An Overview of US GAAP vs IFRS: Similarities and Differences

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When companies report financial and accounting information, they typically adhere to a standardization that will allow others to interpret the data they are presenting. There are a number of accepted standards varying with the location or type of business, but the two most relevant are United States Generally Accepted Accounting Principles—US GAAP, used in its namesake the United States—and International Financial Reporting Standards—IFRS, an international accounting standard that is issued by the International Accounting Standards Board or IASB, and used by the majority of countries around the world and referred to as the gold standard of financial reporting. While many US companies adhere to reporting according to the US GAAP standard, inter- and multi-national companies may report using both standards in order to maximize adherence to regulation and wider understanding. Note that, while this is possible, there are very few examples of companies being "dual listed," or publishing both under US GAAP and IFRS standards.

Beginning with the United States Generally Accepted Accounting Principles (US GAAP), the system is developed and maintained by the Financial Accounting Standards Board (FASB) and the Emerging Issues Task Force, and is the standard used by the United States

Securities and Exchange Commission (SEC). GAAP is a rule-based system that, when adhered to, can allow for improved communication of a company's financial and accounting disclosures. It is used by both profit-driven and not-for-profit companies in the United States, though the SEC only mandates that publicly traded companies adhere to the standard. GAAP is based on ten key rules: the Principle of Regularity, the Principle of Consistency, the Principle of Sincerity, the Principle of Permanence of Methods, the Principle of Non-Compensation, the Principle of Prudence, the Principle of Continuity, the Principle of Periodicity, the Principle of Materiality, and the Principle of Utmost Good Faith. The Principle of Regularity is the concept that companies following the GAAP standard adhere to the rules of that standard. The Principle of Consistency states that the standards of GAAP are consistently applied in the company's reporting process. The Principle of Sincerity states that the preparers of the disclosure are acting to provide an accurate description of the company's finances and accounting. The Principle of Permanence of Methods furthers the Principle of Consistency, but specifically notes that consistency should be seen in all the financial reports not just in the reporting process. This consistency should be seen both across and within reports. The Principle of Non-Compensation states that all negatives and positives should be reported without accounting (pun not intended) for debts that may be compensated later. The Principle of Prudence states that every attempt should be made to prevent the influence of speculation on the reported data. The Principle of Continuity states that it should be assumed, when creating the financial statements, that the company will continue to operate. The Principle of Periodicity states that the accounting entries should be distributed across suitable time periods, typically the standard fiscal periods of quarters and years. The Principle of Materiality states that the preparers must attempts to share all the finances and accounting data in their reports, in other words full disclosure must be attempted.

And the Principle of Utmost Good Faith states that all participants in the disclosure process must be honest and act in good faith in their disclosure duty.

International Financial Reporting Standards, or IFRS, are a set of reporting standards that areissued by the International Accounting Standards Board, IASB. Currently, the IFRS is adhered to by companies operating in more than 167 countries, but the United States and Chinaare notable exceptions as they adhere to the earlier discussed US GAAP standard and the Chines Accounting Standards for Business Enterprises—ASBE—respectively. The IASB states that these rules were developed to help improve understanding of published financial data via consistency, standardization, transparency, efficiency, and accountability. There are a few standard requirements through the IFRS, though there is variability from sector to sector and companies must also give additional information like a summary of accounting practices on top of the IFRS report. Parent companies adhering to the IFRS must also create separate reports for each of their subsidiaries. The main requirements of IFRS are a statement of financial position, a statement of comprehensive income, a statement of changes in equity, and a statement of cash flows. The statement of financial position is equivalent to a balance sheet, though this statement is reported in adherence with the standard. The statement of comprehensive income is similar to a profit and loss statement but includes declarations of other incomes related to property and equipment. The statement of changes in equity shows the changes in a company's earnings and profits for the period. And the statement of cash flows shows the financial transactions that the company has partaken in over the financial reporting period.

