The IFRS [1] accounting framework is commonly called the accounting and reporting Esperanto since IFRS are to the financial communication what the Esperanto is to linguistics: an ambitious project to create a universal economic language for all companies and enable all stakeholders to the financial information of an entity to understand each other, beyond local or industry-specific accounting guidance (1).

ANTOINETTE ESPOSITO-CANO

GLOBAL GAAP – THE NEW ACCOUNTING AND FINANCIAL ESPERANTO?

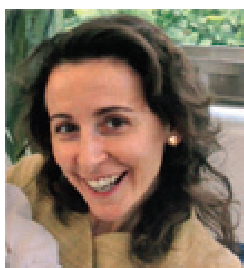
Single model of financial information – a review from the perspective of IFRS and US GAAP

1. INTRODUCTION

It has been nearly a decade since the International Accounting Standards Board (IASB), the standard setter for International Financial Reporting Standards, and its U.S. counterpart, the Financial Accounting Standards Board (FASB), launched the ambitious project of converging the two main "global" accounting frameworks: the IFRS and the US GAAP [2]. The aim was to overcome the national and industry specificities and give birth to a global set of high-quality accounting standards. The Global GAAP were supposed to bring transparency, consistency, uniformity and comparability to the financial information as an answer to the challenging globalization of economies and markets.

Despite all efforts undertaken and results achieved in terms of convergence of accounting and reporting standards, whether by the adoption of IFRS as the national accounting framework (the so-called endorsement approach [3]) or by the publication of local accounting standards similar to IFRS (the so-called convergence approach), there is still a long way to go before any economic transaction receives the same accounting treatment, whether in China, Switzerland, France or the United States.

Furthermore, the 2008 financial crisis seems to have marked a step back to the traditional accounting models, such as the historical cost instead of fair value – to the point that the two standard-setters had to reaffirm several times their commitment to the convergence project. The financial crisis seems to have evidenced the limits of a single model of financial information – and its inability to faithfully reflect certain economic transactions.



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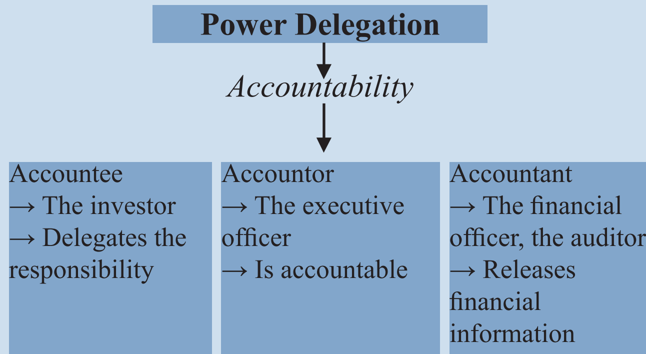
Why do significant divergences still persist, despite all efforts to build a unique accounting framework? Is the goal of convergence and uniformity of accounting standards an objective by itself? In this ambitious project, do IFRS, as a universal accounting and reporting language, constitute a panacea or otherwise a sweet utopia? What will happen to the American accounting framework, often seen as a rival model?

2. ACCOUNTING: THE ECONOMIC LANGUAGE OF A CORPORATION

Christian de Boissieu and *Jean-Hervé Lorenzi,* in their report *Normes comptables et régulation de la filière du chiffre (2),* placed Accounting – and the debate about accounting convergence – as one of the main issues of corporate governance. The reporting and accounting information, as a "channel of communication and representation" for the stakeholders of a company (officers, directors, investors, auditors, counselors, rating agencies, analysts), summarizes not only the legal and tax environment in which a corporation operates but also the relationships around responsibility and control in business administration. The financial information made available to management (reporting) and the financial information released to investors (disclosures) is prepared in conformity with generally accepted accounting standards and is aimed to ensure a perfect connection between the economic reality of a company and the accounting representation of it. The three basic functions of accounting are indeed (3):
→ to record operations (in order to faithfully reflect the economic substance of these transactions); → to measure performance, both in terms of flows (focus on the income statement) and in terms of net assets (focus on the balance sheet) → to exercise control, especially by those who delegate management to the executive officers.

Thus, the linguistic metaphor is often used when referring to accounting because, as for language, accounting results from the need for a representation (which result, which financial position, which commitments?) and for communication (to satisfy the need for control) within a social group (the company and its stakeholders) (3).

Table 1: **THE RESPONSABILITY OF BEING ACCOUNTABLE**



Source : Bibliographic reference (3)

Accounting is the language of Corporate Governance, as running a business relies on the responsibility for executive officers to be accountable towards stakeholders (3), under the managing power that directors and other stockholders have delegated to them (see Table 1).

Therefore, accounting is the language of the economic life of a corporation (4). It is the key element underlying all relationships between the company and its financing providers: by reviewing the financial statements of an entity, lenders seek to assess the recoverability of their loans and receivables; the stockholders' objective will be to evaluate accurately the quality of their investment. As such, accounting is at the heart of the company's human relationships and the accounting language can easily become a factor of conflict of interests or a "power issue", in line with the agency theory [4].

This is the challenging issue behind the current debate around the application of generally accepted accounting standards and the convergence towards a global accounting set of accounting standards. The objective is to report faithfully – and at a lower cost – the economic substance of the transactions and operations in which the company is involved (avoiding the multiplication of specific and fragmented accounting representations) and to reconcile within a sole source of financial information the objectives and interests of each stakeholder of the company: for the shareholder, select the most profitable investments and for the lender, assess the risk of default of the debt instruments issued by the entity. Even if the goals are conflicting, all the stakeholders share in fact the same decision making tool: financial analysis. A unique model of financial information aims to overcome these conflicts and present fairly the financial position of an entity.

3. REPLACING THE ACCOUNTING DEBATE IN ITS HISTORICAL PERSPECTIVE

The year 2002 marked the project of convergence towards a unique model of financial information. Indeed, many events occurred in 2002, which had significant implications for the financial community. Prior to 2002, in the context of national economies with a low degree of integration, the local accounting frameworks were deemed to provide entities with an acceptable accounting representation. Actually, certain authors do not hesitate to compare the financial community of the early 2000s to a huge "Babel Tower" (1): multiple accounting languages were used, often specific to each country. Multiple statutory accounting requirements and many local standard setters co-existed, without much collaboration between them. This 'multiple-accounting' reality made quite difficult – certain would say impossible without significant accounting adjustments – the comparison of financial information for companies operating within the same industry but of different nationalities. International Accounting Standards, then identified by the acronym "IAS" [5], were primarily used as a consolidation tool by listed corporations with foreign operations. Additionally, the IAS had little legitimacy, due to the informal structure of its standard-setter, the International Accounting Standards Committee (IASC), when compared to its American counterpart. The US GAAP, which application was based on very detailed accounting rules, were built over nearly 70 years of accounting and financial history and literature, while the IASC was created in 1973 [6]. More than 150,000 pages of accounting rules (against only 2,500 for the IAS), which left little room for exceptions and interpretations, ensured in US GAAP completeness and accuracy in the accounting treatment of a transaction, regardless of the specificities of the industry or sector of activities[7]. Additionally, the SEC[8], responsible for federal securities laws enforcement and regulation of securities markets in the United States, worked closely with the FASB in providing accounting guidance after reviewing and interpreting accounting positions taken by certain listed entities on new, unusual or complex transactions. The accounting guidelines and financial disclosure requirements promulgated by the SEC had the force of law. The US GAAP were also intended to eliminate any distortion between the economic substance of a transaction and its accounting treatment. There had to be an accounting rule for any economic transaction or trade operation, leaving no room to interpretation or judgment.

