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U.S. GAAP or IFRS - A Review of Literature

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Abstract

Purpose: This paper purpose is to report the differences between U.S. GAAP and IFRS by presenting a review of literature available on the topic.

Methodology: This paper is based on review of 27 research papers. This paper is divided into two parts. First part presents the previous studies focused on business aspects (companies can ill afford the cost of an increasing number of GAAP standards and impact on investors) and second part presents the previous studies focused on fundamental differences between U.S. GAAP and IFRS.

Findings: This paper is based on review of literature that present the differences between U.S. GAAP and International Financial Reporting Standards (IFRS). As per the studies done, U.S. GAAP contains more detailed, specific requirements than IFRS. In some instances, IFRS does not contain any corresponding guidance and, in others, IFRS contains higher-level or general guidance that is not directly comparable to the U.S. GAAP requirement.

Originality/Value: This paper findings are based on 27 research papers only. As accounting standards are changing due to change in current economic situations, there is a large scope for the future studies based on U.S. GAAP and IFRS differences and impact of those difference on the investors.

Introduction

International Financial Reporting Standards published by the International Accounting Standard Board (the IASB Board) for financial reporting of the companies by using common accounting standards across international boundaries. These standards are adopted by many countries globally including European Union. U.S. GAAP are developed and maintained by FASB with the assistance of the Emerging Issues Task Force and the Private Company Council for profit oriented as well as non-profit oriented companies (KPMG, 2020). U.S. GAAP are used for financial reporting purposes by many companies outside U.S. as well. There are significant differences between IFRS and U.S. GAAP as found by different studies conducted over the years. Due to differences, it is difficult for investors to compare companies' financial statement prepared by using IFRS and U.S. GAAP as mentioned by Fosbre, Kraft, & Fosbre, (2009). Multinational companies following U.S. GAAP are spending time and money to convert their financial statements as per IFRS. They are required to convert the financial statements to provide information to their investors so they can compare the financial statements of different companies around the world. Number of studies have been done to find differences between IFRS and U.S. GAAP in context of fundamental differences, impact on investors and economy. This paper aims to report the differences between U.S. GAAP and IFRS by presenting a review of literature available on the topic. For meeting the objective, this paper is divided into two parts. First part presents the previous studies focused on business aspects (companies can ill afford the cost of an increasing number of GAAP standards and impact on investors) and second part presents the previous studies focused on fundamental differences between U.S. GAAP and IFRS.

First PART: Based on Business Aspects

Based on the following literature review, it is found that the corporation reporting under IFRS report higher revenue as compared to the corporation reporting revenue under U.S. GAAP. It is required for users of financial statement including investors to aware about the significant numerical differences (Henry, Lin & Yang, 2009). Multinational companies will be able to save labour cost and time for preparing financial statements by adopting IFRS (Fosbre, Kraft & Fosbre, 2009). McEnroe & Sullivan (2014) mentioned that SEC estimated million dollars cost for some companies in transition of U.S. GAAP to IFRS. Based on previous studies done, author concluded that convergence, rather than adoption of IFRS seems more feasible. Fajardo (2016) also supported global set of accounting standards as it provides consistent, transparent, reliable, and comparable accounting information to the investors. Cost of convergence and changes required in legal and regulatory system create difference between stronger and weaker economies approach towards convergence of U.S. GAAP to IFRS (Toudas, 2018).

Hughes and Sander (2007) conducted a study to find out the differences between U.S. GAAP and IFRS by considering the 20 convergence projects. It is concluded that income differences are likely to persist for several years. It is mentioned that U.S. accountant should understand and adjust the differences for evaluating and comparing companies' report prepared as per IFRS and U.S. GAAP.

Ilse Maria Beuren, Nelson Hein and Roberto Carlos Klann (2008) conducted a study to analyze the impact of IFRS and U.S. GAAP differences on the economic indicators of English companies. Based on regression and correlation analysis, a significant correlation was observed between the differences in economic-financial indicators of the companies calculated based on AS sent to the LSE and the NYSE. The authors observed no significant impact of accounting standard differences on the economic indicators of English companies.

Henry, Lin and Yang (2009) conducted a study to find out the impact of convergence and IFRS adoption by EU on the financial results. The study found that reported net income is higher by following IFRS than the reported net income calculated as per U.S. GAAP. The study concluded that significant numerical differences are exist between financial results presented as per IFRS and as per U.S. GAAP. It is required for the users of financial statement including investors to aware about the significant numerical differences.

Fosbre Anne, Kraft Ellen & Fosbre Paul (2009) stated that it is difficult for investors to compare companies' financial statement prepared by using IFRS and U.S. GAAP. As per their study, IFRS offers a sophisticated and a simplified program for a fresh start in financial reporting for the investors as compared to complex U.S. GAAP standards. Multinational companies will be able to save labour cost and time for preparing financial statements by adopting IFRS.

Smith (2012) stated that reported net income under GAAP is higher than reported net income under IFRS. Author found no significant differences between IFRS- and GAAP-reported financial statement items and suggested that IFRS adoption will not cause a major change in U.S. financial reporting results but individual firms may encounter significant differences for IFRS- and GAAP-based financial statements items.

Evan, Houston, Peters and Pratt (2012) used a web-based case to compare firm's earning management behaviour by using U.S. GAAP and IFRS. From the study conduced, it is found that higher level of reporting discretion is perceived by financial officers under IFRS as compared to U.S. GAAP which leads to greater likelihood of earning management. The authors mentioned that U.S. GAAP shows stronger preferences for real earning management as compared to IFRS. U.S. firms managing earning upward have a strong preference for real earning management reporting under U.S. GAAP as compared to reporting under IFRS.