While the brief summaries of each accounting standard may suggest vast differences between the two, the end goals—clarity and transparency—and the base data—basic accounting fundamentals—are the same. The main differences occur in the way each system tackles

achieving those goals. US GAAP is a rules-based system, meaning there are a set of published rules that are maintained by FASB that are meant to cover as many situations as are possible, and that companies adhering to the US GAAP standard must prepare their reports in accordance with those rules. The rules-based foundation on which the standard is built means that comparison between companies is made easier as the reports adhere to the same preparation guidelines. This also means that reported data is more likely to be accurate as it adheres to the tight rule system, minimizing contradictions and ambiguity. This also makes reviewing and confirming the reports easier. With that being said, however, as human ingenuity is boundless so too are the ways companies may want to manipulate data to better fit their specific goals. If a method is devised that skirts around the rules or may be ethically ambiguous without outwardly breaking the established rules, the system is found to be fallible. Because of this, the published guidelines for US GAAP are several times longer than those for IFRS as every time a hole is found in the rules, a new rule must be created to "plug" it. Rather than adhering to a rules-based system, IFRS is a 'principles-based' system. This means the IFRS standards are looser and are open to interpretation. The IFRS is much more akin to general guidance that may be applied to most generally encountered accounting scenarios, while the reporting the most individualized situations is left up to the discretion of the accountants preparing the report. This make comparison between companies more difficult but allows the standard to be applied across a much wider girth—reflected in the simple number of countries that adhere to this standard.

The US GAAP standard is further differentiated from IFRS in a few distinct ways; the first is in the way inventory is accounted. US GAAP allows for use of Last In First Out, LIFO, inventory estimates, a method not allowed by IFRS. The LIFO method can often be used to minimize the reported profits thus minimizing tax burden, and the fact that US GAAP allows for

both LIFO and FIFO—First In First Out, the only method allowed by IFRS—inventory estimations, companies can choose whichever method may reduce their tax liability when creating their reports.

When looking at the way the systems handle 'intangible assets' such as research and development another different arises. US GAAP allows the research and development costs incurred to be reported as an expense while IFRS separates the two, noting research costs as an expense and development costs are capitalized—added as a fixed asset.

Interestingly, a number of differences have been sorted out between the two regimes.; such as the accounting for revenue recognition. Under previous guidance, FRS required that revenue be recognized once the value is of the good or service delivered. Further, it divided transactions into different groups and categories, and allowed different methods for recognizing revenues depending on whether it is contract based, how much of a contract hasdbeen completed, and whether or not the revenues can be recovered during the period being reported. US GAAP stated specifically that revenue must be either realized or earned, then prescribes detailed rules on the recognition of that revenue and the way it should be reported depending on the type of industry the company belongs to. These differences in revenue recognition, however, have been converged with the joint workings of the two accounting setters which has resulted in the issuance of US GAAP ASC 606 and IFRS 15: Revenue Recognition with Customers. Revenue recognition now is a consistent, single reporting worldwide reporting model based on a five step process. On the other hand, other convergence models such as lease accounting has resulted in many differences between the two accounting seters. US GAAP and IFRS differ substantially in accounting for leases despite years of joint convergence efforts.

US GAAP does not allow for inventory reversal—when a company ‘writes-down’ the amount of value that is lost when inventory falls below the price that company paid for it. This is allowed under IFRS, meaning IFRS allows companies to declare a fair market value of their inventory rather than the initial cost.And, finally, the way liabilities are reported is another difference between the two standards. IFRS prescribes no distinction between short- and long-term liabilities while US GAAP indicates a specific 12-month period that will separate the two.

Again, while these differences may seem vast it must be noted that the two systems converge much more than they diverge. This continues to become the case as new rules and guidelines are issued year over year to adapt to the ever-changing landscape of business. Whether one or the other system is more correct is a difficult determination to make, the US GAAP system is a stronger attempt at regulating the reporting of financial data. The framework provides for a balance between trust and naivete, and freedom and regulation. While in an ideal world companies would be completely forthright in reporting their accounting data, it would be silly to think that they would not attempt to minimize their tax burden and, to be honest, it would be silly of them not to if the system allowed for it. The strict rules minimize the skirting of regulations and reporting, though the freedom in reporting assets like inventory still allows them to maneuver and adapt their tax burden depending on their situation. It also can be though to reward ingenuity to some degree, a principle inherent to ‘American-ness,’ as if one is able to find ways within the rules to adjust their dues, they can. Whether those loopholes of sorts will remain in subsequent iterations of the guidelines is not easy to say, but that again fuels further accounting dexterity in the future.

In closing, the authors believe that a day will come when accounting reporting will be based on a single reporting model, which will tailor IFRS. However, this day may be decades

form reality. The consistency and comparability of worldwide reporting cannot be over-emphasized and something in need in today's financial markets.

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