In 2002, the Enron debacle and the financial scandals that followed showed cruelly the weaknesses of the American accounting framework and tolled the bell for US GAAP as the best accounting and reporting set of accounting standards. The American accounting framework, based on accounting rules rather than principles, was not infallible. The rules could be circumvented through the creation of certain contractual transactions or complex operations; malpractices were committed, shaking Corporate America after the dot.com bubble burst (see Table 2).

The IFRS replaced then the IAS and arose, through the creation of the IASB [9] as an international standard-setter – independent from governments and state authorities – as an accounting framework that stood up against the US GAAP. While the US GAAP were viewed as rules-based, very detailed and involving the use of quantified thresholds and criteria, the IFRS were viewed as principles-based. Substance prevails over form. The IFRS rely on the use of strong professional judgment (especially in making assumptions and using significant estimates) and on a solid monitoring ground from governance bodies. The IFRS adoption by the European Union as the mandatory accounting framework for European securities markets gave legal legitimacy to the international accounting standards. Europe, "mosaic of

Table 2: **THE ACCOUNTING «TRICKS» OF ENRON AND WORLDCOM**

With the dot.com bubble burst and the accounting irregularities and criminal conduct of some officers, the financial community faced a deep financial information crisis, damaging Corporate America's foundations. The scandals that led to the bankruptcy of enterprises that were considered models of performance and management, such as Enron and WorldCom, cruelly evidenced the gap existing between the economic situation of these companies and its accounting - and financial reporting - representation. The US GAAP accounting rules were deemed to leave no room to interpretation, which would impede creative accounting. But this virtue of the US GAAP turned out to be a fertile ground for accounting engineering, consisting in designing accounting transactions (contractual or financial arrangements) with the sole purpose of circumventing the accounting rules. The main "tricks" used by the Enron's and WorldCom's top management are summarized hereunder (4) (7):

→ Unprofitable and poorly performing investments were taken out of the balance sheet:
This scheme of accounting engineering was based on the creation of financial structures called Special Purpose Entities ("SPE"). These entities were not consolidated since they were owned at less than 50% (the accounting rule of consolidation being then based on the concept of control)[1]. Additionally, regulators had not formally defined the minimum amount of common stock at inception of these SPE vehicles – amount that the SEC implicitly had fixed at 3%. Thus, Enron used to contribute to these SPE its unprofitable assets which were deconsolidated. To attract investors, Enron also used heavy equity-linked collaterals, which, in compliance with the then-applicable accounting rules, were considered to be off-balance sheet commitments to be disclosed in the notes to the consolidated financial statements– quite briefly in the case of Enron.

→ The revaluation of certain assets and recognition of fictitious gains:
Enron also used the SPE scheme to record gains in the consolidated statement of income by artificially revaluating certain unprofitable or impaired assets. This arrangement consisted in entering into a contract with an SPE by which Enron granted to the vehicle the right to use these assets at prices higher than their carrying value. More cynically, Enron even reassessed the entire categories of related assets, based on the assertion that the contractual price was determined to be the best estimate for market prices.
→ The multiplication of complex financial transactions and the use of derivative financial instruments:
Enron entered into many speculative activities through the use of derivatives (on commodities and other financial underlyings) totally disconnected from its core business.
→ No bright line between investments and expenses (7):
For WorldCom, the accounting irregularities consisted in capitalizing operating rental costs for unused Internet networks in order to hide operating losses and meet the performance expectations of analysts. The fraud was detected in 2002 by Cynthia Cooper, a famous whistleblower, who was WorldCom internal control officer, during an audit on fixed assets. Manual entries amounting to hundreds of millions of dollars were actually recorded each quarter in the balance sheet as prepaid capacity (sort of prepaid rights of use), which did not correspond to any "classical" tangible or intangible asset category.

Thus, by designing fictitious transactions and by determining them to be reliable measurement of fair value (4), Enron and WorldCom overestimated the value of their lowest productive assets.

[1] In the case of Enron, the other shareholder was often an officer, such as the chief financial officer for example.

national specificities" welcomed the application of a unique set of accounting standards since accounting uniformity constituted one of the components of the European integration.

In this context, the "Norwalk Agreement", signed in 2002 by the FASB and the IASB, evidenced the willing of both standard-setters for a close collaboration. The aim was to overcome the differences in the accounting representation of economic transactions or, at least, to "make compatible" the two predominant international accounting frameworks. Through the execution of a memorandum [10], the two organizations committed in 2006 to jointly held the convergence project. The first stone for the construction of global accounting standards (Global GAAP) was placed.

4. TRANSPARENCY, UNIFORMITY AND COMPARABILITY OF FINANCIAL INFORMATION – STAKES OF A UNIQUE ACCOUNTING MODEL IN A GLOBAL ECONOMY

People in favor of the accounting convergence project point out the contradiction that exists between the increasing interconnection of markets and the local use of numerous national accounting frameworks. For investors, these accounting pluralities make the financial information less clear, more technical, or even inconsistent: how can the same transaction be translated and recorded in different ways according to the applied set of accounting standards? For corporations that issue financial instruments on capital markets, these multiple accounting transcriptions blur the financial information, which creates "interferences" in their financial communication (9). The proliferation of financial information provided to markets increases volatility, which submits executive officers to the torments of signaling theory. Let's take the example of a high tech company which incurs significant research and development expenditures. In application of IFRS, development costs are intangible assets, reported in the balance sheet, while under US GAAP research and development expenses are operating costs and cannot be capitalized. Irony of this situation: the financial position of this entity is radically different depending on the applied accounting framework. In the first case, the development expenditures reported on the balance sheet increase the value of the company while in the second case, the company becomes poorer by penalizing its income statement with such expenses!

