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Dear Dr. Garefalakis,

I am writing to confirm that your multi-authored article *Differences between US GAAP and IFRS during the years of financial crisis within basic conceptual figures as well as at the cash flow statements* by Kanellos Toudas, Alexandros Garefalakis, and Marios Menexiadis will be published in Volume 8 IJEBL, in issue 8/4.

Best regards,  
Professor Ruth Taplin, Editor,  
Interdisciplinary Journal of Economics and Business Law (IJEBL)

***Differences between US GAAP and IFRS during the years of financial crisis within basic conceptual figures as well as at the cash flow statements***

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**Abstract:**

*Generally Accepted Accounting Principles (GAAP)* are widely accepted and approved by US *Securities and Exchange Commission (SEC)* while the *International Financial Reporting Standards (IFRS)* are a set of international accounting standards for business. Globalization creates the need for the implementation of globally accepted accounting standards. *IFRS* and *US GAAP* need to converge in order to eliminate the gap between them. So far, at least 127 countries have adopted *IFRS* and this number is expected to rise to 150. During the convergence process, *IFRS* are expected to have an increased impact on international markets as they reflect more accurately the financial status of a company. In the present paper, the differences and convergence of the two sets of accounting standards (*U.S. GAAP* and *IFRS*), stemming from the ongoing global financial crisis, are presented.

**Keywords:** International Accounting Standards Board (IASB), Financial Accounting Standards Board (FASB), International Financing Reported Standards (IFRS), United States General Accepted Accounting Principles (US GAAP).

## **1. Introduction**

US GAAP is the generally accepted accounting principles adopted by the US Securities and Exchange Commission (SEC). The Financial Accounting Standards Board (FASB) has published US GAAP in an extensible business reporting language, starting in 2008.

International Financial Reporting Standards (IFRS) - IFRS have been designed as a common global language for business affairs, so that the accounts of the companies included in the financial statements are understandable and comparable between international borders. This comes as a consequence, of the increasing international trade participation and is considered particularly important for companies that have transactions in different countries. They are also referred to as the gradual replacement of many different national accounting standards.

Over the years, the phenomenon of globalization in the markets has become more and more pronounced. All these changes require specialized knowledge. There is also a disposition for businesses to grow in foreign markets, which creates the need for the introduction of uniform accounting rules so that the investors have the best possible information and control over any investment wherever they take place. In the meantime, it is imperative to come as close as possible to IFRS and US GAAP and to smooth out their differences.

From this point of view, an effort - quite difficult within a dynamic environment - is made by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to alleviate these differences.

Approximately 127 countries have adopted IFRS (Warren et al, 2014) and the forecast is to increase to 150 (Tyson, 2011). This raises the need for IFRS to engage US GAAP. In the process and effort of the two committees, on IFRS and US GAAP, there have been several conflicting views, mostly from academics, on which standards and rules are best to be followed. Therefore, IFRSs are expected to have a greater impact on international financial markets and better reflect the business position. (Florou & Kosi 2013).

In the present paper, according to the recent bibliographic reference, an attempt is made to capture and map out key similarities and differences between IFRS and US GAAP on key conceptual figures and on cash flow statements.

## **1. US GAAP και IFRS**

### **General Accepted Accounting Principles - US GAAP**

Accounting principles approved by the US Securities and Exchange Commission (SEC) are generally accepted. While the SEC has stated that it intends to move from US GAAP to International Financial Reporting Standards (IFRS), the latter differ significantly from US GAAP and progress is slow and uncertain.

The Financial Accounting Standards Board (FASB) has published US GAAP in an Extensible Business Reporting Language (XBRL) starting in 2008.

### **International Financial Reporting Standards – IFRS**

International Accounting Standards have been designed as a common global language for business affairs, so that the accounts of the company's financial statements are understandable and comparable between international borders. They are a consequence of increasing international trade participation and are particularly important for businesses that trade in

different countries. They are the gradual replacement of the many different National Accounting Standards and the rules to be followed by accountants, in order to keep accounting books, comparable, understandable, reliable and appropriate for domestic or foreign users.

## **Brief history**

Regarding the path that has been followed up until recently by the International Accounting Standards, we can, on a semi-logical basis and based on the degree of significance of the events, note the following dates:

**2002:** the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) jointly agree to work to ensure that IFRS and US GAAP are compatible with each other.

**2005:** The EU adopts IFRS for all companies listed on international markets. The US Securities and Exchange Commission (SEC) and the European Commission decide to work on a common convergence map.

**2007:** The SEC allows all foreign (non-US) companies to use IFRS.

**2008:** The SEC proposes a timetable and the prerequisites for adoption of IFRS.

**2010:** The SEC redefines the prerequisites on that cruise plan.

**2013:** Target date for the FASB and the IASB for the Joint Standards Project. Also target date for the SEC to approve IFRSs.

