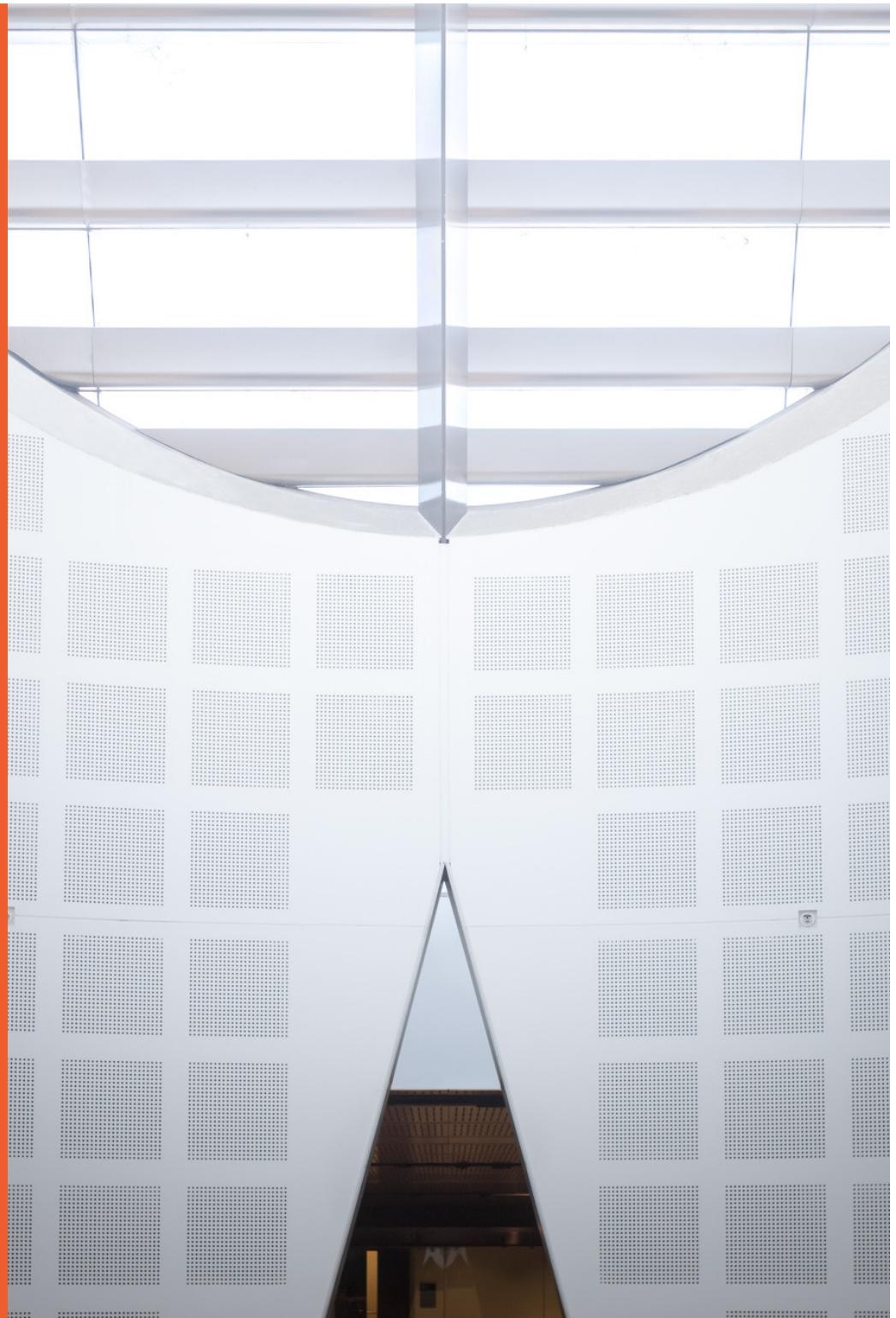


ACCT 6002

IFRS and US GAAP



THE UNIVERSITY OF
SYDNEY



IFRS and US GAAP

- **Text readings:**
- Comparative *International Accounting*: Chapters 5 and 10
- **Academic paper, on Canvas:** Zeff, S.A. (1995) 'A perspective on the U.S. public/private-sector approach to the regulation of financial reporting', *Accounting Horizons*, Vol. 9, No. 1.

