COMPARATIVE STUDY REGARDING THE MAIN DIFFERENCES BETWEEN US GAAP AND IFRS

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Abstract:

Internationally, there are two organizations which play a significant role in the field of financial reporting regulatory bodies. These are the Financial Standard Accounting Board (FASB) and the International Accounting Standards Board (IASB). These bodies have admitted that, in order for international capital markets to function properly, a single set of high quality international accounting standards is necessary. This phenomenon involves the spread of IFRS in the world, on the one hand, and the convergence of FASB-IASB. Yet there are differences. SEC, the American standardization body, is in no hurry to achieve convergence. Moreover, as stated by some authors, we witness the existence of a paradoxical situation: that in which IFRS and the conceptual framework are influenced by American standards.

The scientific approach of this research paper consists of two parts: the first part we presented the main differences in the recognition and measurement of the items in the financial statements and while in the second part we present the main differences in the presentation of financial statements. Regarding the research methodology, the methodological, theoretical and scientific base is represented by the universal research methods: the dialectical method of acquiring knowledge (analysis, synthesis, deduction) as well as the rational methods of acquiring knowledge (observation, reasoning, selection, comparison). As research tools for the theme of the current paper are as follows: online research (use of the FASB, IASB, IFAC databases), the electronic databases available through the library, books, journals, legislation.

Key words: convergence, US GAAP, IFRS

JEL classification: M41

INTRODUCTION

The convergence of the accounting standards is an advantage for the companies listed on the stock exchange from two points of view: firstly, they do not need to prepare several sets of financial statements, saving significant amounts of money, and secondly, the comparability of financial data is ensured. In this respect, under the 2002 Norwalk agreement, FASB and IASB decide to bring closer the American standards to the international ones (Baker, Burlaud, 2014). However, it seems that many years are required to ensure the convergence of the two referential.

The main difference between IFRS and U.S. GAAP is that the American standards are based on rules and IFRS is built on basic principles. A rule-based standard does not mean that the standardisation bodies have not used principles to establish them but that rules play a major role in implementing the standard. Regarding this controversy, of the principle-based standards versus the rule-based ones, there is considerable debate. The rule-based standards, the dominant approach of FASB, try to anticipate all or most of the problems and find solutions, while the principle-based standards, the dominant approach of IASB, are less prescriptive and are based on the objectives and the principles which need to be followed. As a result, U.S. GAAP is comprised of approximately 17,000 pages, while IFRS contains about 2500 pages (Belverd, Needles, Marian, 2011).

The American approach, based on detailed rules, proves to be a source of increased complexity (Couleau-Dupont, 2010). Instead, according to the approach based on principles, the standards are based on general principles and conventions which are included in the conceptual frameworks. "The general principles correspond to the hypotheses which form the basis for the development of financial statements, of the financial information objectives regarding its usefulness for users, and of the definition of the elements contained within the financial statements. The conventions are intended to guide the preparation of the accounts for the evaluation and presentation of the elements included in the financial statements" (Hoarau, 2008).

Shamrock Steven (2012) provides a visual representation describing US GAAP as a large brick wall, in which there is a brick which best suits the transaction and which places it in this place while IFRS is more like a shelf with ordered jars, which are taken out as necessary and the content of which is combined to create the best mixture.

A classification of the main types of differences was performed by the FASB and is as follows (Doupnik, Perera, 2007): differences in definition, differences in recognition, differences in assessment, alternatives, lack of requirements or recommendations, differences in presentation.

The two committees, in the development of new standards or in their review process, guide themselves according to the conceptual framework (IASB for IFRS, U.S. GAAP for FASB). As a result, the differences between them can contribute to the appearance of differences between the standards. In 2004, due to the convergence process between the two referential (IFRS and U.S. GAAP), FASB and IASB have begun to work together to develop a common and improved conceptual framework which will provide the basis for developing common standards.

The project has eight steps and the two bodies are currently working on the first four (Gorgan, 2013): qualitative objectives and characteristics, item definition, recognition and derecognition, evaluation, the concept of reporting entity, the limits of financial reporting - disclosure and information requirements, purpose and status of the conceptual framework, use of the he conceptual framework for non-profit entities and other issues.

The first phase was completed and resulted in the issuance of a conceptual framework which includes the objective of financial reporting and the qualitative characteristics of useful information (SFAC 8). To complete the other phases, however, there is no schedule. However, although the two councils have reached some temporary conclusions regarding the definition of elements, recognition and derecognition, the measurement of the elements in the financial statements as well as the concept of reporting entity, it seems that the harmonisation of IFRS and U.S. GAAP is always a work in progress.

