, 150, 154.

101. See OFFICE OF THE CHIEF ACCOUNTANT & OFFICE OF ECON. ANALYSIS, U.S. SEC. & EXCH. COMM'N, STUDY PURSUANT TO SECTION 108(D) OF THE SARBANES-OXLEY ACT OF 2002 ON THE ADOPTION BY THE UNITED STATES FINANCIAL REPORTING SYSTEM OF A PRINCIPLES-BASED ACCOUNTING SYSTEM § I.C (2003).

102. *Id.* § I.G.

103. *Id.*

104. *Id.*; Katherine Schipper, *Principles-Based Accounting Standards*, ACCT. HORIZONS, Mar. 2003, at 61, 68.

105. See VAN RIPER, *supra* note 67, at 105.

106. See Lawrence W. Smith, *The FASB's Efforts Toward Simplification*, FASB REP., Feb. 28, 2005, at 2, 3-4.

107. See George J. Bentson, *The Regulation of Accountants and Public Accounting Before and After Enron*, 52 EMORY L.J. 1325, 1329-31 (2003).

108. See Charles R. Plott & Shyam Sunder, *A Synthesis*, 19 J. ACCT. RES. 227, 231 (1981).

109. See Dale Buckmaster et al., *Measuring Lobbying Influence Using the Financial Accounting Standards Board Public Record*, 20 J. ECON. & SOC. MEASUREMENT 331, 340 (1994).

innovations get choked off to the extent that they decrease auditability and expose the audit firms to legal risk.¹¹⁰

All of this is true, but, given the pressures that have come to bear on the FASB, it is difficult to imagine a different evolutionary course for GAAP. In effect, the FASB has had to take our second-best world as it finds it. It is a nasty place where incentive problems impair the auditor–client relationship, auditability matters, and the standard-setter has to worry about scandal prevention.¹¹¹ Rules, although not ideal, have advantages because they provide a base of common assumptions and knowledge for preparers, auditors, and users. They decrease differences in measurement; they make noncompliance more evident. And, as room for differences in judgment narrows, transparency and comparability are enhanced.¹¹² GAAP has followed from defensible trade-offs.

In summary, the FASB put itself on history’s winning side with decision usefulness, overcoming management resistance along the way.¹¹³ It thereby aligned itself not only with the SEC but also with the broader economic shift away from “managerialism” toward capital market governance under the shareholder value norm.¹¹⁴ The story of GAAP’s evolution is thus a story about standard setting in the U.S. markets, where separated ownership and control predominates while tensions between managers and shareholders are exhaustively worked out in regulation and litigation. The FASB opted for conservatism, verifiability, and rules because it operates in this environment, not because of a theoretical commitment to a dysfunctional approach to standard setting. The IASB, with its shorter history and different regulatory context, has pursued different values. Accordingly, it is not enough to describe the IASB as “independent” and its standards as “high quality” to end the convergence discussion in its favor.

110. See George Mundstock, *The Trouble with FASB*, 28 N.C. J. INT’L L. & COM. REG. 813, 817 (2003).

111. See William W. Bratton, *Rules, Principles, and the Accounting Crisis in the United States*, 5 EUR. BUS. ORG. L. REV. 7, 14–18 (2004) (describing advantages of rules in the auditing context).

112. See Schipper, *supra* note 104, at 68.

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

114. Interestingly, a recent report on accounting from an SEC advisory committee recommends additional user representation on the FAF. See ADVISORY COMM. ON IMPROVEMENTS TO FIN. REPORTING, U.S. SEC. & EXCH. COMM’N, FINAL REPORT OF THE ADVISORY COMMITTEE ON IMPROVEMENTS TO FINANCIAL REPORTING TO THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION 4 (2008), available at <http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf> [hereafter ACIFR REPORT]. The recommendation is understandable, but hardly pressing in light of the FASB’s commitment to decision usefulness.

IV. POLITICS GOING FORWARD

The politics of accounting had a stable equilibrium in the U.S. for three decades. On one side stood the SEC, the FASB, market intermediaries,¹¹⁵ and the users, jointly backing decision usefulness. These interests dominated. Management stood on the other side, pushing back as it looked for a larger zone of reporting discretion. The big audit firms stood between them, looking for standards that enhanced their rents and diminished the threat of litigation. The standards themselves reflected the interests thus aligned.