This lack of uniformity generates higher preparation costs for the company. Many sets of financial statements must be prepared according to the different regulations applicable on the markets on which securities of the company are listed. Let's remain on our previous example and imagine that the primary economic environment of this company is the U.S. market (major customers,

key suppliers, key competitors). Its securities are also traded on the NASDAQ. Imagine then that the company, under Dutch law, must apply the IFRS for statutory purposes. This corporation, for the sake of comparability with its peers, will decide to apply US GAAP as its primary financial statements. It consequently needs to prepare two sets of accounts: IFRS financial statements for mandatory statutory reporting and US GAAP financial statements for its primary economic environment. In 2007, as part of the international convergence project, the SEC allowed non-US companies listed on a U.S. stock market to submit their filings in accordance with IFRS [11]. However, our Dutch society will prefer to maintain two accounting standards and will continue to give financial information to the American stock market in compliance with US GAAP. Why such an expensive decision? Also for the sake of comparability, the aim being to facilitate communication with financial analysts and investors whose point of reference and comparison in the economic environment of this company is the US accounting framework. As a conclusion, a single set of accounting standards would decrease transaction costs, increase global comparability for investors, increase efficient allocation of capital and ease cross-board access to capital.

5. THE FIRST STEPS TOWARDS CONVERGENCE: MORE THAN A FIRST DRAFT OF GLOBAL GAAP

Considerable efforts have been made to harmonize the accounting guidance worldwide and, despite the obstacles, the results are there (8). The IFRS are spreading rapidly throughout the world, either by adoption or by convergence (see Table 3).

The cooperation between the FASB and the IASB has paid off and a new accounting framework has gradually been built around new models of accounting, drawing the features of a global set of accounting standards. Challenging issues must be faced, especially in an economic environment that is changing dramatically and becoming increasingly complex. The number of transactions involving financial instruments, derivatives, stock options and other share-based payments, pension funds, goodwill and intangibles keeps growing. New transactions are created, new instruments are invented, and each time they are more advanced, more complex and more innovative. The era of "cognitive" capitalism is characterized by a large number of businesses whose assets are primarily intangible assets (3). The rumors of an upcoming IPO of Facebook, for example, suggest a valuation of the business at $100 billion, putting the social network at the same level of market capitalization as Exxon Mobil, General Electric or JP Morgan Chase, some of the giants of the capital markets [12]. The accounting and valuation models for these new operations must be defined (4).

5.1. A universal measurement unit - fair value. This valuation model is opposed to the historical cost model, whereby the carrying value of an asset is its acquisition cost, adjusted at closing by the amount of amortization or, when necessary, of impairment losses (see Table 4). The latest proposals from the IASB and the FASB on accounting for financial instruments illustrate the contrast between these two approaches. Measuring the value of certain financial assets based on historical or amortized cost does not make sense from an accounting standpoint. The valuation of a portfolio of listed equity securities, for example, should not be based on historical cost since, as instruments of equity, these financial assets are not held for purposes of final repayment at maturity, which corresponds to the features of a debt instrument, not equity.

Table 3: IFRS AROUND THE WORLD
Capital markets in which the use of IFRS is mandatory (M), permitted (P) or under enactment (UE)

Endorsement	Convergence
European Union (M)	Brazil (M)
Russia (P)	India (UE)
Mexico (UE)	China (UE)
Switzerland (P)	Australia (M)
Japan (UE)	
South Korea (P)	
Argentina (P)*	
Turkey (M)	
United States (P)*	
Saudi Arabia (M)**	
South Africa (M)	
Canada (M)	

* Foreign Public Issuers Only
** Banks Only

Source: PwC IFRS adoption by country interactive map; http://www.pwc.com/us/en/issues/ifrs-reporting/country-adoption.

The fair value model (sometimes full fair value [13]) has gradually gained ground in accounting, for the following reasons (4):
→ the increasing role of markets in financing businesses and corporations: the market price (marked to market model) becomes "standard of value". → a high level of market volatility: in order for the financial position to be representative of the economic reality of a business, it must reflect these changes in value. → the weight of pension funds and the increasing use of derivatives. → equity instruments (stock options, shares) granted as remuneration or payment instruments.

The fair value model is consistent with the accounting convergence project since it tends to increase comparability in financial reporting. The market price is actually objective evidence of value when compared to historical cost. The latter corresponds to an accounting representation specific to an entity and the value given in the accounts is determined by the conditions under which the operation was executed. Recently (June 2011), the IASB and the FASB have reached a common definition of fair value and agreed on the disclosures to be included in the notes to the financial statements. The US standard-setter was the precursor on this topic when it defined, in 2007, fair value as "the price that would be paid to sell an asset or transfer a liability in a

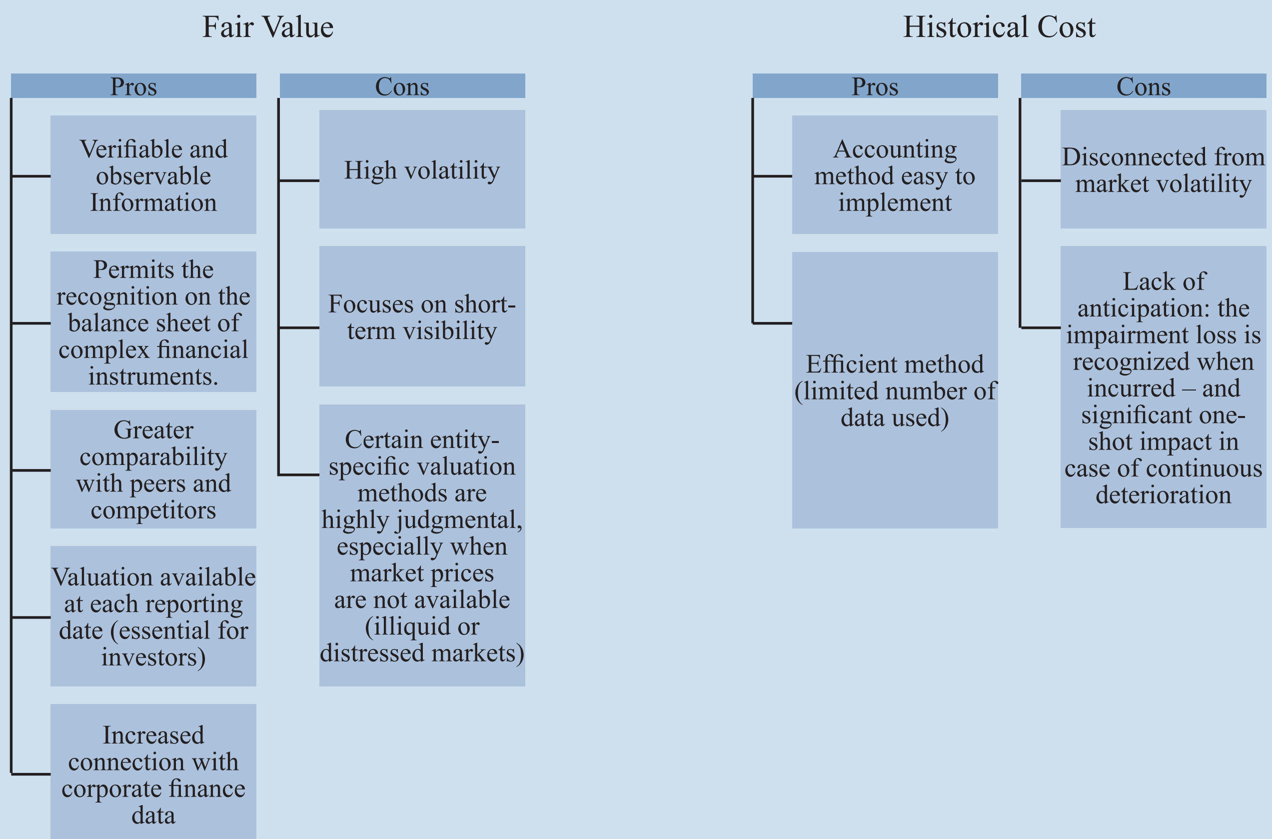
transaction between market participants at the date of valuation [14]". This definition is based on the concept of an exit price rather than an entry price, determined in an efficient market (the market participant is a rational economic agent). With this definition, the revaluation by Enron of an entire category of underperforming assets would not have been possible (see Table 2). The US GAAP has defined in the same accounting standard a hierarchy composed of three levels of fair value measurement:

→ Level 1: quoted prices in active markets for identical assets; → Level 2: significant other observable inputs (estimates corroborated by market data, such as quoted prices for similar assets) → Level 3: significant unobservable inputs.

Detailed disclosures must be provided in the notes to the financial statements on assets and liabilities measured on a recurring and non-recurring basis at fair value. These disclosure requirements include detailed information on assumptions and estimates used to measure fair value for assets and liabilities under the level 3 hierarchy. With the publication in June 2011 of IFRS 13, Fair Value Measurement, the IASB adopted such fair value definition and hierarchy, and the convergence between both accounting frameworks has been, at least on this point, attained. [15].

5.2. Bringing off-balance-sheet transactions onto the balance sheet. The use of fair value as an accounting valuation method is one solution that standard-setters have found to face the increasing number – and growing complexity – of transactions that, due to the lack of appropriate accounting treatment specified in the standards, were considered to be off-balance sheet items. A long and slow process of cooperation –and negotiation – led both standard-setters to agree on the same accounting guidance for some of these transactions in order to reach a single accounting treatment (although certain differences in the application remain). Under IFRS (IFRS 2 [16]) and in US GAAP (ASC 718-20), a share-based payment must be reported in the financial statements. In case of grants of equity instruments (e.g. the grant of stock options to employees) the related compensation is measured based on the fair value of the equity instruments granted. The compensation is a labor cost to be recorded in the income statement. The charge is recognized ratably from grant date over the requisite service period (the vesting period). Indeed, the equity instruments are granted to employees as remuneration – additional to salary – for rendering services during a specified period (often greater than one year). Under the principle that costs must be recorded on the same period as the benefits expected from these expenditures, the compensation related to the grant of equity instruments (stock options, free shares ...) must be

Table 4: **VALUATION AT CLOSING DATE: FAIR VALUE VS. HISTORICAL COST**



Source: Bibliographic reference (9)

recognized ratably over the period during which an employee is required to provide service in exchange for the award granted (see Table 5).

In addition to pension obligations and other long-term and post-retirement benefits, a guarantee – when an entity acts as the guarantor for a third party – is another example of obligations now recognized as a liability and recorded as such in IFRS and US GAAP while it used to be reported off-balance sheet. In 2002, the FASB dealt with this accounting issue – Enron had used heavy collaterals to deconsolidate unproductive assets (see Table 2) – and released Interpretation No. 45 (FIN 45). An entity that acts as a guarantor for a third party [17] must record a liability corresponding to the fair value of such guarantee, the liability being extinguished over the guarantee period. Again, fair value is central to the accounting treatment. In 2005, the IASB adopted the same view and modified the scope of IAS 39 to include financial guarantee contracts. An alternative accounting treatment is permitted to guarantors: either these commitments are accounted for under IAS 39 as amended, or they fall within the scope of IFRS 4 dealing with insurance contracts. In both cases, the principle is the same: the issued guarantees are no longer off-balance sheet items.

One of the most critical elements for a unique financial reporting model is the accounting treatment of financial instruments, derivatives and other hedging transactions. The financial crisis has indeed propelled this issue at the top of the accounting debate. The IASB and the FASB continue to work to align accounting models for the products of a complex and multifaceted financial sphere, which sometimes takes over the economic world. The common denominator to these accounting issues for financial instruments, particularly derivatives and hedging instruments: they correspond to assets and liabilities to be recorded in the balance sheet and evaluated at fair value.

5.3. Comprehensive income, revenue recognition, leases - the first effects of an accounting revolution. For nearly a decade, the IASB and the FASB have worked for the creation of a single model of financial reporting. Efforts were not vain and great progress has been made. The memorandum of understanding for international convergence signed by both standard-setters includes a number of accounting issues on which the FASB and the IASB are committed to work in priority, such as: → financial instruments and hedge accounting; → leases; → revenue recognition; → consolidation; → insurance contracts; → presentation of comprehensive income; → valuation at fair value; → provisions and contingent liabilities, → pensions and other postemployment benefits → presentation of the financial statements; → emission trading schemes.

5.3.1. Global GAAP: a comprehensive approach of net income. A first "innovative" accounting concept: comprehensive income. The valuation at closing date of certain assets and liabilities at fair value generates a second issue: how – and where- to reflect these changes in value in the financial statements? Indeed, the notion of unrealized gain or unrealized loss carries a contradiction: how to account in the income statement a gain or loss that has not yet been incurred? If, in a given period, an asset is sold with a gain, the gain on the sale is an income of the period. But is it fair to reflect in the income statement an income generated by an increase in fair value while the asset has not been sold yet? To answer this question, the global GAAP have expanded the notion of "result" to a broader concept: the comprehensive income [18]. The comprehensive income is composed of the net result as reported in the statement of income and the "other comprehensive income [19]" ("OCI"). The latter, reported in equity, includes deferred changes in value and revaluation reserves, which will be "recycled" in earnings when the underlying transaction generating the actual gain or loss will occur. Thus, changes in fair value of certain hedging instruments (cash flow hedge) or financial assets classified as available-for-sale are recorded in OCI at closing date and will be recorded in the income statement when the underlying transaction will affect earnings (e.g. occurrence of the forecasted hedged transaction or sale of the financial asset).

This new comprehensive income accounting concept has resulted in a change in the presentation of financial statements. In June 2011, the FASB issued new guidance for the presentation of comprehensive income. The new guidance eliminates the current option to report Other Comprehensive Income and its components in the statement of changes in equity. An entity can elect to present items of net income and other comprehensive income in one continuous statement – referred to as the statement of comprehensive income – or in two separate, but consecutive, statements. Each component of net income and each component of OCI, together with totals for comprehensive income and its two parts, would need to be displayed under either alternative. The statement(s) would need to be presented with equal prominence as the other primary financial statements.

