РАЗЛИКИТЕ ПОМЕЃУ МЕЃУНАРОДНИТЕ СТАНДАРДИ ЗА ФИНАНСИСКО ИЗВЕСТУВАЊЕ И ОПШТПРИФАТЛИВИТЕ СМЕТКОВОДСТВЕНИ ПРИНЦИПИ

д-р Александар Костадиновски, д-р Оливера Ѓоргиева Трајковска

DIFFERENCES BETWEEN INTERNATIONAL FINANCIAL REPORTING STANDARDS AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Aleksandar Kostadinovski PhD[1], Olivera Gorgieva Trajkovska PhD[2].

Abstract

Global accounting standards improve the functioning of global capital markets by providing better information to investors and other users of financial statements. They decrease the costs of preparing and interpreting financial statements and decrease cost of capital. Investing in emerging markets, impose the need to know the world's two main accounting systems: Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). GAAP is used principally in the United States, IFRS is used in the European Union and many other countries. Many countries have their own accounting systems, although most conform to one main system or the other as they work to keep their markets modern. All accounting systems follow double-entry practices that categorize transactions as revenue or expenses, assets or liabilities. The two primary accounting systems have a few differences between them that may affect the results. If we understand the differences between GAAP and IFRS, we can make a better evaluation of numbers from companies that follow any system.

Keywords: *accounting standards, harmonization, convergence, FASB, IASB.*

[1] Assistant Professor at Economic Faculty – University "Goce Delcev" – Stip, Republic of Macedonia, aleksandar.kostadinovski@ugd.edu.mk

[2] Assistant Professor at Economic Faculty – University "Goce Delcev" – Stip, Republic of Macedonia, olivera.trajkovska@ugd.edu.mk

INTRODUCTION

The global movement to adopt International Financial Reporting Standards (IFRS) is the paramount financial reporting issue of the 21st century. Over 100 countries now require IFRS as the basis of financial reporting by their publicly-traded companies. For the past several years, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) have been working together to achieve convergence of International Financial Reporting Standards (IFRSs) and generally accepted accounting principles in the United States (US GAAP). In 2002, as part of the Norwalk agreement, the Boards issued a Memorandum of Understanding (MOU) formalizing their commitment to: [3]

• making their existing financial reporting standards fully compatible as soon as practicable; and

• coordinating their future work programs to ensure that, once achieved, compatibility is maintained.

IASB and FASB agreed that a common set a high – quality, global accounting standards was a priority of both Boards. Based on a proposed timetable developed by the U.S. Securities and Exchange Commission, acceptance of IFRS in the U.S. could be as early as 2015.[4] Understanding IFRS is critically important to management accountants, auditors, financial analysts, corporate executives, and others involved with financial reporting.

Ten years later we can see that differences between IFRS and US GAAP remain significant in many areas and are of keen interest to the preparers and users of financial statements. This paper has two objectives. The first is to describe some of the key differences between U.S. GAAP and IFRS. The second is to compare actual financial statements in which results were reported under both IFRS and U.S. GAAP.

BACKGROUND

A universal or global system of accounting has been widely touted as a benefit to investors, as worldwide adoption of IFRS would facilitate comparability of financial statements prepared in different countries. If adopted by all countries, IFRS would provide uniformity regarding how and what financial information is disclosed. The globalization of business, along with advances in technology, has fostered interconnected worldwide capital markets. How IFRS will affect a company's accounting process is of great importance to management accountants, auditors, corporate executives, investors, lenders, financial analysts, regulators, and others connected to corporate financial reporting. Corporate management is responsible for the quality and reliability of financial statements. The proposed replacement of U.S. GAAP with IFRS makes understanding the impact of IFRS on corporate financial reporting more essential than ever.

Formed in 2001, the International Accounting Standards Board (IASB) replaced its predecessor, the International Accounting Standards Committee (IASC), which itself was formed in 1973. The objective of IASB is to develop a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles.[5] The IASB promulgates standards in a series of pronouncements designated International Financial Reporting Standards. Standards previously issued by the board of the IASC were subsequently adopted by the IASB. These older standards, which had been issued between 1973 and 2000, continue to be designated International Accounting Standards (IASs). The non-superseded IASs are part of IFRS.