The Roadmap disrupts this equilibrium. GAAP has come to be seen as one of the deadweight domestic regulatory costs that make U.S. capital markets unattractive to foreign issuers. Thus has the SEC, looking to lighten its touch, abandoned a standard-setter that it had long protected, citing the capital market interests in so doing. But the SEC, at the same time, severs connections to the capital market interests that aligned to favor decision usefulness. The SEC's comparability justification looks only to a subset of capital market users—those investing in the global context—without asking whether U.S. users as a whole will benefit from the shift.

A question arises respecting the various interest groups' reactions to the Roadmap. These can be accessed through the comment letters in the SEC file. The letters underscore the foregoing analysis. The audit firms are in favor, and the capital market users are against. Interestingly, the managers are split.

A. Audit Firms

The Big Four audit firms voice the strongest support.¹¹⁶ They want a

115. See VAN RIPER, *supra* note 67, at 98.

116. See Letter from PriceWaterhouseCoopers LLP to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Apr. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-218.pdf>; Letter from KPMG LLP to Florence E. Harmon, Acting Sec'y, U.S. Sec. & Exch. Comm'n (Apr. 16, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-114.pdf>; Letter from Deloitte & Touche LLP to Elizabeth Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Apr. 3, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-87.pdf>; Letter from Ernst & Young LLP to Elizabeth Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (March 4, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-59.pdf>; see also ADVISORY COMM. ON THE AUDITING PROFESSION, U.S. DEP'T OF THE TREASURY, FINAL REPORT (2008) at C.3–C.4 (remarks of U.S. Treasury Secretary Henry Paulson connecting globalization and international financial reporting standards with legal burdens auditors face) & VII.23–VII.32 (reviewing disagreement among Committee members on wide range of litigation defenses and legal protections that auditing firms sought in comprehensive review of issues facing the profession, including effects of globalization and movement towards international financial reporting standards), available at <http://www.ustreas.gov/offices/domestic-finance/acap/docs/final-report.pdf>.

date certain for the switch, and perhaps more importantly, a redirection of the FASB's efforts pending the date certain. Resources, they say, should go into moving along key topics in the convergence process and new standard setting should cease.¹¹⁷ The switch, moreover, should be all-encompassing. IFRS should be accepted as authoritative as it is promulgated by the IASB and carve outs that differentiate national systems should be avoided.¹¹⁸ There is also some push back, but this goes to litigation concerns. IFRS means greater reliance on principles and some "may use hindsight and preferences to unnecessarily challenge and overturn reasonable professional judgments of preparers and auditors."¹¹⁹ The auditors follow up with the classic move of putting the burden on the regulator: the SEC, they say, should make a policy statement describing the factors it brings to bear in articulating the reasonableness of a judgment.¹²⁰

Interestingly, the Big Four appear ready to go ahead with IFRS whether they get the policy statement from the SEC. By implication, forced to choose between GAAP and IFRS without a change in the litigation environment, they will take their chances with IFRS. Why should this be? Three reasons can be suggested. First, Roadmap implementation means switching costs at every U.S. issuer, costs that translate into rents for auditors. Second, as between a financially independent standard-setter and a standard-setter beholden to the audit firms for funding, the audit firms prefer the latter. Third, the FASB's rules have had their intended effect. They make violations easier to observe and verify, which heightens the litigation risk. Principles open up a zone in which treatments follow from business judgments, making violations harder and more expensive to prove. An important point follows: rules are thought to be the tools of corporate insiders who know how to game them. That is true in some contexts, but principles can likewise be gamed. The auditors' enthusiasm for IFRS should make people suspicious.

B. Users

To see such suspicions in the Roadmap comment file, one only needs to look at users' letters, which register strong, policy-based resistance.

117. Letter from PriceWaterhouseCoopers LLP to Elizabeth M. Murphy, *supra* note 116, at 8.

118. Letter from Ernst & Young LLP to Elizabeth Murphy, *supra* note 116, at 7.

119. Letter from Deloitte & Touche LLP to Elizabeth Murphy, *supra* note 116, at 5.

120. *Id.*; Letter from KPMG LLP to Florence E. Harmon, *supra* note 116, at 11. Here the SEC set itself up. The auditors cite the ACIFR REPORT, *supra* note 114, which made this suggestion.