**2015:** The SEC sets the earliest date (milestone) for the adoption of IFRS in 2016 in its public enterprises.

## **2. Similarities and differences between IFRS and US GAAP**

The similarities and differences that exist under US GAAP and IFRS are quite distinct. When comparing US GAAP with IFRS, we find that differences exist in two parts, on the rules and on the principles.

In addition, US GAAP is supported by three aspects: (1) Legal (2) Economics, and (3) A Social Accounting System. On the contrary, IFRSs are based on the accounting standard principle and therefore meet the country's social economic needs.

As a result, the main differences and objectives between US GAAP and IFRS in the states that fell within their scope, were found under the economic, legal, political and social aspect. For example, in Germany they decided to adopt IFRS, the central bank agreed that IFRS was a great accounting model to be followed by the country. Another example that can be depicted is the Netherlands, because Netherlands had to clearly identify own funds outside its financial system, following the guidance of IFRS.

The technical differences that arise between US GAAP and International Accounting Standards are as follows:

(1) The presentation of the financial statements in each accounting standard,

- (2) In the assessment of the financial position of the Balance Sheet and,
- (3) The recording of accounting differences in accounting books.

Therefore, IFRS are found to offer more than US GAAP as they provide an extensive reporting obligation (Warren et al, 2014).

As the SEC started to follow the guidelines, the three institutions that showed interest in narrowing the technical differences between US GAAP and IFRS were: (1) government, (2) professional accountants, and (3) teachers of tertiary education. In addition, when the SEC proposed a plan to IFRS, governments, accountants and educators applied the US GAAP and IFRS timetable for convergence. Moreover, the initial stage of adopting IFRS in the United States was scheduled to take place at the earliest in 2014, given that, in terms of financial reporting, IFRS is more flexible than US GAAP.

In a brief summary of Warren et al (2014), a chronological case of US GAAP convergence with IFRSs was proposed and, in addition, in order to provide the appropriate accounting method for reconciliation between the United States and International Accounting Standards, three conditions must be met following:

- (i) understand the size of the financial reports consolidated under the two standards,
- (ii) have carefully analyzed the items that are reflected in the financial statements and which create discrepancies,
- (iii) the professional crisis reflected in the financial statements should address an overall logic of the two long-term economic decision-making models among nations.

Miller and Becker (2010) and Poon (2012) research studies, have found that if publicly listed companies harmonize their financial statements in accordance with IFRS, investors will receive useful and reliable financial information.

Regarding the differences between US GAAP and IFRS related to the financial reporting aspect, IAS 1 concerning the presentation of financial statements, but does not explicitly provide for disclosure.

In addition, Smith (2012), throughout the research study, discusses the importance of presenting the Balance Sheet as follows: "Assets - Liabilities = Equity", in the form in America US: Asset = Liabilities + Shares of Equity.

For example, Shareholders' Equity as stated in IAS 7 is quite similar to SFAS No. 95, presented under US GAAP. However, with regards to the disclosure of information in the financial footnotes of IFRS, the currency must be disclosed in the financial footnotes.

US GAAP, on the other hand, does not require the United States publicly traded companies to disclose the currency in the footnotes of the financial statements, as it is relatively understandable that each company.

The consolidation of financial statements also in accordance with IFRS, favors a control model, while that of US GAAP prefers a risk and reward model. Some entities are consolidated under FIN 46 (R) and must be presented separately in accordance with IFRSs.

According to IFRS, in the income tax, extraordinary items are not separated in the income statement. With US GAAP, they appear below net income.

Expenses for development costs can be capitalized in accordance with IFRSs if certain criteria are met and are considered as "expenses" in US GAAP.

Another relative difference between US GAAP and International Accounting Standards is the inventory method.

According to IFRS, the inventory accounting methods allowed are, FIFO and the weighted average cost method, while LIFO is banned under IFRS. US GAAP, on the other hand, allows all three accounting methods, which are FIFO, LIFO and the weighted average cost method.

Another difference based on the relationship between US GAAP and IFRS is the value of investment property. The similarities and differences between US GAAP and IFRSs remain in the technical aspect and in selected items presented in the financial statements in accordance with Smith, (2012).

Thus, according to IFRS, inventories are valued at cost and must not exceed net realizable value.

Also, IAS 41 provides specific guidance on biological assets and agricultural production. According to US GAAP, inventories are valued at the lowest cost-or-market, but with a maximum of net realizable value and a lower limit minus a normal profit margin.

Consequently, if the replacement cost is below the net realizable value, IFRS and US GAAP will export different valuations.

Still, according to IFRS, there is no distinction between profit or loss or expense-losses in the income statement. Two different approaches can be used regarding the change in shareholders' equity.