5.3.2. Global GAAP: Let's revisit revenue recognition. To overcome their differences, the two standard-setters have not hesitated to take sometimes a third way on the path of convergence by designing new accounting approaches. This is the case of the exposure draft issued jointly by the FASB and the IASB about revenue recognition and leases, two revolutions for

Table 5: **EXAMPLE OF SHARE-BASED PAYMENT**

On January 1, 2010, a company involved in research and development activities grants 100,000 free shares to three of its engineers. The right to these shares will vest within three years (i.e. the engineers must remain employees of the company for the next three years, until January 1, 2013). The fair value of the shares on January 1, 2010 (grant date) is CHF 10. The total compensation amounts to CHF 10 * 100,000 = CHF 1 million, recognized for 1/3 in 2010, 1/3 in 2011 and 1/3 in 2012 (assuming that none of the three engineers resigns before January 1, 2013). The compensation is assimilated to an employee benefit and charged to earnings, the credit side of the entry being equity (future dilution).

issuers and users of financial statements [21].
Revenue recognition is deeply redesigned to overcome specificities in certain industries and provide a global accounting model, applicable to any transaction generating income. If the exposure draft under discussion were ratified as it is, resulting in a final jointly issued standard, revenue recognition would follow the following five-step process:

1. Identify the contract(s) with the customer:
This step aims to determine if certain contracts with the same customer must be combined and determine the level of transaction at which revenue recognition is to be performed.
2. Identify the Separate Performance Obligations in the contract:
This concept of se*parate performance obligations* overpasses the simple view that the company sells one or more services, one or more products. The sale of one product may, for example, imply several separate performance obligations. The sale of software often includes a warranty commitment and additional services related to the software, such as training, upgrade or maintenance services. In order to assess revenue recognition, these separate performance obligations must be identified.
3. Determine the Transaction Price:
This concept aims to cope with complex billing processes, specific to certain industries. The transaction price may actually have fixed and variable components or certain elements of the transaction price may be conditioned to the achievement of future performances (e.g. the payment of royalties in the event of future sales). Determining the transaction price is highly judgmental and involves the use of significant estimates based on probability computations.
4. Allocate the Transaction Price to the Separate Performance Obligations:
Once the Transaction Price is determined, it must be allocated to each performance obligation identified in step 2. This allocation is based on the standalone selling price of each performance obligation taken individually (market value).
5. Recognize revenue:
In this last step, the entity will determine when it must record the portion of revenue allocated to each performance obligation (at the time of product delivery, once the service is provided or over the service period).

The exposure draft developed jointly by the two standard-setters was re-exposed for comments last June, and a final accounting standard is expected for, at the earliest, 2012 (but its application is not expected before 2015).

5.3.3. Global GAAP: All leased assets financed through debt?
Leases are undoubtedly the most controversial accounting discussion at the time. The question raised by the standard-setters is the following: does a lease agreement correspond, in substance, to the acquisition of an asset financed through debt? From an economic standpoint, the lease of an asset is actually a way to issue a financing agreement in which the lessor is the lender and the lessee the borrower. The future lease payments meet the definition of debt: a schedule of financial flows defining the terms of repayment of the funds and the lender's remuneration during the period of use of the leased item.

The currently applicable accounting standards [22] already answer partially this issue, since both IFRS and US GAAP distinguish between operating leases (where rental has no investment purposes) and capital or financial leases in which the lessee controls the use of the leased asset and acts, consequently, as its economic owner (see Table 6).

While IFRS and US GAAP share on this point the same conceptual view, they differ in application, since US GAAP are primarily based on rules, less judgmental than the principles-based IFRS accounting framework. Thus, criteria 3 and 4 (see Table 6) are quantified in US GAAP, while they are based on qualitative assessment under IFRS. Does this reflect a lack of rigor from the IASB? The criticism would be hasty. The IASB has just learned from the misadventures of Enron and WorldCom: accounting rules can lead to bad accounting by excess of formalism.

Consider the following example: a company with a weak capital structure (high debt to equity ratio) needs to make a strategic investment (e.g. acquisition of machinery). Short in cash, this entity also seeks to raise funds to finance its working capital. A new loan to finance the investment would increase its debt ratio, further degrading its capital structure and jeopardizing working capital financing. Under US GAAP, a lease arrangement designed as an operating lease would enable the company to lighten its debt. The terms of the agreement can for example include a lease term that is less than 75% of the economic life of the leased machinery. If the estimated use life is 8 years, for example, a contractual lease term of 5 years and 9 months (72%) can be agreed instead of, say, 6 years. The present value of future lease payments could also be determined in order to represent 85% of the fair value of the leased machinery (which is below the threshold stipulated in the standards). The IFRS would not allow this kind of "bypass" on the accounting principle and the economic substance of the transaction would prevail. Professional judgment would conclude that a ratio of 72% on the lease term criterion and a ratio of 85% on the value criterion correspond to the major part of useful life and fair value, respectively, thus having to classify the lease arrangement as a capital lease and recording a new debt in the balance sheet.

The proposed new accounting standards for leases go further by eliminating the accounting treatment of operating leases. The distinction between operating leases and finance leases disappears, establishing a single accounting model for lessees. Don't financial analysts and credit rating agencies adjust the consolidated balance sheets of public companies by reintegrating in their computation of debt ratios all commitments for lease payments (as disclosed in the notes)? The exposure draft on lease accounting currently under discussion states that a lease should be reflected in the financial statements as follows:
→ recognition of an asset representing the right to use the leased item during the lease term; → recognition of a liability for the lessee's obligation to pay future lease payments to the lessor.

Deliberations and debates on this project are numerous and animated, but the recent position of the IASB and the FASB

has been to reaffirm the single accounting model for lessees. The exposure draft is still under discussion. The two standard-setters have recently decided to re-submit the exposure draft for comments. The final standard is expected for, at the earliest, 2012.

Other advances of the international convergence project, no less critical than those developed in this article, have helped to give shape to a single set of accounting standards. These include the last standards published in May by the IASB on investments: IFRS 10, Consolidated Financial Statements, IFRS 11, Joint Arrangements and IFRS 12, Disclosure of interests in other entities. With the publication of these standards, the IASB and the FASB have come closer to a common solution to supersede the conceptual divergences between IFRS and US GAAP on consolidation. In the U.S., the Enron SPE arrangements have shown that the notion of control (an equity investment is considered to be a subsidiary to be consolidated with a stake percentage greater than 50%) is not sufficient to justify consolidation - or deconsolidation - of a subsidiary that de factowould serve the interests of the holding company, even at a minority stake. That is why the FASB chose in 2003, with the publication of FIN46R [23], to adopt a consolidation model based on interest rather than control. The equity investments in which a company holds a variable interest (Variable Interest Entities, or "VIE") must be consolidated if the company is determined to be the primary beneficiary. With the publication of IFRS 10, the IASB has developed a single consolidation model that acknowledges that a company can hold a minority interest in an investee to be consolidated when it has power, exposure to variability in returns, and a linkage between the two. Finally, with the publication of IFRS 11, the IASB consolidation model eliminates the so-called "proportional consolidation method", prohibited in US GAAP. One more step towards Global GAAP; one more stone to build a single accounting framework; an accounting and reporting Esperanto under construction.