The Council of Institutional Investors lays this out.¹²¹ The Council, before it will endorse IFRS, wants to see, *inter alia*: (1) the same quality information coming from IFRS as from GAAP; (2) equally good application by issuers and enforcement by regulators; (3) sufficient resources at the IASB and full-time commitments from its members; (4) a clear cut commitment to decision usefulness at the IASB; and (5) a governance structure at the IASB that guarantees insulation from interference by governmental actors.¹²² Looking at the Roadmap, the Council finds none of these guarantees forthcoming.¹²³ The financial analysts concur. They want a roadmap with milestones shaped by investor concerns and think the FASB–IASB convergence project suffices for this purpose.¹²⁴ The Standard & Poors letter provides another example of the users' concerns. As a large credit rating agency; Standard & Poors spends as much time reviewing financial statements as any organization in the world. It agrees with the other user critics, noting that principles-based standards are fine in theory, but make sense for a heavy user only if the system incorporates additional disclosure requirements that enable the user to look through to the particular application decision.¹²⁵ Nothing in IFRS or in the Roadmap assures this information.

C. Preparers

The Roadmap poses a cost–benefit tradeoff for the preparers and their managers. The cost is the near-term out-of-pocket cost of making the switch. The benefit is the longer-term advantage of shifting to a more flexible standard-setter. It should be noted that the benefit does not lie in an expectation that U.S. management can dominate the IASB where it

121. See also Letter from Christianna Wood & Louis F. Moret, Co-Chairs, Accounting & Auditing Practices Comm., Int'l Corporate Governance Network, to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Apr. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-221.pdf>; Letter from Mary Hartman Morris, Investment Officer, Cal. Pub. Employees' Ret. Sys., to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Apr. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-226.pdf>; Letter from Jack T. Ciesielski, Investors Technical Advisory Comm., Fin. Accounting Standards Bd., to Florence E. Harmon, Acting Sec'y, U.S. Sec. & Exch. Comm'n (Jan. 30, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-32.pdf>.

122. Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Florence E. Harmon, Acting Sec'y, U.S. Sec. & Exch. Comm'n 2 (Apr. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-194.pdf>.

123. *Id.* at 1–2.

124. See Letter from Kurt N. Schacht & Gerald I. White to Florence Harmon, *supra* note 44, at 3.

125. Exactly so. See Letter from Neri Bukspan et al., Standard & Poor's Ratings Servs., to Florence E. Harmon, Acting Sec'y, U.S. Sec. & Exch. Comm'n 3 (Apr. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-172.pdf>.

has failed to dominate the FASB. The IASB also has a reputation for independence.¹²⁶ Moreover, given its broader, global roster of constituents, any particular demands emanating from a single national interest group or regulator are bound to resound less forcefully than they would in a domestic standard setting context. The advantage for management lies in the “elbow room” imported by a shift to a shorter, less directive stack of standards. A shift to IFRS ameliorates the problem of “standards overload” in one swoop. Indeed, given one global standard-setter and national governments and interest groups worldwide, it might prove quite difficult for the IASB to establish new standards, ameliorating the “overload” going forward.

The corporate issuers’ comment letters can be sorted in accordance with their reactions to the cost–benefit question. Most resist the Roadmap on out-of-pocket cost grounds, asking why they should be asked to spend millions on switching in a time of economic stress and noting that the FASB–IASB coordination process holds out a less costly route to convergence.¹²⁷ Others, particularly large multinationals with subsidiaries that report under IFRS, are more welcoming¹²⁸ but would like additional time to accomplish the switch. Still, others worry about particular treatments, with the IFRS restriction to FIFO inventory accounting being a particular contentious issue in certain industries.¹²⁹ Significantly, many mention the importance of assuring an “appropriate” level of U.S. input into IFRS.¹³⁰ Apparently, the IASCF’s requirement

126. It famously held its ground against the French banks and their government on fair value treatment on macro-hedging. See Ruder et al., *supra* note 16, at 579–86. More recently, however, IASB’s reputation became tarnished when it relented to European Union pressure to match U.S. adjustments respecting market to market accounting of distressed debt securities in bank portfolios. See, e.g., Phillip Inman, *UK Accounting Watchdog Threatens to Quit Over EU Rule Change*, GUARDIAN (London), Nov. 12, 2008, at 26 (describing the resultant threat to resign of Sir David Tweedie, IASB’s chairman).

127. For a bristling enumeration of unaddressed cost concerns, see Letter from Richard H. Murray, Chairman, Ctr. for Capital Mkts. Competitiveness, U.S. Chamber of Commerce, to Elizabeth Murphy, Sec’y, U.S. Sec. & Exch. Comm’n (Apr. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-184.pdf>.

