What are the major differences between gaap and ifrs

In the field of accounting, there are two financial reporting standards – International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (US GAAP). Convergence between IFRS and US GAAP is one of the bigger issues in the global implementation of IFRS. At present, all US entities have to file accounts prepared under local US GAAP except for the overseas issuer of securities, they have option of using IFRS from 2010. IFRS is the most commonly used system in the world, and this method of accounting for publicly traded companies is used by more than 100 countries. FASB and IASB continues work collaboratively in adoption of new standards. But do you know the difference between them? We have compiled a clear table of basic differences between IFRS and US GAAP for you, which will help you with that. Sep 09, 2020 | By Michael Whitmire The underlying accounting rule that debits must equal credits applies around the world, but precisely how those debits and credits eventually show up in the financials depends on whether your company has to report under U.S. GAAP or international standards. Here in the United States, public companies have to report under GAAP, while around 120 countries around the world use a different set of standards, known as IFRS. Let's take a look at what those standards mean, and what the main differences are. What is GAAP? Generally accepted accounting principles, or GAAP, is promulgated by the Financial Accounting Standards Board (FASB). GAAP had its origins in the 1929 stock market crash. The SEC requires domestic registrants to report under GAAP. Private companies in the U.S. are not required to follow GAAP, but most companies that provide audited financial statements to banks and other stakeholders use GAAP accounting. If you work in corporate finance in the U.S., you live and breathe GAAP. The overarching goal of FASB is to "establish and improve financial accounting and reporting standards to provide useful information to investors and other users of financial reports and educate stakeholders on how to most effectively understand and implement those standards." When everyone follows the same set of principles, comparability of financial information between companies is easier. You're comparing apples to apples, not apples to oranges. A criticism of GAAP is that it's overly complex, especially for smaller non-public companies. In response, the Private Company Council (PCC) was established in 2012 as an advisory board to FASB. Since then, the two groups working together have carved out simplifications for private companies in areas such as hedge accounting, amortization of goodwill, and variable interest entities. What is IFRS? International financial reporting standards (IFRS) are developed and approved by the International Accounting Standards Board (IASB), which is based in London. Since the formation of the IASB in 2001, over 120 countries around the world, from Afghanistan to Zimbabwe, have adopted IFRS in whole or part. Like FASB, the IASB, is also developing carve outs for smaller businesses. GAAP vs. IFRS: What are the differences? Because we live in an increasingly global economy, understanding the key differences between these accounting methods can help when you need to compare financials from different countries. U.S. companies that are part of multinational entities may have to prepare financials under both standards. Ignoring these differences can lead to unpleasant surprises in acquisitions because net income and equity can be vastly different. Rules-based vs. principles-based GAAP is primarily rules-based, and includes many industry-specific standards. In contrast, IFRS is principles-based, and requires judgment and interpretation to determine how the standard applies to a given situation. Since the early 2000s, there have been various projects aimed at convergence between the two sets of standards. While the SEC's support for convergence has diminished of late, the recent big updates to revenue recognition and lease accounting were joint projects between FASB and IASB. The resulting standards share the same broad principles-based approach, and differ primarily in the details. For example, FASB's update to Revenue from Contracts with Customers, ASC 606 and IASB's update, IFRS 15, share the same five-step process for revenue recognition. However, the two standards are not absolutely identical. Under ASC 606, the fair value of any noncash consideration in a contract, such as shares or advertising, must be measured at contract inception. But under IFRS 15, no date is specified, so the value of noncash consideration can be measured when it seems most appropriate, whether at contract inception or perhaps at the time that the noncash payment is received. Likewise, the updates to lease accounting under GAAP and IFRS (ASC 842 and IFRS 16, respectively) share a common framework, but have a few differences. IFRS has a de minimus exception, which allows lessees to exclude leases for items with a value under $5,000. GAAP has no such blanket exception, but allows organizations to establish a materiality threshold in their accounting policies for capitalization. Another difference is that ASC 842 retains a distinction between operating leases and finance leases while IFRS 16 classifies all leases as finance leases. Financial Statements Under GAAP, balance sheet assets are reported in descending order of liquidity, with current assets at the top. Owners' equity is reported at the bottom. IFRS reverses the order of liquidity and starts with non-current assets, and places owners' equity in the middle, between assets and liabilities. The statement of cash flows is also a bit different. Under GAAP, interest paid, interest received, and dividends received are all classified as operating activities. Dividends paid go under financing activities. IFRS is more flexible: interest and dividends paid can be either operating or financing activities, while interest and dividends received