The organizational structure of the IASB was derived from a strategy review undertaken by its predecessor body, the board of the International Accounting Standards Committee. The IASB

---

[3] Global IFRS leadership team. "IFRSs and US GAAP - A pocket comparison", An IAS Plus guide, Deloitte, 2008. Website: www.iasplus.com (February 16, 2013).
[4] Smith, L.M." Key Differences between IFRS and U.S. GAAP: Impact on Financial Reporting", A FAR Grant Research Summary, 2011, p.2.
[5] International Accounting Standards Board (IASB)."Who we are and what we do?" IFRS Foundation, 2013. Website: http://www.ifrs.org/The-organisation/Documents/Who-We-Are-English-2013.pdf (February 16, 2013).

structure includes a monitoring board of capital market authorities, which appoints members of the IASC Foundation, which is the parent body of the IASB. The IASC Foundation is overseen by a geographically diverse group of trustees. The foundation provides oversight of the IASB (IASB 2010).

In pursuit of its objective, the IASB works in close cooperation with stakeholders around the world, including investors, national standard-setters, regulators, auditors, academics, and others who have an interest in the development of high-quality global standards. Progress toward this objective has been steady. All major economies have established time lines to converge with or adopt IFRSs in the near future. The international convergence efforts of the organisation are also supported by the Group of 20 Leaders (G20) who, at their September 2009 meeting in Pittsburgh, US, called on international accounting bodies to redouble their efforts to achieve this objective within the context of their independent standard-setting process. In particular, they asked the IASB and the US FASB to complete their convergence project.

At the time of this writing, IFRS acceptance includes more than 12,000 companies located in 120 nations, which have required or permitted the use of IFRSs. The number is likely to exceed 150 countries within the next few years. Accountants, auditors, corporate executives, investors, and other corporate stakeholders will need to become knowledgeable regarding IFRS. Correspondingly, professional associations and industry groups will need to incorporate IFRS into their educational materials, publications, testing, and certification programs.

Differences in accounting standards among nations are traced to a number of factors, including political systems, sources of capital, inflation, taxation, culture, accidents of history, and business complexity. For example, political systems define who is in charge of accounting standards in a nation. Whether capital is raised in equity markets or through debt financing affects the need for transparency and disclosure. Nations with high inflation generally need inflation-adjusted numbers in corporate financial reports; this is not necessary in countries such as the U.S., which historically has experienced relatively low levels of inflation.

The accounting standards developed in the U.S. are different from IFRS, as U.S. standards are tailored to the unique environment of the U.S., while IFRS is tailored to meet worldwide financial reporting requirements, including those of the U.S. but other countries, too. Consequently, IFRS is not the "ideal" solution for any individual nation, but the standards strive to be the ideal solution for the overall global financial markets. If there were no global financial markets and corporate stocks were traded only within one nation, then the need for IFRS in specific countries would be less obvious. IFRS is a global solution to a global need. To the extent possible, of course, the IASB attempts to develop IFRS with consideration to needs of individual countries such as the U.S.

Resistance to adopting IFRS includes the following: (1) agreeing on who will create the rules, (2) how different the IFRS rules will be from a nation's domestic GAAP, (3) costs of changing GAAPs, and (4) national sovereignty.[6] In the U.S., many accountants are generally satisfied with the work of the Financial Accounting Standards Board[7] and are not at all sure about turning over the standard-setting process to the IASB. There is concern about how different the new accounting standards might be and the cost of changing over to those new standards. Turning over the standard-setting process to a foreign organization is a major source of concern.

IFRS is often referred to as being principles based, while U.S. GAAP is said to be more rules based. Estimates are that, if printed, U.S. GAAP would amount to about 25,000 pages, and IFRS would take up only about 2,000 pages. With fewer pages and less specifics, IFRS often lacks the very detailed guidance included in U.S. GAAP. Regardless of differences in size, both U.S. GAAP and IFRS have the same goal of transparent and full disclosure financial reports. IFRS includes a "fairness exception" that is much like a "Rule 203 exception" under U.S. auditing standards. Under IFRS, if management determines that applying a standard would result in misleading financial representation, then management must follow a different application to attain a fair presentation.

---

[6] Smith, L.M. op.cit. p.3

[7] http://www.fasb.org (February 16, 2013).

DIFFERENCES BETWEEN IFRS I U.S. GAAP

While there are areas of difference between U.S. GAAP and IFRS, similarities exceed differences. Differences can be regarded as cosmetic or substantive. Cosmetic differences are primarily associated with appearance or location of information in financial reports. Substantive differences cause differences in the value of an item or whether an item is reported at all.