6. GLOBAL GAAP: THE MYTH OF SISYPHUS?

"and I saw Sisyphus in violent torment, seeking to raise a monstrous stone with both his hands. Verily he would brace himself with hands and feet, and thrust the stone toward the crest of a hill, but as often as he was about to heave it over the top, the weight would turn it back, and then down again to the plain would come rolling the ruthless stone. But he would strain again and thrust it back, and the sweat flowed down from his limbs, and dust rose up from his head." *Homer*

Some believe that building a single set of international accounting standards is a herculean undertaking. For others – the most skeptical – the advent of Global GAAP is a sweet utopia, the illusion of perfection in financial reporting, and the quest for the Holy Grail of the standard-setters. Like Sisyphus, the hero of the Greek mythology, the IASB and the FASB are quite successful, on some accounting issues taken individually (business combinations, share-based payments, assets to be disposed of by sale...), to heave the convergence stone over the top of the Global GAAP mountain. Unfortunately, once the convergence is reached for one issue, another divergence appears or is confirmed, and everything has to start all over again. Macroeconomic events undermine the convergence project. New breaches open. The 2008 financial crisis has questioned the consistency of the fair value model. Just as US GAAP in 2002 with the bankruptcy of Enron and WorldCom, the IFRS have not been able to predict the collapse of Lehman Brothers or reflect in the financial information released to investors the financial systemic risk represented by the Too Big To Fail financial institutions (10) (11). The most alarmist rumors circulate about the IFRS transition in India (some say it is difficult, other predict

Table 6: **IFRS AND US GAAP CRITERIA FOR DESIGNATION OF A FINANCIAL LEASE**

	IFRS	US GAAP
Criterion 1	The lease transfers the ownership of the asset to the lessee by the end of the lease term	The lease transfers the ownership of the asset to the lessee by the end of the lease term.
Criterion 2	Bargain purchase option	Bargain purchase option
Criterion 3	The lease term covers the major part of the economic life of the asset.	Criterion is quantified at higher than 75%
Criterion 4	At the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.	Criterion quantified at higher than 90%
Criterion 5	The leased asset is of a specialized nature such that only the lessee can use it without major modifications being made.	Not specified
Indicators of situation	If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee.	Not specified
	Gains or losses from the fluctuations in the residual fair value fall to the lessee.	Not specified
	The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.	Not specified

possible setbacks). Japan, upon the disastrous consequences of the tsunami, announced last June that it may delay its conversion project. The latest issued standards, too complex in their application, too heavy in their disclosure requirements seem to be too burdensome. Most of the stakeholders have lost sight of the purpose of these disclosures. In some countries, like Switzerland (12), there is a turning back to national standards and traditional models of accounting. The idea that the IFRS would represent an Anglo-Saxon point of view serving financial markets' interests is gaining pace. The IFRS are believed not to fit to the economic reality of local economies, composed largely of small and medium-sized enterprises. The success of the IFRS for SME and the formation in the US of a working group dedicated to private companies, the Blue Ribbon Panel [24], evidences that belief. The deadline on priority convergence issues, previously set for June 2011, has been rescheduled to the end of the year. The SEC, which was to take position in June 2011 on the adoption of IFRS in the US, announced last May that it would take the time for transition (not before five to seven years) by proposing a process of "hybrid" convergence with a complicated name invented for the occasion: the condorsement (contraction of convergence and endorsement) (see Table 7). The US GAAP, before dying to give birth to IFRS as the U.S. set of accounting standards, will have to reach an acceptable level of similarities with the international accounting framework. On each of these announcements, the stone of convergence rolls down the hill. Like Sisyphus, the standard-setters have to start over again.

6.1. Fair value questioned. As we enter into the post-Lehman Brothers era, it is quite interesting to read what economists, experts and specialists wrote on fair value accounting after the dot.com bubble burst and the Enron and WorldCom scandals. In this regard, the essay Les normes comptables et le monde post-Enron, published in 2003, is very instructive (2) (3) (4) (5). Jacques Mistral highlighted the risk in using valuations at fair value, which is more "a seductive theoretical reference than a rigorous guide in accounting" (4). This theoretical model is the best response in case of liquid and efficient markets, but in case of distressed markets, mark to model takes step over mark to market. The assessment becomes highly judgmental and the evaluation of assumptions and estimates becomes much more difficult. The risk of manipulation is increased. We are then quite far away from the objective of higher comparability in financial information that the defenders of the fair value model cherish. While the fair value model is supposed to connect accounting to economics, it takes the financial information away from the real sphere as it is built on complex engineering models disconnected from economic reality. Additionally, with a higher degree of volatility in the income, it is becoming more difficult to read the performance generated from operations. Another criticism made to the fair value model: it works on a short-term basis and it is not suited for the illiquid assets that the company wants to hold until maturity, which is not consistent with the going concern principle (9).

The reactions in 2000 of the Federal Reserve Board and the Basel Committee to the proposals of the FASB and the IASB on IAS 39 [25] appeared to be (4), in light of the 2008 financial crisis, almost premonitory:
→ the fair value model is not adapted to the nature of the balance sheets of banks; → the volatility of this model makes the prudential approach more fragile → the risk of manipulation of assessment models is increased → market analysts prefer to get as reported accounting information and make their own adjustments. This last point is particularly interesting in the perspective of the lease accounting joint project, for which a strong argument is that the recognition of all lease arrangements in the balance sheet will be in line with and will improve analysts' job.

The strongest critics came primarily from two sectors: banks and insurance companies, the two sectors that shook the the financial world in 2008. Let's take the case of Lehman Brothers. It adopted in 2007 Financial Accounting Standard No. 159 [26], which permits to elect the fair value option to measure certain assets and liabilities at fair value (fair value variations being immediately recognized in earnings). This standard was published for IFRS convergence purposes, since IAS 39 already permitted this fair value option. While the financial position of the Bank deteriorated, the value of its debt securities (bonds) collapsed; mechanically, the amount of debt liabilities fell, thus creating a profit, despite all financial logic. The accounting representation of a bank in full financial meltdown and close to bankruptcy was... gain recognition in the income statement.

Another overwhelming fact: it was thought that the accounting irregularities committed by Enron and WorldCom earlier in the decade were stories of the past. US GAAP, in contact with IFRS, were supposed to give more weight to accounting principles, the ethical foundation of accountability and to corporate governance. Within investigations around Lehman Brothers bankruptcy, certain accounting treatments are being questioned, such as the accounting of repos 105 [27] (11) (10). The collapse of the U.S. banking giant could be due not only to the subprime crisis, but also to questionable accounting treatment of certain transactions.

