

Accounting Standards Update

News from MSPC's SEC Services Team

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US GAAP vs. IFRS — What's the Difference?

Conversion from US Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS) is fast approaching. Already, IFRS is used in 100+ countries. Approximately 40 percent of global Fortune 500 companies currently use IFRS, and by next year, companies in Canada, India and Japan will be using the international standards. Mexico plans to join the IFRS crowd in 2012.

And where's the US? Not yet on the bandwagon. It appears that 2014 would be the earliest that the SEC would require US public companies to use IFRS.

Of course, many people believe that US GAAP is *the* standard by which all others should be measured. And while a lot of effort has been put into "converging" IFRS and US GAAP, there are still differences.

Generally, IFRS is more "principles" based and provides much less detail than US GAAP, which is more "rules" based and more prescriptive. Some of the differences between IFRS and US GAAP are intentional. They were adopted by the International Accounting Standards Board (IASB) because they represent "best practices" around the world. Other differences are more focused on interpretation, with the IASB leaving it to tax and audit professionals to interpret the standards based on the accounting principles represented.

Among the more notable differences highlighted by the American Institute of Certified Public Accountants (AICPA) and others:

Inventory: IFRS does not permit last in first out (LIFO) as an inventory costing method. Also, under US GAAP, if inventory is written down, it cannot be written back up. IFRS allows inventory to be written back up if certain conditions are met.

Provisions/Contingencies: IFRS has a different probability threshold and measurement objective for contingencies. Under US GAAP, the accrual is based on the most probable outcome. With IFRS, the accrual is based on the best estimate. In terms of restructuring, IFRS accounts for restructuring costs at an earlier point — when a formal plan is announced — while US GAAP requires a formal commitment.

Revenue Recognition: IFRS guidance regarding revenue recognition is less extensive than US GAAP and contains relatively little industry-specific information.

Fair Value Measurement: IFRS generally considers fair value as a transaction "entry" price rather than an "exit price" under U.S. GAAP.

Income Taxes: Under US GAAP, where there is uncertainty in tax position, accounting is based on the sustainability of the tax position in Tax Court. Under IFRS, accounting for tax consequences reflects management's expectations of what's going to happen.

Leases: IFRS recognizes gain on an operating sale-lease back immediately, where US GAAP amortizes the gain over the lease term.

Impairments: The US GAAP model is more forgiving than the IFRS model; impairment exists when the carrying value exceeds undiscounted cash flows. Under IFRS, impairment exists when carrying value exceeds fair value. However, IFRS allows reversal of impairments, while US GAAP does not.

Discontinued Operations: IFRS defines a discontinued operation as a reportable business or geographic segment or major component thereof, whereas US GAAP defines it as an operating segment, a reporting unit, a subsidiary or asset group.

It is hoped that by the time IFRS is adopted in the US that many of these differences and others will have been resolved. The SEC is actively working to iron out these differences in ways with which US companies will be comfortable. In fact, the SEC has stated that “continued progress toward convergence” will be a factor in its decisions about IFRS adoption in the US.

Pros & Cons

That said, adoption seems inevitable. Those in favor of adoption argue that a single set of international accounting standards will make it easier for investors to compare financial results and understand opportunities in the growing global marketplace. IFRS would also make it easier for multinational companies to present their financial statements consistently from country to country.

Those not so sure about adoption argue that IFRS will never match the standard set by US GAAP and that compliance will be an issue around the world.

Of course the true scope and scale of the conversion effort to move from US GAAP to IFRS is still to be determined, but it certainly will require education and training for companies' in-house accounting personnel as well as CPAs.

Stay tuned for more updates as the SEC and IASB continue to refine their convergence efforts.

If you have any questions about IFRS or would like to discuss this topic further, please contact James Pellecchia at (908) 272-7000 x 3723 or JPellecchia@mspc-cpa.com.