Regarding cosmetic differences, International Accounting Standard 1 (IAS 1) does not prescribe a particular format for presentation of financial statements. As a result, multiple formats have evolved in practice. The presentation of the balance sheet in many countries that are, or were, members of the British Commonwealth use the format: Assets – Liabilities = Stockholders' Equity, rather than the U.S. format of Assets = Liabilities + Stockholders' equity. In addition, balance sheet items are shown from least liquid to most liquid, the reverse of the U.S. format. Another example of a cosmetic difference is use of different words to refer to the same financial statement item. A few examples are as follows, with the international term followed by the U.S. counterpart: turnover – sales; stocks – inventory; share capital – common stock or paid-in capital; share issue premium – additional paid-in capital; debtors – accounts receivable; creditors – accounts payable; revenue reserves – retained earnings.

With regard to substantive differences, under IFRS, there is no distinction between revenues/gains or expenses/losses on the income statement. Regarding the statement of changes in stockholders' equity, two different approaches can be used. The IFRS benchmark treatment is similar to U.S. GAAP; the alternative treatment allows for items such as capital transactions to be included in notes.[8]

Regarding the statement of cash flows, under IAS 7, the statement of cash flows is a required statement. Requirements of IAS 7 are much the same as SFAS 95 in the U.S., with a few differences. In the U.S., interest paid, interest received, and dividends received are shown in the operating section, while dividends paid are shown in the financing section. Under IFRS, interest paid, interest received, and dividends received are normally accounted for as operating cash flows as well. Interest paid may be accounted for as a financing cash flow, however, while interest received and dividends received may be accounted for as investing cash flows, because they are costs of obtaining financial resources or returns on investments. Non-cash transactions (such as issuance of bonds for long-term assets) do not need to be disclosed on the face of the cash flow statement.

Regarding notes to the financial statements, IFRS requires disclosure of currency used in the financial statements. The currency used on the IFRS financial statements need not be the primary currency of the company. For example, a company based in Australia, with operations primarily in Southeast Asia, could choose to use the euro as its reporting currency.

Regarding inventory accounting, under IFRS, FIFO and weighted average methods are permitted, but LIFO is not an acceptable treatment.[9] Both IFRS and U.S. GAAP require lower-of-cost-or-market (LCM). Still, "market" is defined differently. Consequently, different valuation amounts may result. Unlike U.S. GAAP, IFRS permits subsequent write-up after write-down. Under IFRS, inventory is valued at cost, not to exceed net realizable value (NRV). NRV is sales proceeds less additional costs to complete and to make the sale. IAS 41 provides special guidance for biological assets and agricultural produce. Under U.S. GAAP, inventory is valued at lower-of-cost-or market (LCM) with market being defined as replacement cost (RC), but with an upper limit (ceiling) of NRV and a lower limit (floor) of NRV minus a normal profit margin. Consequently, if replacement cost is below NRV, IFRS and U.S. GAAP will have different valuations.

Regarding property, plant, and equipment (PP&E), under IFRS, the benchmark treatment under IAS 16 is to report PP&E at cost net of depreciation and potential impairments. IAS 16 provides for an alternative treatment, to revalue PP&E to fair value. Companies may use "highest and best use" to determine fair value. After a company begins to revalue PP&E, it must continue to doing so ". . .with sufficient regularity to ensure that the carrying amount does not differ materially from that which

---

[8] Santaro J. & Munter P."IFRS compared to US GAAP: An overview". KPMG International Standards Groups, 2012.p.10

[9] Ibid. p.48

would be determined using fair value at the balance sheet date."[10] Consider the following scenario: Land that cost 200,000 is revalued to its fair value of 240,000 on December 31 with the following journal entry:

December 31 Land 40,000

Revaluation Surplus 40,000

Regarding investment property, under IAS 40, investment property is defined as property held for rental or capital appreciation or both. Investment property may be accounted for under the "fair value model" or the "cost model." Under the fair value model, changes to fair value are recognized on the income statement. Under the cost model (cost less accumulated depreciation), fair value must be disclosed in notes.[11]

Regarding leases, under U.S. GAAP, leases are classified as capital if one or more of four criteria are met: title transfer, bargain purchase option, lease term equals or exceeds 75% of economic life, or present value (PV) of minimum lease payments (MLP) greater than or equal to 90% of the asset's fair market value (FMV).[12] Under IFRS, the criteria are less rigid. Under IAS 17, a lease is classified as either an operating lease or a finance lease (U.S. GAAP refers to finance leases as capital leases). Per IAS 17 a finance lease "…transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred." Four of the eight IFRS criteria are as follows:[13] 1) the lease transfers ownership to the lessee, 2) the lessee has a bargain purchase option, 3) the lease term is for the "major part" of the economic life of the asset, 4) the present value of the minimum lease payments "amounts to at least substantially all of the fair value of the leased asset." Depending on one's interpretation of "major part" and "substantially all" in the third and fourth criteria, U.S. GAAP and IFRS would yield different classifications of a lease.