Learning objectives

After this week's studies, you should be able to:

- outline both high-level differences between IFRS and US GAAP
- explain the procedures for the setting and enforcement of accounting standards in the United States, including the relationships between public and private sector institutions
- give examples of some detailed differences between US and IFRS requirements
- outline the problems involved with the convergence of IFRS and US GAAP and with adoption of IFRS in the United States

Nobes Interview with Hoogervorst and Tweedie

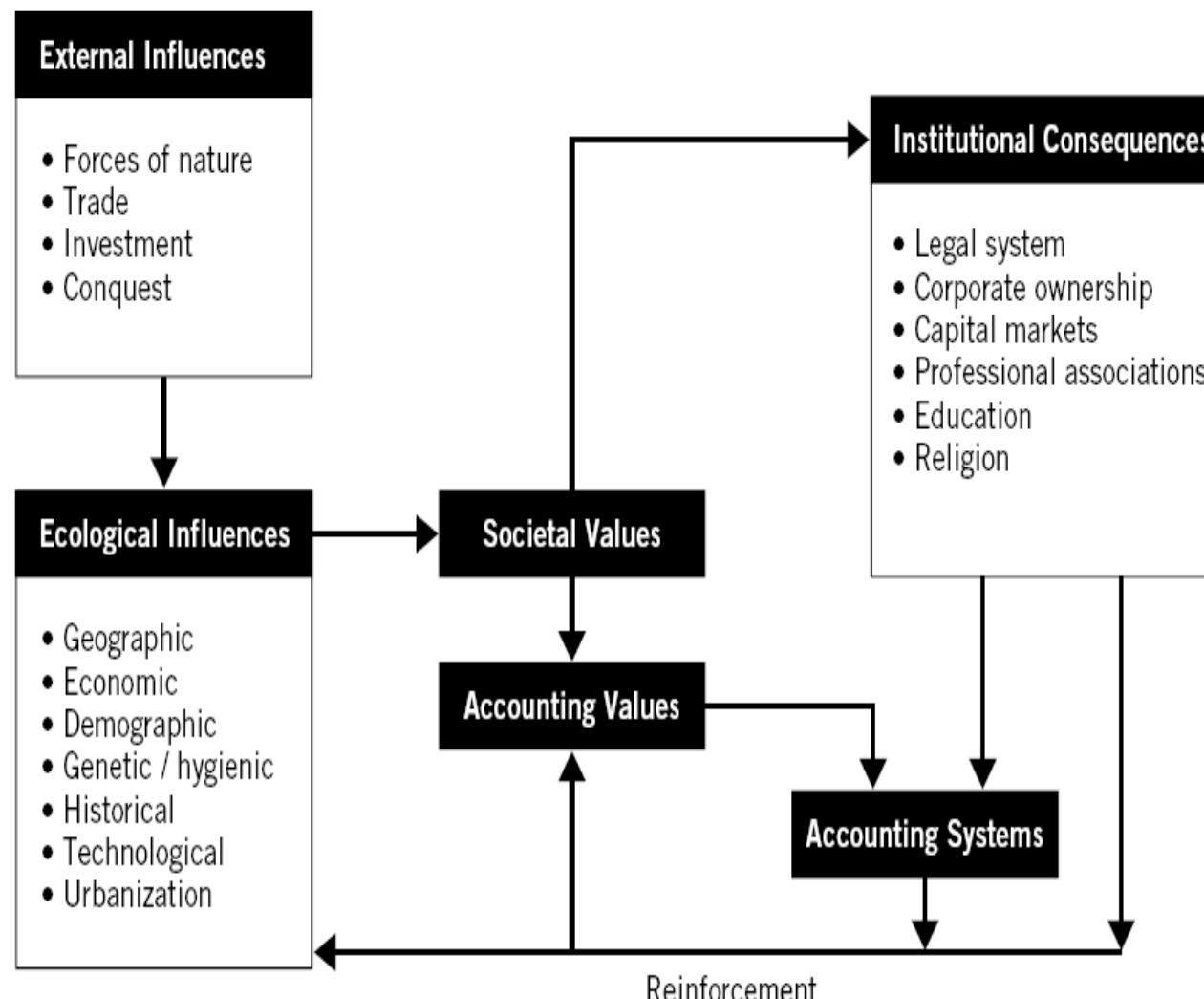
<https://www.youtube.com/watch?v=fz9CQzR0b5g>