are either operating or investing activities. Companies can choose the option that seems most appropriate for their particular situation. Income statements are also a bit different under the two sets of standards. Under IFRS, entities can classify expenses either by function or nature (depreciation or salaries, for example). If a functional classification is chosen, then at the very least, allocations must be made to present selling expenses separately. While GAAP itself has no such requirement, SEC registrants must follow specific rules, which include functional categories and specific line item descriptions. In practice, most US entities use a functional classification. Inventory Accounting for the flow of inventory is another area where the two sets of standards differ. Both GAAP and IFRS allow First In, First Out (FIFO), weighted average cost, and specific identification methods for valuing inventories. Under GAAP, Last In, First Out (LIFO) is also permitted, but LIFO isn't allowed under IFRS. While both methods allow write-down of inventory values if the fair market value decreases, only IFRS allows reversal of those write-downs if the market value later recovers. GAAP takes a more conservative approach, while inventory values can be more volatile under IFRS. Intangibles According to both IFRS and GAAP, goodwill arises only in a business combination. Until the early 2000s, goodwill was amortized, but changes to both standards switched to a new model that required testing for impairment. But because impairment testing is costly and seems to provide little useful information to stakeholders, both FASB and IASB are currently considering proposals that would allow amortization of goodwill. FASB has already made the change for private companies with a recent update that allows goodwill to be amortized straight-line over the lesser of ten years or its estimated useful life. Goodwill isn't the only intangible asset that companies may have on their books. To remain competitive, organizations incur research and development cost to develop new products or services. Under both sets of standards, all costs during the research phase are expensed as incurred. But when the project moves into the development phase, the standards diverge. The development phase is typically triggered by the establishment of technical feasibility. Under IFRS, when key criteria have been met, costs during the development phase are capitalized. Key criteria include the achievement of technical feasibility and the anticipation of future economic benefits. The resulting self-created intangible is amortized over its estimated useful life. However, under GAAP, development costs are expensed as incurred, unless this is for software. GAAP has specific standards that deal with internally developed software that differentiate between software developed for internal use and software that will be sold, leased or marketed to outsiders. For software that will be used internally, GAAP requires capitalization during the development phase until the software goes live. If the software is for external use, capitalization is required once technological feasibility has been demonstrated until it is ready to be released. Valuation of Assets Under both sets of standards, long-lived assets, which include property, plant, and equipment, are initially valued at acquisition cost. Under both GAAP and IFRS, fixed assets are depreciated over their estimated useful life. If the asset consists of multiple components with different useful lives, IFRS requires separate depreciation of those components. Component depreciation is allowed under GAAP, but isn't mandatory. Under IFRS, assets can be later revalued to fair value, whether this is an increase or a decrease in value. Revaluation is not allowed under GAAP. Investment Property This is an asset category specific to IFRS which does not exist in GAAP. Investment property is defined as property held for rental income or capital appreciation. Like other assets, investment property is initially valued at cost, and can be later revalued to market value.   Impairment Losses When the fair value of an asset is less than its carrying value, both sets of standards allow for recognition of an impairment loss. The carrying amount is the net of the recorded value of the asset and any accumulated depreciation, amortization or impairment losses. This applies to goodwill, intangible assets and fixed assets. However, the standards differ in the mechanics of calculating impairment losses, and whether impairment losses can be reversed. Under GAAP, an impairment loss has occurred when the carrying amount of an intangible asset, including goodwill, exceeds its fair value. Fixed assets are impaired when the carrying amount exceeds both its fair value and the undiscounted cash flows that can be attributed to that asset. The impairment loss to be recognized is the difference between the carrying amount and the fair value. With IFRS, the carrying amount of an asset is compared to its recoverable amount, which is the greater of (a) the fair value of the asset less selling costs or (b) the present value of future cash flows that can be attributed to that asset. Impairment losses are the difference between the carrying amount and the recoverable amount. GAAP prohibits the reversal of all impairment losses. But, under IFRS, impairment losses for intangibles other than goodwill and for fixed assets can be reversed. Reversal of impairment losses under IFRS are capped at the asset's initial carrying amount. Mastering the Differences This post just scratches the surface of the differences between GAAP and IFRS. Converting between GAAP and IFRS can be a daunting task, and anyone undertaking that task will need more resources than this brief article. And, as the standards themselves continue to evolve, the differences between GAAP and IFRS will also evolve. We can only hope that one day the similarities will vastly outweigh the differences.

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