Regarding deferred taxes, according to U.S. GAAP, if a company has a deferred tax asset (DTA), the company must determine whether a valuation allowance is needed. A valuation is required if "more likely than not" a part or all the DTA will not be realized. DTA would be recorded at gross and a corresponding allowance would also be recorded. Under IFRS, DTA is recorded only if the DTA is expected to be realized; the DTA is reported at net, not the gross and allowance. Under IFRS, deferred tax assets and deferred tax liabilities are reported only as long-term, while U.S. GAAP would distinguish short- and long-term.

Some other comparisons between U.S. GAAP and IFRS are as follows:

• Discontinued operations – similar.

• Long-term construction contracts – IFRS does not permit completed contract method.

• Derivatives – similar.

• Hedge accounting – similar.

• Segment reporting – IFRS is more comprehensive.

Under U.S. GAAP, if a parent/subsidiary relation relationship exists, then consolidated statements must be prepared. Determining the relationship under IFRS, the emphasis is on the parent's ability to govern and obtain benefits from the subsidiary, while U.S. GAAP puts the emphasis on existence of a controlling financial interest. Unlike U.S. GAAP, IFRS permits stand-alone parent-company-only financial statements.

---

[10] Smith, L.M. op.cit.p.7
[11] http://www.iasplus.com/en/standards (February 18, 2013).
[12] http://www.fasb.org/pdf/fas13.pdf (February 18, 2013)
[13] Santaro J. & Munter P. op.cit p.75

EMPIRICAL ANALYSIS OF ACCOUNITNG VALUES UNDER IFRS AND U.S GAAP

Researchers have examined financial reports that include both U.S. GAAP and IFRS results. In a study by Smith and Files[14], an examination is made of accounting values on financial statements of corporations headquartered in the European Union (EU) that list stock on the New York Stock Exchange (NYSE), for years 2005 and 2006. The sample was limited to these firms and years because these years fall between two important rulings, the first made by the EU and the second by the United States. Beginning in 2005, all EU firms were required to use IFRS-based financial reports. In 2007, the U.S. Securities and Exchange Commission ruled that non-U.S. firms using IFRS would no longer be required to reconcile to U.S. GAAP when reporting earnings.[15] Consequently, 2005 and 2006 are unique years in which EU firms trading in U.S. markets would provide financial statements using two different standards: IFRS and GAAP. Financial statements by non-U.S. firms are reported annually to the SEC using a Form 20-F.

Table 1. IFRS- versus U.S. GAAP-Reported Financial Statement Information of EU Firms Cross-listed on the NYSE

		Reportet using IFRS ($MM)					Reportet using US GAAP ($MM)				
	N	MEAN STD	MEDIAN STD	STD. DEV.	MIN	MAX	MEAN STD	MEDIAN STD	STD. DEV.	MIN	MAX
Revenue	126	46,109	28,132	60,079	116	306,731	50,548	28,253	72,597	116	384,653
Net Income	126	4,420	3,092	7,359	-26,031	28,864	5,394	2,858	7,821	-780	31,864
Total Assets	126	200,707	48,591	385,299	511	1,860,758	188,187	49,124	320,453	342	1,406,955
Total Liabilities	126	154,351	20,793	354,151	-11,149	1,745,830	155,296	23,996	310,838	18	1,442,989
Shareholder Equity	126	43,912	15,437	124,210	44	972,466	33,926	15,438	51,039	50	287,989
EPS (basic)	122	14.68	1.93	39.70	-21.51	186.30	7.39	1.67	19.98	-36.87	92.96
EPS (diluted)	126	13.97	2.02	38.23	-21.51	184.90	7.64	1.76	20.01	-36.87	91.91

Source: Smith, L.M." Key Differences between IFRS and U.S. GAAP: Impact on Financial Reporting", A FAR Grant Research Summary, 2011.p.8

Table 1 compares the financial statement numbers reported under International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting. Each firm, which is headquartered in the EU but lists stock on the New York Stock Exchange (NYSE), is mandated by the EU to report using IFRS and mandated by the Securities and Exchange Commission (SEC) to provide reconciliation of differences between IFRS and U.S. GAAP in a Form 20-F. Table shows summary statistics for the financial information obtained for the EU firms, as reported under both IFRS and U.S. GAAP. The mean net income reported under IFRS and GAAP are $4,420 and $5,394 million, respectively. Thus, net income reported under GAAP appears to be higher. The median net income value is higher under IFRS, however ($3,092 million under IFRS versus $2,858 million under GAAP).