128. See, e.g., Letter from Robert Traficanti, Vice President & Deputy Controller, Citigroup Inc., to Elizabeth Murphy, Sec’y, U.S. Sec. & Exch. Comm’n 1 (Apr. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-157.pdf>.

129. For a summary of corporate responses, see Letter from Paul J. Cienki, Chairman, Corporate Roundtable on Int’l Fin. Reporting, & Matthew M. Miller, Executive Dir., Corporate Roundtable on Int’l Fin. Reporting, to Elizabeth M. Murphy, Sec’y, U.S. Sec. & Exch. Comm’n (Apr. 20, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-202.pdf>. The writers represent an ad hoc group of seventy-five senior financial executives from thirty U.S. companies, organized to channel reactions to IFRS.

130. See, e.g., Letter from Jamie S. Miller, Vice President & Controller, Gen. Elec. Co., to Elizabeth Murphy, Sec’y, U.S. Sec. & Exch. Comm’n 3 (Apr. 21, 2009), available at <http://www.sec.gov/comments/s7-27-08/s72708-232.pdf>.

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that four of the sixteen IASB seats be taken by North Americans¹³¹ is not seen to assure an “appropriate” level of influence by U.S. management.

D. U.S. Interests in an IFRS World

If the Roadmap in the end takes us to IFRS, what will the new political equilibrium look like? The comment letters imply that the old conflicts will again be acted out in the new global context.

To see why, compare the position taken by the auditing firms with that of the managers. The auditing firms stress that mandated IFRS will work only if U.S. interests, including the SEC, take a deferential posture to the IASB. Under this view, opting in means accepting the IASB and its governance structure as authoritative, even if U.S. interests find the standards produced inappropriate. When the comment letters from management express doubts about the magnitude of U.S. input at the IASB, they, in effect, express doubts about the viability of IASB authoritativeness. Even if IFRS, in its present form, is more congenial to management as a general proposition, there is no guarantee of future suitability. For all anyone knows, the IASB could in the long run compound the problem management has had with the FASB—an independent IASB could start establishing standards the managers dislike without any U.S. actor being in a position to stop it. Now turn to the users, who express concerns about authoritativeness from another point of view. They worry that the IASB, as it goes forward in its amorphous global governance position, will prove subject to the influence of foreign governments and interest groups who lack a commitment to decision usefulness.

Thus the Roadmap raises a political question concerning the framework of relations between the SEC and the IASB. The U.S. could take a deferential posture toward the IASB, as the audit firms are suggesting, or it could follow the European Union and reserve a right to endorse or veto new IFRS promulgations, standard-by-standard. The former choice sacrifices accountability and potentially, national economic interests, while the latter holds out a sacrifice of comparability.

If the U.S. takes a standard-by-standard approach, the Roadmap, in the end, delivers us to a revised domestic politics of standard setting. As

131. See TRUSTEES, INT'L ACCOUNTING STANDARDS COMM. FOUND., CHANGES IN THE CONSTITUTION: REPORT OF THE IASC FOUNDATION TRUSTEES ON PART 1 OF THEIR REVIEW 5 (2009), available at <http://www.ifrs.org/NR/rdonlyres/573E48C3-521C-449E-985F-9A7131CDAC17/0/ConstitutionReviewP1May09.pdf>.

each new standard comes down the production line, the SEC either backs IFRS and lives with dissent at political cost or resolves the conflict by opting out of the IFRS treatment and promulgating its own standard with a consequent sacrifice of comparability and increase in compliance costs.

A posture of deference avoids these problems, but only in theory. In practice, every time the IASB proves willing to go forward with a standard over U.S. objections, whether articulated by management, users, or the SEC, a domestic question concerning the national interest in compliance will arise, with the question once again implicating a trade off between the U.S. interest implicated and comparability. In light of the contentious history of GAAP, it is fair to predict that the comparability line inevitably will be crossed. Given this, one wonders whether deference is politically tenable at the get go considering the nebulous monitoring structure instituted by the IASCF. Deference would put U.S. interests into the hands of a transnational standard-setter whose independence is clouded by financial insecurity and whose public accountability lies with a monitoring board on which the SEC holds only one seat and whose powers are advisory only. Such a set-up will not sit easy with U.S. issuers, users, or politicians.