In addition, in the cash flow statement, in accordance with IAS 7, the cash flow statement is a required economic condition.

The requirements of IAS 7 are almost the same as SFAS 95 in the US, with few differences. In the United States, interest paid on interest and dividends received is shown in the operating section, while dividends paid are shown in finance.

According to IFRS, interest paid, interest income, and dividends received are usually treated as operating cash flows. It is also possible that interest paid is also accounted for as cash flow while interest income and dividends received can be accounted for as investment cash flow because they are the cost of financial resources or returns on investments. Non-cash transactions (such as debt securities issued for long-term assets) should not be disclosed in the statement of cash flows.

## **Adjustment differences**

Regarding investment property, in accordance with IAS 40, investment property is defined as property held for renting or revaluing capital, or both. Investment property may be accounted for using the fair value model or cost model. According to the fair value model, changes in fair value are recognized in the income statement. According to the cost model (cost less accumulated depreciation), fair value should be disclosed in the notes.

## **Leases**

For leases under US GAAP, they are classified as equity if one or more of four criteria are met: (a) a transfer of title; (b) the option to buy; (c) the lease term is equal to, or greater than 75% (d) the present value of the minimum lease payments is greater than, or equal to 90% of the fair value of the asset.

According to IFRS, the criteria are less rigid. Under IAS 17, the lease is classified as an operating lease or as a finance lease (US GAAP refers to finance leases as leased capital). Under IAS 17, a finance lease transfers substantially all the risks and rewards of ownership of an asset. Title may or may not eventually be transferred.

Four of the eight IFRS criteria are as follows:

- The lease transfers the ownership to the lessee.
- The lessee has the right to purchase.
- The term of the lease is for the "greater part" of the asset's economic life.
- The present value of the minimum lease payments is at least substantially the total fair value of the leased asset.

### **3. Cash flow differences between IFRS and US GAAP**

There are differences between the two models on the presentation of the cash flow statement, that could potentially lead to differences in the real picture of cash, as well as changes in operating, investing and financing activities. Particularly:

#### **US GAAP:**

Bank overdrafts are not included in cash and cash equivalents. Changes in balances of overdrafts are classified as financial flows rather than cash and cash equivalents.

- There is no requirement for expenditures recognized as assets to be classified as investing activities.
- Taxes generally paid are classified as operating cash flows. There are specific rules on the classification of tax debts associated with shareholders' compensation arrangements.
- There are additional disclosure rules for the supplementary disclosure of interest and taxes paid during the financial year.

#### **IFRS:**

Available funds may include bank overdrafts repayable on demand. Short-term bank borrowings are not included in cash or cash equivalents and are treated as financial cash flows.

- Only expenditures that result in a recognized asset are eligible for classification as investing activities.
- Interests and dividends received must be classified in operating or investing activities, while interest and dividends paid must be classified in cash flows from operating or financing activities.
- Taxes paid should be classified under operating cash flows unless it is specifically identified as a financial or investing activity.

As reported by the Federal Commission or the Financial Accounting Standards Board (FASB), the information flowing from the Cash Flow Statement can help users of the financial statements to make decisions about the amount, timing and degree of uncertainty of future conditions. Its informational value is undoubtedly particularly important, although, there are no particular differences between the International and American Standards in the Statement of Cash Flows, these can lead to significant differences in the amounts considered as cash and cash equivalents since, as cash is not considered overdrafts by banks and interest is also considered as operating flows and cash flow per share is prohibited.



## **The adoption of IFRS in the US.**

The main objective of the IASB is the convergence of global accounting standards and, more generally, the universal acceptance of its standards. In other words, the IASB aims to create a high-quality set of global accounting standards that are acceptable to the general purpose of financial statements. In this context, it is true that in recent years IAS / IFRS has gained more weight and authority, which has led to increased global acceptance. In particular, more than 100 countries today, as mentioned in the introduction, require or allow the use of IASB standards, making it more visible than ever to switch to a globally accepted language. However, it was realized that in order to promote and ultimately achieve the ambitious IASB goal, it would be critical to accept its standards on the other side of the Atlantic, and in particular in the United States.

More and more recognition of IAS / IFRS, has led to strong competition with US GAAP, making these two models work as a duplicate and recognized as possible international accounting regimes. In more detail, it has become a global consciousness that US GAAP was intertwined with the creation of high-quality financial statements, the rapid development of IAS / IFRS triggered controversy over most of the two standards being of superior quality, and raised the question whether IAS / IFRS could be extended to the US and thus, bend the last major obstacle to the global acceptance of the IASB and its standards.