Table 2 Test of Differences between IFRS- and U.S. GAAP-reported Financial Statement Information of EU Firms Cross-listed on the NYSE

	Difference (mean) GAAP – IFRS	T-value	Difference (median) GAAP – IFRS	Chi-square value
Revenue	4,439	1.11	121	0.01
Net Income	974	1.57	-234	0.04
Total Assets	-12,520	-0.96	533	0.08
Total Liabilities	945	0.07	3203	0.44
Shareholder Equity	-9,986	-0.92	1	0.00
EPS (basic)	-7.29	-2.72	-0.26	1.43
EPS (diluted)	-6.33	-2.57	-0.26	0.61

Source: Smith, L.M." Key Differences between IFRS and U.S. GAAP: Impact on Financial Reporting", A FAR Grant Research Summary, 2011.p.8

---

[14] Smith, L.M., and Rebecca Files.. "Measuring the Impact of International Financial Reporting Standards on Market Performance of U.S. Publicly Traded Companies." American Accounting Association Southwest Region Annual Meeting (March), Houston, Texas, 2011;

[15] SEC. "International Financial ReportingStandards." Roadmap Roundtable, 2007. Website: http://www.sec.gov/spotlight/ifrsroadmap/ifrsroadmap-transcript.txt (February 18, 2013).

Table 2 compares the financial statement numbers reported under International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (GAAP) for the same European Union (EU) firms. Each firm, which is headquartered in the EU but lists stock on the New York Stock Exchange (NYSE), is mandated by the EU to report using IFRS and mandated by the Securities and Exchange Commission (SEC) to provide reconciliation of differences between IFRS and U.S. GAAP in a Form 20-F. Table shows results of the analysis of differences between IFRS- and GAAP-reported financial numbers. The mean earnings per share is the only mean with a statistically significant difference between IFRS and GAAP, and no items have significantly different medians. Lack of significant differences between IFRS- and GAAP-reported financial statement items is a notable finding, as it suggests that IFRS adoption will not cause a major change in U.S. financial reporting results, at least in an overall context. Admittedly, individual firms may encounter significant differences for specific financial statement items between IFRS- and GAAP-based results.

CONCLUSION

The movement toward adoption of International Financial Reporting Standards has become a global juggernaut, with over 120 countries now accepting or requiring IFRS for financial reporting by publicly traded companies. U.S. adoption of IFRS appears quite possible, but is still far from certain. Differences between U.S. GAAP and IFRS can be cosmetic or substantive. For example, regarding financial statement presentation, cosmetic differences include use of the accounting equation (A=L+SE versus A- L=SE), terminology, and order of liquidity. Substantive differences involve matters such as inventory valuation, PP&E, leases, and deferred taxes. The FASB and IASB are working together in efforts to converge the two sets of accounting standards.

An examination of financial reports that include both U.S. GAAP and IFRS results shows that there is little difference between IFRS- and GAAP-reported financial statement overall average values. This is an important finding, as it suggests that U.S. adoption of IFRS will not cause major changes in U.S. financial reporting results, at least overall. Of course, individual companies may still be significantly affected on specific accounting items.

REFERENCES

1. Global IFRS leadership team. “IFRSs and US GAAP - A pocket comparison”, An IAS Plus guide, Deloitte, 2008. Website: www.iasplus.com (February 16, 2013).
2. www.fasb.org/pdf/fas13.pdf (February 18, 2013)
3. www.iasplus.com/en/standards (February 18, 2013).
4. International Accounting Standards Board (IASB).”Who we are and what we do?” IFRS Foundation, 2013. Website: http://www.ifrs.org/The-organisation/Documents/Who-We-Are-English-2013.pdf (February 16, 2013).
5. Santaro J. & Munter P.”IFRS compared to US GAAP: An overview”. KPMG International Standards Groups, 2012.
6. SEC. “International Financial Reporting Standards.” Roadmap Roundtable, 2007. Website: http://www.sec.gov/spotlight/ifrsroadmap/ifrsroadmap-transcript.txt (February 18, 2013).
7. Smith, L.M., and Rebecca Files.. “Measuring the Impact of International Financial Reporting Standards on Market Performance of U.S. Publicly Traded Companies.” American Accounting Association Southwest Region Annual Meeting (March), Houston, Texas, 2011.
8. Smith, L.M.” Key Differences between IFRS and U.S. GAAP: Impact on Financial Reporting”, A FAR Grant Research Summary, 2011.