Ray Ball's interview on IFRS-US convergence (Not examinable)

<https://www.youtube.com/watch?v=o4P05klvMK0>

- Poll your views.

Cultural Influences on Accounting Systems



Sources of information on various countries

<https://www.icaew.com/en/technical/by-country>

US versus UK

Many of the things in IFRS that are different from US GAAP come from UK GAAP:

- the creation of the IASC was driven by the UK, and the IASC/B has always been in London
- So, we start by comparing the US with the UK

US and UK accounting: similarities

Things that are similar:

- language
- legal system
- accounting in 1800
- important stock markets
- old and powerful audit profession
 - i. set US standards until 1973
 - ii. set UK standards until 1990
- then private sector standard setters
- tax disconnected from financial reporting for many topics
- conceptual framework (US of late 1970s, UK of 1999)

1. US and UK: differences

Differences:

- no Companies Acts in US (from 1844 in UK; followed in Australia and HK)
- Wall Street Crash of 1929 led to Securities and Exchange Commission (SEC) of 1934; no equivalent in UK
- SEC likes detail:
 - i. rules versus principles
 - ii. no 'true and fair' override

Rules versus Principles

- Rules are:
 - More precise
 - More rigorous
- But:
 - When detail is prescribed, and ‘the letter of the law’ is followed, this can undermine the quality of the reports

Example:

- Our company owns 48% of the voting shares of Company X.
Is X a subsidiary?

US GAAP: no; only when ownership is more than half of the voting shares
IFRS: yes, if there is control in practice

- US companies CANNOT depart from rules even if the result is misleading (see Enron of 2001)

2. US and UK: differences

Differences:

- no Companies Acts in US (from 1844 in UK)
- Wall Street Crash of 1929 led to Securities and Exchange Commission of 1934
- SEC likes detail:
 - i. rules versus principles
 - ii. no ‘true and fair’ override
- **UK still has private sector enforcement:**
 - Financial Reporting Review Panel
- UK affected by EU law from 1981, including adoption of IFRS in 2005; UK has kept IFRS after leaving EU in 2020
- UK GAAP from 2015 is a version of “IFRS for SMEs”, whereas US GAAP has slightly converged with IFRS, but is still different

Table 5.1

Vodafone income statement (£m)

	Six months to 30.9.2004			
	UK GAAP adjustments	Presentational	Accounting adjustments	IFRS
Revenue	16,796	(54)	–	16,742
Operating (loss)/profit	(1,615)	(598)	6,972	4,759
Exceptional non-operating items	22	(22)	–	–
Non-operating income and expenses	–	16	–	16
Net financing costs	(291)	91	(35)	(235)
(Loss)/profit before tax	(1,884)	(513)	6,937	4,540
Tax	(1,559)	865	(163)	(857)
Exceptional deferred tax credit	572	(572)	–	–
Minority interests	(324)	220	36	(68)
(Loss)/profit for the period	(3,195)	–	6,810	3,615
Basic (loss)/earnings per share	(4.77p)			5.40p

Source: Adapted from Vodafone income statement in the *Vodafone Interim Announcement, 2004*.