6.2 Financial and hedging instruments – the eternal disagreement. Much is expected on the convergence project for financial instruments. This sub-project has four components:
→ financial assets; → financial liabilities; → impairment; → hedge accounting.
On this topic, the IASB and the FASB seem to work separately and quite in different directions. Unlike leases and revenue recognition, both organizations have not published a joint exposure draft on financial instruments. The IASB is a step ahead. IFRS 9 [28], dealing with financial assets, has already been published while the FASB is still working on an exposure draft. The IFRS 9 was amended in 2010 to incorporate provisions related to financial liabilities. The IASB has recently proposed to delay the date of adoption of the standard to January 1, 2015.

Regarding the impairment of financial assets, the comment letters received from financial institutions is instructive. Two worlds – and two accounting views – are emerging: U.S. banks

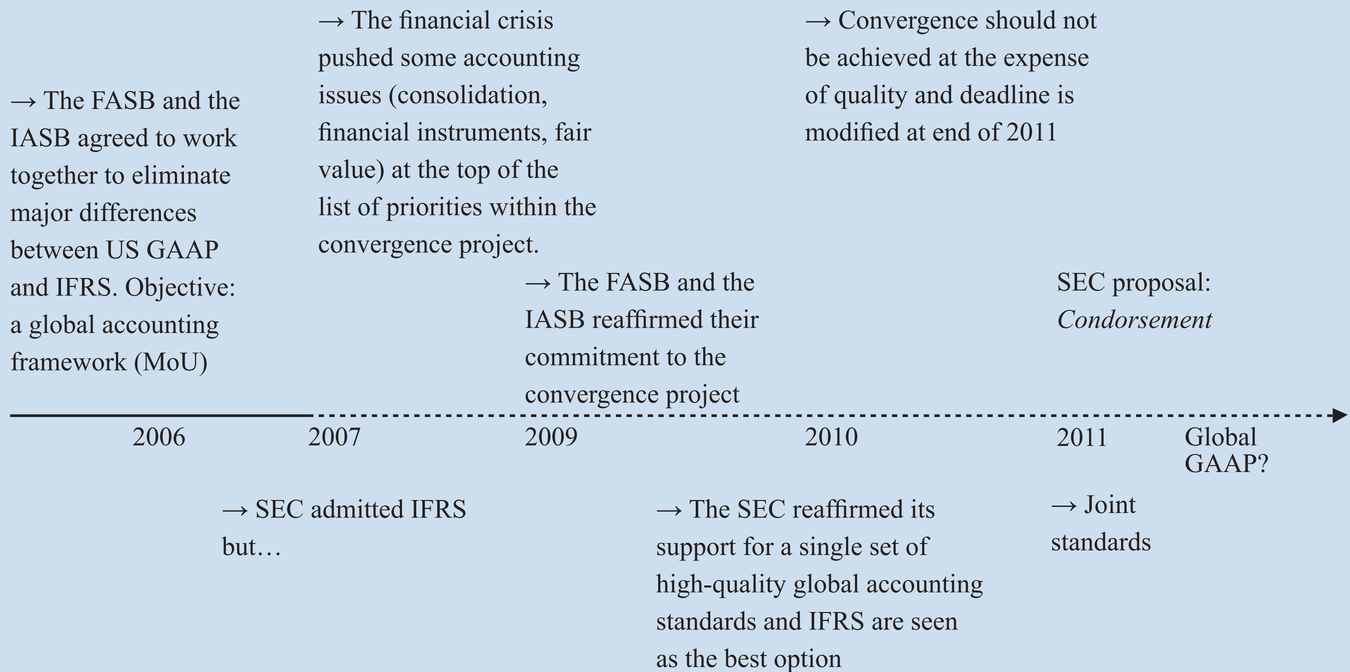


Table 7: **CONVERGENCE PROJECT: THE ROAD TOWARDS GLOBAL GAAP**

and European banks, whose opinions, in many respects, diverge.

The progress on hedge accounting is the most disappointing of all. The IASB appears to be ambitious, seeking to simplify hedging designation and documentation guidance in order to align Corporate Accounting with the strategic objectives of Corporate Treasury. The U.S. approach is different. The FASB is more cautious in its proposals. It is also regrettable that differences in the application of hedge accounting to certain operations, which after all are very common (such as hedge of intra-group transactions or the designation of combined options as hedging instruments), are not resolved.

6.3 US GAAP vs. IFRS – significant conceptual differences remain. Differences in accounting between IFRS and US GAAP are still numerous and it is not the purpose of this article to list them. However, the number of conceptual differences, even if significant in their magnitude, is limited. It is therefore surprising that after a decade dedicated to the emergence of a single set of accounting standards the IASB and the FASB have not committed to resolve these differences first. In addition to the contrast between principles-based standards (IFRS) and rules-based US GAAP, the following conceptual divergences should be highlighted:

→ revaluation of tangible assets, permitted by IAS 16, Property, Plant and Equipment, but prohibited in US GAAP; → the component approach, applied for the depreciation of tangible assets (IAS 16), not stated in US GAAP; → accounting for compound financial instruments, or hybrid financial instruments (e.g., a convertible bond), where in IFRS the split accounting is applied, consisting in recording separately the debt component of the instrument from the equity component (e.g. the equity conversion option); → capitalization of development costs (IAS 38, Intangible Assets), recognized as intangible assets under IFRS and as charges in US GAAP. The latter is particularly interesting in the current era of cognitive capitalism. The assets of innovative companies (Google, LinkedIn, Facebook, Yahoo! ...) are dematerialized. Why, in this context, the IASB and the FASB don't explore, as they did for leases and revenue recognition, the path for accounting innovation by offering a new accounting model that supersedes their divergence on this point?

7. THE LIMITS OF UNIFORMITY IN CORPORATE ACCOUNTING

7.1. Even in accounting, everything is a matter of culture and national sovereignty. The primary functions of accounting are to fulfill tax and statutory requirements, despite globalization of economies and markets. This explains the resistance of certain local accounting frameworks to the IFRS / Global GAAP wave. Table 3 shows the acceptance of IFRS on capital markets in major countries, most of which are part of the G20, but that does not mean that IFRS is, or will naturally be, the statutory and tax financial framework in these economies. The European Union is a representative example of this situation. The EU is also a unique historical case where the political power agrees to delegate authority to a private global organization (5), a step that the United States seems more reluctant to take.