In the end, all roads on the Roadmap lead to the same end point—a reconstituted domestic politics of accounting standard setting. Assuming that the SEC adopts IFRS in whole, how long will it then take before domestic interests coalesce trumping a new IASB standard? Whether this happens sooner or later, it will indeed happen, and when it does the U.S. IFRS will begin a long, painful process of reverting to U.S. GAAP. Given this projection, convergence emerges a relative rather than an absolute proposition. So the policy question is this: What is the most feasible degree of convergence? This, in turn, suggests that we would be better off sticking with the FASB and the painstaking GAAP-IFRS convergence process.

CONCLUSION

The SEC announced the Roadmap's pending appearance in August 2008, only to delay its release until November 2008. The financial system collapsed between the two dates, with negative implications for globalization imperatives. Matters, such as loss of listing business to foreign markets and issuer comparability in global markets, loom less large when securities issuers and regulators have more pressing economic problems. Issuer comment letters expressing cost concerns underscore the point, concerns now brought forward in the SEC's new

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Work Plan.

Out-of-pocket costs are not the only factor weighing in GAAP's favor. The SEC that produced the Roadmap made the classic mistake of a regulator grappling with business lost due to jurisdictional competition. The earlier global domination of U.S. equity markets gave the U.S. the privilege of imposing its own terms on foreign entities.¹³² Unfortunately, the U.S. can no longer do this. A choice is posed—should the U.S. continue to go its own regulatory way or instead reconstitute its markets so as to catch the at-the-margin consumers now listing securities elsewhere? It is important that the regulator addressing the choice avoids panic¹³³ and takes a capacious view of the costs and benefits. The past cannot be recaptured; something has to be sacrificed. The regulator also needs to remember that the presence of regulatory competition in the fact pattern does not, by itself, imply a policy result. Competition in a global securities market does not have the same economic properties as competition in a market for widgets. Regulation markets are complicated places where costs and benefits do not automatically signal catering to the marginal consumer. Protecting domestic markets must be weighed against global market share and reduction of global market frictions.

The SEC, instead of facing the issues, suffered a global panic attack, truncating its cost-benefit calculus to focus only on interests at the global level. Its new “Work Plan” signals that the panic has passed but without guaranteeing that the matter will be determined in a context free of scare talk and false global policy imperatives.

Meanwhile, the IASB, emboldened by the Roadmap, is starting to show its true colors. Two weeks before the SEC released its Work Plan, the IASB's oversight board announced that it would “emphasise that convergence is a strategy aimed at promoting and facilitating the adoption of IFRS, but it is not an objective by itself.”¹³⁴ In other words, the IASB sees no reason to implement new standards to cater to American tastes in financial reporting, tastes not shared among the preparers on its present roster of constituents. Unfortunately for the IASB, a report in the *Financial Times* read this as abandonment of the convergence objective. There followed a quick retraction by Gerrit

132. See generally Chris Brummer, *Stock Exchanges and the New Market for Securities Law*, 75 U. CHI. L. REV. 1435 (2009).

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

134. Rachel Sanderson, *IASB Softens Stance on Convergence*, FIN. TIMES (London), Feb. 15, 2010, available at http://www.ft.com/cms/s/0/9ac01cde-1a36-11df-b4ee-00144feab49a.html?nclink_check=1.

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Zalm, the Chairman of the Trustees of the IASC Foundation,¹³⁵ but the take-it-or-leave-it point had been made. The SEC's subsequent release of the Work Plan, with its emphasis on further cooperation by the IASB, lobs the ball back over the net. The game's outcome is anybody's guess at this point.

The damage done by the Roadmap is there for all to see. The SEC withdrew its support for the FASB–IASB convergence process. Now it confronts persuasive reassertions of desirability of the convergence process in its own comment file even as the IASB, taking a cue from the Roadmap, signals its disinterest in convergence. How is the SEC to retrace its steps at this point?

A convergence process, by definition, entails adjustments on both sides. That means bargaining, a process undercut when the Roadmap pulled the trumps from the national hand. It is not too late to restore them: the SEC should veer off the Roadmap and return to its base in GAAP. That accomplished, the FASB and the IASB can return to the table to work toward a feasible degree of convergence.

135. See Press Release, Int'l Fin. Reporting Standards, Trustees Clarify Position on IFRS Adoption Objective and Support for Convergence (Feb. 16, 2010), available at <http://www.iasb.org/News/Announcements+and+Speeches/Trusteesconvergencesupport.htm>.