Table 15.1

Old UK GAAP: SSAPs and FRSs, as at the end of 2014

SSAP	
4	Accounting for government grants
5	Accounting for value added tax
9	Stocks and long-term contracts
13	Accounting for research and development
19	Accounting for investment properties
20	Foreign currency translation
21	Accounting for leases and hire purchase contracts
25*	Segmental reporting
FRS	
1	Cash flow statements
2	Accounting for subsidiary undertakings
3	Reporting financial performance
5	Reporting the substance of transactions
6	Acquisitions and mergers
7	Fair values in acquisition accounting
8	Related party disclosures
9	Associates and joint ventures
10	Goodwill and intangible assets
11	Impairment of fixed assets and goodwill
12	Provisions, contingent liabilities and contingent assets
13	Derivatives and other financial instruments: disclosures
15	Tangible fixed assets
16	Current tax
17	Retirement benefits
18	Accounting policies
19	Deferred tax
20	(IFRS 2) Share-based payment
21	(IAS 10) Events after the balance sheet date
22*	(IAS 33) Earnings per share
23*	(IAS 21) The effects of changes in foreign exchange rates
24*	(IAS 29) Financial reporting in hyperinflationary economies
25	(IAS 32) Financial instruments: disclosure and presentation
26*	(IAS 39) Financial instruments: recognition and measurement
27	Life assurance
28	Corresponding amounts
29*	(IFRS 7) Financial instruments: disclosures
30	Heritage assets

Note: *Apply particularly to listed companies.

Table 16.5

Some differences between UK GAAP and IFRS for individual company financial reporting

Topic	UK GAAP	IFRS
1 Formats of statements	Specified by Companies Act	Not specified
2 Investment property	Fair value (unless undue cost or effort)	Cost or fair value
3 Government grants for assets	Choice of immediate income or deferred income	Choice of deduction from asset or deferred income
4 Intangible assets with indefinite lives	Amortised over 10 years	Must not be amortised but annually tested for impairment
5 Development costs meeting certain criteria	Can be capitalised	Must be capitalised
6 Interest on construction	Choice of expensing or capitalising	Must capitalise
7 Financial assets	Two categories	Four categories
8 Pension obligations	Simplified calculation allowed	Projected unit credit method
9 Deferred tax	Based on 'timing differences plus'	Based on temporary differences
10 Lessees	Capitalise finance leases	Capitalise all leases (with small exceptions)
11 Revenue on contracts that can be reliably estimated	Percentage of completion method	On transfer of control to customer

IFRS and US Comparison

- Principles versus rules (as discussed earlier)
- Asset measurement:
 - Optional measurement at fair value under IFRS (but not US GAAP):

IAS 16 Property, plant and equipment

IAS 38 Intangible assets with an active market

IAS 40 Investment property

US GAAP contains fewer explicit options than IFRS

Greater permission in IFRS to use FV than in US GAAP

There is the requirement to use FV for unlisted investments (IFRS 9) and biological assets (IAS 41). This is not the case in US GAAP

Some other US/IFRS differences

Topic	US	IFRS
1 Impairment test	Based on undiscounted cash flows	Based on discounted cash flows
2 Reversals of impairment	Not allowed	Required when suitable
3 Development costs	Expensed (except software)	Capitalised when meeting criteria

