

THOMAS R. CARPER, DELAWARE, CHAIRMAN

CARL LEVIN, MICHIGAN
MARK L. PRYOR, ARKANSAS
MARY L. LANDRIEU, LOUISIANA
CLAIRE McCASKILL, MISSOURI
JON TESTER, MONTANA
MARK BEGICH, ALASKA
TAMMY BALDWIN, WISCONSIN
HEIDI HEITKAMP, NORTH DAKOTA

TOM COBURN, OKLAHOMA
JOHN MCCAIN, ARIZONA
RON JOHNSON, WISCONSIN
ROB PORTMAN, OHIO
RAND PAUL, KENTUCKY
MICHAEL B. ENZI, WYOMING
KELLY AYOTTE, NEW HAMPSHIRE

United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510-6250

October 14, 2014

VIA U.S. MAIL & EMAIL (glhinchman@F-A-F.org)

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Convergence That Isn't Working

Dear Chairman Golden:

I am writing to express my continued concern over the efforts of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to converge U.S. generally accepted accounting principles (GAAP) and the International Financial Reporting Standards (IFRS). FASB and IASB have been working on the convergence project for more than a decade and have produced a set of new standards with many troubling features. I fear that the convergence project as a whole, as well as FASB's most recent efforts to converge revenue recognition standards, are undermining U.S. financial reporting integrity.

The United States has the largest, most efficient, and deepest capital markets in the world, and it has attracted and fostered more foreign investment than any other market. One of the reasons for this success has been our transparency, requirements for full financial disclosure, and, above all, active oversight and regulation of our markets. U.S. GAAP has been the gold standard for financial reporting requirements and has contributed to this success. In contrast, the IFRS rely more on principles than requirements, invite multiple interpretations, have been more difficult to enforce, and have been subjected to abusive practices to circumvent effective accounting disclosures. In many instances, IFRS permit less transparency and greater variations in financial reporting than GAAP. Given past convergence efforts, the U.S. may be left with a principle-based approach which is less precise and won't guarantee the same level of trust and reliability as GAAP, weakening U.S. standards and offering less investor protection.

Relaxation of Revenue Recognition Standards

FASB and IASB's recent announcement regarding the newly converged revenue recognition standard illustrates the problems. On May 28, 2014, FASB issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), describing the new standards. The new approach includes principle-based standards and requires an entity to use estimates more extensively than permitted by GAAP. Although FASB and IASB

initiated the project to clarify the principles for recognizing revenue and to develop a common revenue standard that could be used for domestic and cross border financial reporting, the new standards appear to have weakened U.S. GAAP revenue recognition standards and may open the door to greater revenue recognition abuses.

U.S. GAAP provided industry-specific guidance standards for revenue recognition. The U.S. Securities and Exchange Commission (SEC) interpreted certain of those revenue recognition standards for financial statement reporting in Staff Accounting Bulletin No. 101 (SAB 101). The staff noted that revenue should not be recognized until it is realized or realizable and earned. More specifically SAB 101 requires that collectability from the customer must be “reasonably assured” in order for revenue to be recognized. That meant that there must be a high probability that a manufacturer will receive payment from a customer, even when goods have been delivered, before revenue may be recognized. For example, a manufacturer sending goods to a distributor who has the option to return unsold goods to the manufacturer did not lead to revenue recognition merely upon delivery of goods under GAAP.

With convergence, however, the GAAP standards are replaced with a generalized approach based upon contractual relationships between sellers and customers. The new convergence standards provide a principle-based set of rules for accounting for revenue. They allow an entity to recognize revenue as it transfers goods or services to customers in an amount reflecting the revenue it expects to receive. The new approach allows the recognition of income as soon as a business sends inventory to a distributor instead of allowing a company to declare income only when the distributor actually sells that inventory to a third party. This approach invites a repetition of past revenue recognition abuses in which manufacturers recognized revenue when they sent inventory to a distributor at the end of a quarter, only to have that inventory returned after the quarter-end due to a lack of sales. The new standards make it much more difficult to combat that type of deceptive financial reporting.

Need for Anti-Abuse Rule

The convergence revenue recognition standards allow an entity to use estimates more extensively and exercise more subjective judgments than previously permitted under GAAP. Finance executives and corporate accountants will have to, and will be encouraged to, use their judgment much more than they’ve ever had to before. Given competitive pressures and the history of accounting abuses over the last two decades, greater reliance on management judgment to ensure proper accounting disclosures does not build confidence. Shifting from a detailed rules-based approach to a more generalized principles-based approach creates greater opportunities for abuse and, if some companies take advantage of the looser rules, creates greater competitive pressures for other companies to follow suit. The convergence standards simply offer less investor protection and may return us to a time when financial reporting fraud was more prevalent.

Convergence was intended to take the best attributes from both GAAP and IFRS to produce accounting standards that would improve world-wide accounting disclosures; instead, it seems to be resulting in a convergence on the weakest rules from each. FASB also seems all too willing to surrender U.S. control over its accounting standards to follow IASB’s lead, despite the

fact that the SEC delegated its standards-setting authority to FASB, not IASB, under Section 108 of the Sarbanes-Oxley Act. I urge FASB to reorient its participation in the convergence project to ensure that the convergence standards reflect the best, not the weakest provisions, in the two systems. In particular, FASB should consider strengthening the new standards for revenue recognition. At a minimum, FASB should issue anti-abuse rules to combat the potential misuse of the principle-based convergence standards and make enforcement of accurate accounting standards both possible and effective.

Thank you for your consideration in this matter.

Sincerely,



Carl Levin
Chairman
Permanent Subcommittee on Investigations