In France, predominance is given to the State as a user of the financial information (for tax purposes), while in Germany, primacy is given to the lender. Thus, accounting standard-setting authorities are different in these two countries: the Ministry of Economy and Finance in France, the Ministry of Justice in Germany [29]. Anglo-Saxon reality is quite different. In the United States, the financial information is mainly used by

investors and the regulation body of financial information is the SEC. Thus, other stakeholders also interested in having visibility over the financial position of the Company (e.g. lenders) have a hard time finding their objectives covered by the Anglo-Saxon accounting models whose underlying reference is the market. How can IFRS, as applicable local accounting standards, overcome this contradiction to meet interest and expectations of the diverse stakeholders using the financial information? This also raises the question of capital market regulation in Europe. If convergence to IFRS as future global GAAP is a prerequisite for European integration, the endorsement of accounting standards by the European Union does not seem sufficient. In 2003 the question was already asked (2): When will a European SEC be created?

7.2. The accounting language carries its own onomatopoeia. Who could distinguish the call of a French rooster from the one of an English rooster, or of a Spanish one? The animal is the same, regardless its nationality! Yet a French person will reproduce the call by a proud "cocorico", an English man will hear a phlegmatic "cock-a-doodle-doo" and a Spaniard a flaming "quiquiriqui". It is the same in accounting. Where the U.S. accountant sees an expense, the European one can see an investment. Accounting for development costs, as described above, demonstrates the foregoing. A convertible bond is a debt for the accountant across the Atlantic, just like a classical bond, while his European colleague will see two radically different financial instruments to be accounted for separately. It is interesting to mention that one of the major difficulty of the IFRS adoption project in Japan is the translation of the standards to transcribe the text as fairly as possible, taking into account all the nuances of the Japanese language. This reference to linguistics tends above all to remind that accounting is a human representation and is more a social science than an exact one. The "multiaccounting" reality is also multicultural. Is the cultural uniformity possible? Is it really to be desired?

8. CONCLUSION

A new accounting representation for a new representation of corporations

The accounting language is plural because it changes according to the party to whom it is addressed. Thus, "all companies have the same economic language – accounting – but not all speak the same language" (3). Within the company, the accounting languages are many: there is, for example, internal and external reporting, statutory and consolidated financial statements, tax reporting. Some are not more accurate than others. They aim to cover the needs of each specific stakeholder. The "vain and reckless pursuit of accuracy" (2) in the construction of a global set of high-quality accounting standards would be dangerous, and would represent significant costs for corporations.

Accounting languages differ among themselves depending on the specific legal, statutory and cultural specificities of their environment. U.S. GAAP illustrates this point very well. The complete list of accounting rules full of formalism corresponds to the specificities of the American legal system and practice of claims, lawsuit filings, and legal disputes. (2).

Two theoretical concepts of a business exist (2):

→ the company viewed as an issuer of financial instruments (debt and equity securities), the objective being to create and maximize value for investors. In this model, the financial information is primarily addressed to stakeholders.

→ the company viewed as an economic institution, in which value is created through the interaction of various stakeholders in an economic, social and environmental environment increasingly globalized. One of the goals of the business in this model is to increase social responsibility and accounting serves all users of the financial information. It creates the social link between the community of stakeholders and the corporation.

In this final conception of the company, the new accounting and financial Esperanto is still to be invented.

Notes: * The article summarizes topics dealt with in the Seminar held on 22.9.2011 in Lausanne, Switzerland: "Accounting Standards – Several accounting representations for the same economic reality?". The conclusions of this paper are based on the status of standards and of the international convergence project as of July 31, 2011. **1)** International Financial Reporting Standards. **2)** Generally Accepted Accounting Principles in the United States of America. **3)** Trad.: adoption, approval, promulgation. **4)** Shareholders take the risk of the "industrial adventure" of the company, with no guarantee of future rewards and remuneration [6]. In this, shareholders take much more risk than lenders. The latter has in fact a contractual right, materialized in the loan agreement, through the obligation of the company (the borrower) to repay principal and interest as determined therein. In addition, shareholders appoint executive officers to run the business, and delegates therefore a part of their management power. It is then crucial that management acts in the interest of shareholders and not in their own interest. Similarly, lenders must ensure that management takes decisions that do not jeopardize their own interests by pushing the company into situations of illiquidity, insolvency or bankruptcy. **5)** International Accounting Standards. **6)** The FASB was also established in 1973, but the SEC as a regulatory body, is much older than the IASC. **7)** Very detailed accounting rules exist to address the specificity of certain industries such as oil and gas or mining, media, entertainment and telecommunications. **8)** Securities and Exchange Commission. Independent regulatory body established in 1934 following the Great Depression, which was at the time also considered as a financial information crisis. **9)** The International Accounting Standards Board ("IASB"), modeled as its U.S. counterpart, the FASB, replaced the IASC. **10)** Memorandum of Understanding ("MoU"). **11)** Until 2007, non-US companies could submit financial statements in accordance with IFRS but were required to prepare and disclose in their filings with the SEC a reconciliation (equity and earnings) between IFRS and GAAP. This requirement was abolished in 2007. **12)** What We Know About the Facebook IPO - the Wall Street Journal, June 17, 2011. **13)** When all balance sheet items are valued at fair value. **14)** Financial Accounting Standard No. 157, Fair Value Measurement. **15)** Previously, the IFRS definition of fair value was closer to an entry price: "The amount for which an asset could be exchanged or a liability settled, between knowledgeable and willing parties in an arm's length transaction." **16)** IFRS 2, Share-based Payments. **17)** In case of default of the guaranteed party, the guarantor stands ready to pay in lieu of the borrower. **18)** In English, Comprehensive Income. **19)** In English, Other Comprehensive Income. **20)** ASU 2011-05. IFRS included this modification to the financial statements as early as 2007 (IAS 1 revised). **21)** The process for publication of a new standard is as follows: the standard-setter submits an exposure draft to comments from constituents, who respond, until a given deadline for comments, through comment letters. The standard setter receives and reviews all comment letters and amends, or not (the position is always motivated) the exposure draft. The final standard is then published. For the revenue recognition exposure draft, more than 1,000 comment letters were received, a record in the history of accounting standards. 800 comment letters were received on the proposed joint standard for leases. **22)** IAS 17 and IFRIC 4 for IFRS, standards FAS 13 and EITF 01-8 (now codified in accounting ASC 840) for US GAAP. **23)** FASB Interpretation No. 46 (revised), Consolidation of Variable Interest Entities ("FIN 46R"). **24)** Working and consultation expert group set up in the United States to determine the most appropriate set of accounting standards for private companies. Among its proposals: amendments to US GAAP to make them more consistent with the economic environment of SMEs and the creation of an independent standard-setter for private companies. **25)** IAS 39, Financial Instruments: Recognition and Measurement. **26)** Financial Accounting Standard No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. **27)** Interpretation according to which these short-term borrowings were not recognized in the balance sheet as liabilities, improving the debt ratio of the bank. **28)** IFRS 9: Financial Instruments (Phase 1: classification and valuation of assets and liabilities). **29)** The bankruptcy law is the last protection of the lender when the shareholder exercises its right to "default".

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