The two IASB and FASB boards have been working since 2002 to achieve convergence of IFRS and US GAAP. The commitment of the two councils was strengthened in 2006 by setting specific targets by 2008. Recognizing the progress made and taking other factors into account, the US SEC (Securities and Exchange Commission) decided in 2007 to non-US issuers to publish US financial in accordance with IFRS, without having to present their agreement with US GAAP. It also decided to allow US publishers to publish US financial statements in accordance with IFRS. In 2008 the two Councils renewed their agreement and set new targets by 2011. As of 2009, the Councils meeting the G20, the European Union and other interested organizations issue progress reports which, among other things, mention the intensification of their work and their results for some issues concerning differences between the two frameworks. As a result, the IASB and the FASB have tried and achieved significant convergence between IFRS and US GAAP as opposed to other issues that remain outstanding.

Observing the major events and changes that took place in the last decade to eliminate the differences between the two reference frameworks and towards a single global framework we can present some important dates:

- 2001 - Formation of the IASC Foundation and the IASB.
- 2002 - The European Union passes a regulation on the adoption of IFRS by listed companies in 2005. IASB and FASB sign an agreement and are committed to reducing the differences between IFRS and US GAAP, starting with the conversion efforts.
- 2005 - Almost 7,000 listed companies in Europe adopt IFRS.
- 2007 - The SEC withdraws the requirement to reconcile the financial statements of non-US companies, which they publish under IFRS, with the American accounting principles.
- 2008 - The SEC proposes a guide to possible mandatory adoption of IFRS by US GAAP users.
- 2009 - The G20 supports IFRS as an important step in reforming the Financial System.
- 2010 - The SEC publishes a statement that supports Convergence and Global Accounting Standards and asks for the development and execution of a plan to develop high quality internationally accepted accounting standards and to align IFRSs with US GAAPs. This is

supposed to reduce the concerns that emerged with the 2008 guide, help public transparency and benefit investors.

- 2011 - The Memorandum of Understanding (MOU) was finalized, which initially in 2006 highlighted many important convergence projects between the IASB and the FASB.

Efforts to integrate IFRS in the US is ongoing and guided by the market itself. Specifically, 450 companies are operating in the U.S., based in the European Union, Canada, Mexico, Brazil and South Korea, have a market share of over \$ 3 trillion and already use IFRS to create their financial statements. China is also in the process of adopting IFRS.

In addition, the IASB created in 2013 a financial model just to bridge the technical difficulties between IASB and FASB in the financial statements.

Another factor in the continued and universal adoption of IFRS is that of the above 450 multinationals operating in the US, only 62% of them reported that the transition costs to IFRSs are less than \$ 500,000. Companies with sales of over \$ 1 billion reported that the transition costs are less than 0.1% of their annual turnover.

Consequently, we conclude that the transition costs are manageable by the top management of these companies. A worthwhile point of reference is also that 27 EU countries. have adopted IFRS, as well as another 100 countries on the world map have adopted IFRS for public organizations.

The year 2016 was expected to apply IFRS to the Asian market in countries such as Japan, India and China. At the same time, the G-20 countries were pushing for and advocating global implementation at a global level.

In general, approaches tend to converge to a common point that differs due to different principles and rules of practice in each entity (KPMG 2013). A major issue is when the practices will be identified (Ernst & Young 2013).

## **4. Conclusions**

From the above, we conclude that the universal application of IFRSs by companies operating worldwide is guided by their continued international expansion and operation, as opposed to the different methodological approaches to the valuation of the assets of these companies as they adapt to their national accounting standards (Historic Cost principle as opposed to the application of Fair Value). Uniform financial information becomes imperative that is linked to the further internationalization of businesses.

In conclusion, it may be noted that at a later date, the SEC will require listed companies to adopt IFRSs. In addition, the top 500 listed NYSE listed companies in the New York Stock Exchange have to align their financial statements with IFRS.

As a result, the four main objectives of IASB are:

- (1) develop a unique accounting language,
- (2) the promotion of strong IFRS standards,
- (3) meet the need for governance in the emerging economic market,
- (4) promote IFRS as a high-quality accounting solution, as noted by IAS.

Therefore, the application of IFRS is inevitable and the US government should create a sense of urgency for the preparation of US business leaders. The transfer process from USGAAP to IFRS is part of international practice and leads to the conclusion that IFRS is geared to informing the potential international investor for immediate information and a clearer picture of the financial position. American reality is moving alongside the adoption of IFRS in reduced taxation for capital repatriation.

Along with the increased application of IFRS in the US. the global trend shows a shift by creating high economic standards, as evidenced by the FASB and IASB attitude in the adoption of IFRS. (Murphy, 2014).

However, it should not be forgotten how the presentation of data during the first application and transition is affected. Transferring from one scheme to another will directly and predominantly affect the accuracy of the forecasts, which will be in favor of the more experienced ones, which will decline over the years as experience increases, thus highlighting the need for training and relevant training through the agencies education.

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