THE MAIN DIFFERENCES IN THE RECOGNITION AND EVALUATION OF THE ELEMENTS OF THE FINANCIAL STATEMENTS

The foundation of financial accounting consists of a set of hypotheses**, conventions** and standards known as generally accepted accounting principles (GAAP**).** Depending on the authority which establishes the principles**,** different sets of GAAP can be identified**,** such as the European GAAP(at European level),national GAAP**, U.S.**GAAP and IFRS GAAP**.** Although the different sets of GAAP have many principles in common**,** there are still significant degrees of freedom (Aerts, Walton, 2013)**.**

IAS 2, Inventories, is an example of an international accounting standard which provides a more extensive guidance than U.S. GAAP. Most differences are found among the allowed assessment methods, the calculation of depreciation, the recognition of impairment reversals, the accounting of the inventories resulting from agricultural activities. According to IAS 2, inventories are assessed at the lowest value between cost and net realizable value. Unlike IFRS, U.S. GAAP requires inventories to be assessed at the lowest value between cost and market, where the market is defined as replacement cost which is no higher than the net realizable value (called ceiling) and no less than the net realizable value without the normal profit margin (called floor).

While the net realizable value, in IFRS's perspective, is "the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale", in US GAAP's perspective, it represents the "estimated selling price in the ordinary course of business less the reasonably predictable costs of completion and disposal" (Shamrock, 2012).

Example no. 1

Historical cost	50 USD
Replacement cost (market)	34 USD
Estimated selling price	45 USD
Estimated cost of completion and sale	5 USD
Net realizable value (NRV)	40 USD
Normal profit margin 10%	4 USD
Net realizable value less the normal profit margin	36 USD

Example processed according Shamrock S., (2012), *IFRS and US GAAP-An comprehensive Comparison*, John Wiley&Sons, 2012, p.21

In the example above, under IFRS, the realizable value ($ 40) is less than the historical cost ($ 50), with the result that the stocks are valued at $ 40, resulting in a loss of value of $ 10. Under U.S. GAAP, the stocks are valued at the lowest cost ($ 50) and market ($ 34) but the market must be less than net realizable value ($ 40) and greater than the realizable value less the normal profit margin ($ 36). In this case, stocks are valued at $ 36, resulting in a loss of value of $14. We notice that the loss under IFRS is lower than the loss calculated under U.S. GAAP.

Example no. 2

Historical cost	125 USD
Replacement cost (market)	120 USD
Estimated selling price	123 USD
Estimated cost of completion and sale	8 USD
Net realizable value (NRV)	115 USD
Normal profit margin 20%	23 USD
Net realizable value less the normal profit margin	92 USD

Example processed according Shamrock S., (2012), *IFRS and US GAAP-An comprehensive Comparison*, John Wiley&Sons, 2012, p.21

In example no. 2, under IFRS, the net realizable value ($ 115) is less than the historical cost ($ 125), with the result that stocks are valued at $ 115, resulting in a loss of 10 dollars and under U.S. GAAP, stocks are valued at the lowest cost ($ 125) and market ($ 120) but the market must be less than the net realizable value ($ 115) and higher than net realizable value less normal profit margin ($ 92). In this case, stocks are valued at $ 115, resulting in a loss of value of 10 dollars. This time, the costs are the same.

Example no. 3

Historical cost	80 USD
Replacement cost (market)	65 USD
Estimated selling price	70 USD
Estimated cost of completion and sale	5 USD
Net realizable value (VRN)	75 USD
Normal profit margin 25%	18.75 USD
Net realizable value less the normal profit margin	56.25 USD

Example processed according Shamrock S., (2012), *IFRS and US GAAP-An comprehensive Comparison*, John Wiley&Sons, 2012, p.21

In example no. 3, under IFRS, the net realizable value ($ 75) is less than the historical cost ($ 80), with the result that stocks are valued at $ 75, resulting in a loss of value of $ 5. Under US GAAP: Stocks are valued at the lowest cost ($ 80) and market ($ 65) but the market must be less than the net realizable value ($ 75) and greater than the net realizable value less the normal profit margin ($ 56.25). In this case, the stocks are valued at $ 65, resulting in a loss of value of 15 dollars.

Under IFRS, the cost of the stocks should be determined using the first-in, first-out method (FIFO) or the weighted average cost formula. U.S. GAAP requires the use of both FIFO and the weighted average cost and LIFO is a method of cost calculation allowed by American standards (ASC330-10-30-9). If IFRS requires that an entity must use the same formula to determine the cost for all inventories having similar nature and use for the entity, U.S. GAPP provides that the same cost formula should not be applied to all stocks of similar nature and use (ASC 330-10-30-13 through 30-14).