IAS 38

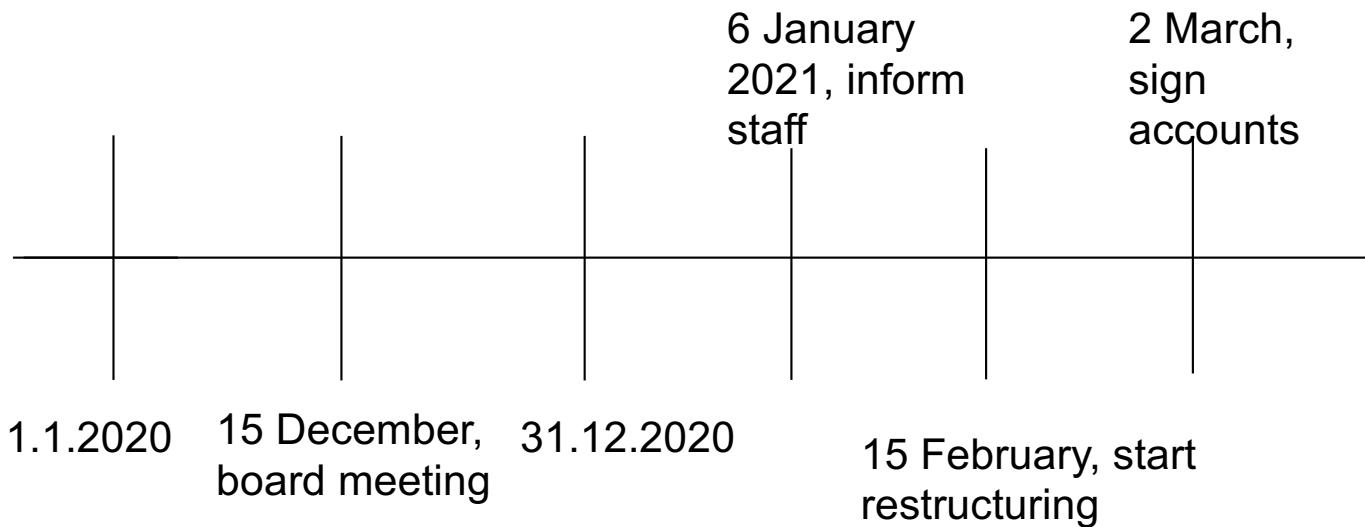
Must be capitalised if:

1. technical feasibility of completing the intangible asset
2. Intention to complete
3. Ability to sell or use
4. Existence of a market
5. Availability of adequate resources to complete
6. The cost can be measured reliably

Cases where IFRS and US rules are incompatible

- IAS 19** *Pensions.* US requires re-measurement gains and losses to be split between income and OCI. IAS requires full charge to OCI.
- IAS 36** *Impairment.* The IAS uses the higher of fair value and discounted future cash flows. The US test uses undiscounted cash flows, but measurement is based on fair value.
- IAS 36** *Impairment Losses.* The IAS requires reversal under suitable circumstances, but that is not allowed in the US (see Lecture 1)
- IAS 37** *Restructuring Provisions.* The IAS recognises these when there has been a public announcement of a formal plan; US GAAP waits until an irrevocable action

Restructuring



IFRS and US incompatibilities (contd)

- IAS 38** *Development Expenditure.* The IAS requires development expenditure which meets certain criteria to be capitalised. Such capitalisation is not allowed by US GAAP
- IFRS 10** *Scope of group.* IFRS uses ‘control’ whereas US GAAP excludes some minority-owned entities but includes VIEs even when not controlled

Other cases where US practice is not consistent with IFRS

IAS 2 *Inventories*: IFRS does not allow LIFO, which is common in the US

IAS 38 *Impairment of indefinite-life intangibles*: US has option to avoid impairment test

Table 10.7

Cost determination for inventory valuation, for 500 companies

	Instances of use
FIFO	325
LIFO	176
Average cost	147
Other	18
	Companies
Use of LIFO by the 176 companies above:	
For all inventories	4
For 50% or more	82
For less than 50%	78
Not determinable	12
Companies using LIFO	176

Note: This table shows methods used by 500 large companies. A company may use more than one method.

Source: Adapted from American Institute of Certified Public Accountants (AICPA) (2010) *Accounting Trends and Techniques*. AICPA, Jersey City, New Jersey, p. 169.

Table 10.8

Examples of adjustments from LIFO

	LIFO (\$m)	Adjustment (\$m)	FIFO (\$m)	% Increase
Ford (2010)	5,917	865	6,782	15
Ford (2014)	7,866	978	8,844	12
Caterpillar (2010)	9,587	2,575	12,162	27
Caterpillar (2014)	12,205	2,430	14,635	20

Source: prepared by the author from the annual reports of the companies.

What about the reverse?

Are there practices allowed by IFRS that are not consistent with practice in the US?

Practices allowed by IFRS but inconsistent with US rules

- IAS 7** *Cash Flows.* IAS allows choice for dividends and interest; US requires them to be “operating”, except that dividends paid are financing
- IAS 16** *Property, Plant and Equipment.* The IAS allows fair value, whereas historical cost is required in the US
- IAS 38** *Intangibles.* The IAS allows fair value for some intangibles, whereas historical cost is required in the US
- IAS 40** *Investment Properties.* The IAS, unlike US rules, allows investment properties to be revalued and not depreciated
- IFRS 9** *Equities.* Optional FV through OCI category; but not in US GAAP

Table 5.3

Reconciliations from IFRS to US GAAP by Bayer, 2006 (€m)

	Income	Equity
As reported under IFRS	1,695	12,851
Business combinations	79	950
Pensions	(168)	11
In-process research and development	(1,375)	(1,454)
Asset impairment	23	(114)
Early retirement program	(27)	74
Revaluation surplus	4	(58)
Other	(17)	2
Deferred tax effect on adjustments	67	3
Minority interest	(12)	(84)
As reported under US GAAP	269	12,181

Source: Adapted from the *Bayer Annual Report, 2006*. Bayer AG, Leverkusen, Germany.

Table 5.4

Reconciliations from IFRS to US GAAP by Alcatel-Lucent, 2006 (€m)

	Income	Equity
Under IFRS	(176)	15,493
Business combinations, goodwill	(403)	4,433
Development costs	39	(146)
Restructuring	(47)	12
Sale and lease-back	(50)	(245)
Compound instruments	39	(840)
Pensions	61	837
Other	(20)	2
Tax effect	(33)	(262)
Under US GAAP	(590)	19,284

Source: Adapted from the Alcatel-Lucent Annual Report, 2006. Alcatel-Lucent, Paris.

Table 5.5

Reconciliations from IFRS to US GAAP by Philips, 2008 (€m)

	Income	Equity
Under IFRS	(91)	15,544
Development costs	(154)	(357)
Amortisation of development	300	—
Pensions	(54)	889
Goodwill impairment	67	339
Goodwill capitalisation	—	81
Intangibles	24	(152)
Financial income/expenses	(313)	—
Equity accounted investees	—	(10)
Tax effects of adjustments	(30)	(122)
Other	87	31
Under US GAAP	(186)	16,243

Source: Adapted from the Annual Report 2008 of Philips NV.

Table 5.6

Reconciliations from US GAAP to IFRS for Norsk Hydro (N kroner millions)

	Net income (2006)	Equity (1.1.2006)
According to US GAAP	17,391	95,495
Pensions	375	(6,012)
Financial instruments	(113)	(792)
Property	(50)	310
Other	128	761
Minority interests	<u>202</u>	<u>981</u>
According to IFRS	<u>17,933</u>	<u>90,743</u>

Source: Compiled by the authors from data available in Annual Report 2007 of Norsk Hydro AS.

Table 5.7

Reconciliations from US GAAP to IFRS for Barrick Gold Corporation (US\$ millions)

	Income (2010)	Equity (31.12.2010)
As reported under US GAAP	3,274	20,734
Capitalised costs	334	952
Reversal of impairment	84	139
Hedging	(39)	(13)
Capitalised interest	(5)	(130)
Other	17	(264)
Tax effects	(83)	(201)
As reported under IFRS	3,582	21,217

Brief discussion of academic article

Zeff, S.A. (1995) 'A perspective on the U.S. public/private-sector approach to the regulation of financial reporting', *Accounting Horizons*, Vol. 9, No. 1.

- Discusses the relationship between government and non-government control over accounting standards
- Zeff aims to provide insight into the US compliance system