As with IFRS, U.S. GAAP requires that when stocks are sold, the carrying amount of those stocks must be admitted as an expense in the period the related revenue is recognized. However, differences exist when the value of any reduction in the carrying amount of stocks to the net realizable value and all losses of stock must be recognized as expenses in the period in which the reduction in value or loss took place. IFRS allows these provisions, unlike U.S. GAAP, because the reversal of any reduction in market value is not allowed.

IFRS states that the pre-harvest stocks of agricultural producers (crop and livestock production) must be measured at fair value less the selling cost. Instead, U.S. GAAP requires these stocks to be valued according to cost, except for the cases when certain criteria are met.

The model based on revaluation requires an item of tangible asset to be recorded at fair value at the revaluation date less any subsequent accumulated depreciation and any accumulated impairment losses. On the other hand, U.S. GAAP does not allow revaluation (except in the case of depreciation) or any reversals of impairment (ASC 350-20-35-13, ASC 350-30-35-20, and ASC 360-10-35-20). Regarding amortization, if IFRS requires each part of an item of tangible asset with a significantly higher cost compared to the total cost of the item to be amortized separately, unlike IFRS, in U.S. GAAP's case, depreciation is not required but is allowed. The depreciation method must be systematic and rational (ASC 360-10-35-4).

One of the most well-known differences between U.S.GAAP and IFRS are the ones related to research and development concerns. The American Standards consider that all the costs of this type should be recognized as an expense, while IAS 38 requires that these research costs be considered expenses while the development costs should be capitalized (Walton, 2011).

There are several research papers on financial accounting that describe the conceptual differences which are fundamental for revenue recognition between them. Thus, the areas of revenue recognition for the two standards involve different criteria for recognizing revenue, deferred payments, long-term contracted revenue recognition (Babington, 2013).

Under U.S. GAAP, in order to be recognized, revenues must be realized or realizable and must be won. Revenue is realized or realizable and earned when the following criteria are met: persuasive evidence of an agreement exists, collectability is reasonably assured, delivery has occurred or services rendered and price is fixed or determinable (Grant Thornton, 2014). IAS 18 requires that goods "should be recognized when all of the following criteria have been satisfied: the seller has transferred to the buyer the significant risks and rewards of ownership, the seller retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the seller and the costs incurred or to be incurred in respect of the transaction can be measured reliably".

THE PRESENTATION OF FINANCIAL STATEMENTS FROM THE PERSPECTIVE OF U.S. GAAP AND IFRS

For the preparation and presentation of general purpose financial statements, an entity applies IAS 1. Under IAS 1, a complete set of financial statements includes (IFRS, 2013): a statement of financial position at the end of the period, a statement of profit or loss and other comprehensive income for the period, a statement of changes in equity for the period, a statement of cash flows for the period, notes comprising a summary of significant accounting policies and other explanatory notes, comparative information prescribed by the standard, the statement of financial position at the at the beginning of the previous period in which the entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

The entities which apply U.S. GAAP prepare financial statements according to the FASB coding (ASC 205 to 280). Moreover, according to the SEC recommendations, entities are required to follow SEC Regulations, respectively Regulation SX and SK. Thus, the American norms provide the following contents for financial statements (Grant Thornton, 2014): statement of financial position/balance sheet, income statement, a statement presenting the total comprehensive income, either in a single continuous statement or in two separate but consecutive statements (ASC 220-10-45-1), statement of changes in equity; presentation of changes in segregated accounts which contain equity (in addition to the retained earnings) could be done in the notes to the financial statements (ASC 505-10-50-2), statement of cash flows, notes to the financial statements. Unlike IAS 1, U.S. GAAP does not specify any requirement for comparative information but it is desirable to do so(ASC 205-10-45-2). Instead, Regulation SX, rule 3-01 (a) and article 3-02 (a), requires the balance sheets for the last two fiscal years and the statements of income and cash flows for three years. If IAS 1 requires the presentation an explicit and unreserved statement of compliance with IFRS in the notes, U.S. GAAP does not require it.

CONCLUSIONS

It is easy to see that in spite of the convergence reports submitted periodically by FASB-IASB, differences between the two referential still exist. Furthermore, IASB launches towards debate, separate from FASB, project DP/2013/1, A Review of the Conceptual Framework for Financial Reporting, on the one hand, and on the other hand, in February 2014, SEC released a strategic plan which applies for the years 2014-2018 through which the reinforcement of FASB's independence is intended, without mentioning anything about the international financial reporting standards. These two events make us suspect that the convergence process is longer than we expected. The fact that the two referential are built on different business cultures as well as on rules versus principles, we believe that they are the main obstacles in achieving convergence.

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