Florou & Kosi (2013) stated that IFRS provides more relevant information to investors as it is capital oriented than countries' GAAP. It's easy for IFRS adopters to raise capital from public debt market than non adopters due to higher quality financial information provided by IFRS.

Willmore (2014) stated that high monetary and non-monetary costs are involved for the companies in transition of U.S. GAAP to IFRS. On May 28, 2014, IFRS 15/ASU 2014-09 was issued which outlined the five steps approach to recognize the revenue. Based on this development, it is believed that IFRS and U.S. GAAP will continue to move closer together.

McEnroe & Sullivan (2014) mentioned that SEC estimated million dollars cost for some companies in transition of U.S. GAAP to IFRS. To convert the financial statements, companies need to train their employees and pay extra money for spending time to the convert the financial statements.

Herbei (2015) stated that differences between IFRS and U.S. GAAP are still existed after convergence process and accountants need to apply professional judgement for taking decisions about accounting treatments to provide quality of financial reporting information to the decisionmakers.

Guillaume & Pierre (2016) stated that it is difficult for investors to compare companies financial statement prepared by using IFRS and U.S. GAAP. As per their study, IFRS offers a sophisticated and a simplified program for a fresh start in financial reporting for the investors as compare to complex U.S. GAAP standards. Companies need to understand the cost involved in the transition to IFRS as they need to provide training to the organizational leaders about IFRS principles-based methods. Investors and shareholders look for consistent and reliable financial statements. Based on previous studies done, author concluded that convergence, rather than adoption of IFRS seems more feasible.

Lindahl & Schadewitz (2016) stated that significant effects can be found due to IFRS and GAAP differences at individual firm level on the indicators of financial performance and position.

Fajardo (2016) stated that conversion of GAAP to IFRS is a difficult approach due to high cost, inadequate training about IFRS and tax laws as well as economic environment vary internationally. The author stated that one global set of accounting standards will benefit investors as it will provide consistent, transparent, reliable, and comparable accounting information. Also, it will facilitate global trade and world capital market.

Abdallah (2016) conducted a study to discuss the challenges faced by MNCs for conversion of financial statement based on U.S. GAAP to IFRS based financial statement and impact of conversion on intangible assets' transfer pricing. From the study, it is concluded that transfer pricing systems of MNCs should be carefully reviewed and updated. The conversion process can have a significant direct impact on transfer pricing methods, income taxes, financial reporting, and global transfer pricing strategies of American MNCs.

DeGennaro (2017) stated that IFRS and U.S. GAAP have different effect on the economy due to different view of financial statement and due to conversion of financial statements based on U.S. GAAP to IFRS based financial statements.

Toudas (2018) analysed that there are several differences between the factors affecting a potential convergence of U.S. GAAP and IFRS at a country level, as well as at an economy level. Cost of convergence and changes required in legal and regulatory system create difference between stronger and weaker economies approach towards convergence to be achieved.

Second Part: Fundamental Differences

Based on the literature review, fundamental differences are found between IFRS and U.S. GAAP. Fundamental differences are found that could affect the reported financial statements during the movement from the U.S. GAAP to the IFRS (Saleha, Rashidb & Suwaid, 2020). As per IFRS 9, one year provision under stage 1 for expected losses is required but full provision for lifetime expected losses is required as per U.S. GAAP which leads to higher provisions during the upswings phase of the financial cycle (Buesa, García and Tarancón, 2020). Inventories are evaluated by using LIFO under U.S. GAAP but this method is not allowed under IFRS. The authors suggested that replacement cost is the best estimate for Net realizable value (NRV) of raw material (Lucchese and Carlo, 2020).

Ucieda (2003) conducted a study to analyze the net income and shareholders' equity reconciliation to U.S. GAAP by considering their frequency, persistence, significance and materiality. The study was conducted by considering all Spanish companies listed in U.S. stock markets for the period of 1991 to 2001 and found that Fixed Assets, Business Combinations, Employee Benefits, Deferred Taxes, Investments, Consolidation, Provisions and business combination adjustments are frequent and material adjustments to Net income and Shareholders' equity in the Form 20-F reconciliations.

Jerman and Manzin (2008) presented the changes regarding Goodwill under IFRS and comparison with Goodwill treatment under U.S. GAAP. The author stated that new International Financial Reporting Standards are moving towards international convergence, but significant differences are still existed between U.S. GAAP and IFRS.

Bao, Lee and Romeo (2010) conducted a study to find the effect of U.S. GAAP and IFRS differences related to reporting inventory, property plant and equipment, intangible assets, and development costs. Based on the study, it is found that IFRS based financial results of the firms have significantly higher current ratio, significantly lower asset turnover and lower debt to asset ratios as compared to these ratios of financial results based on U.S. GAAP.

Gray (2013) stated the potential benefits of elimination of Last In, First Out (LIFO) inventory valuation method allowed under U.S. GAAP. The study observed voluntarily switching from LIFO to other method of inventory valuation by corporations due to low rate of inflation and tax laws.

Willmore (2014) stated that there are many differences between the two sets of standards (U.S. GAAP and IFRS), including inventory valuation, impairments, leases, and financial statement presentation (among other things).

Boonlert-U-Thaia and Duangployb (2015) conducted a study to find the effect of 20 F other information related to differences between U.S. GAAP and IFRS on value relevance of earnings, book value and both. The study found no value relevance of differences in earnings and book value between IFRS and U.S. GAAP and concluded that both provides useful information to investors and other users of financial statement.

Abdallah (2016) stated MNCs are facing different challenges of the switch from the U.S. GAAP to IFRS and found that there are a significant impact of U.S. GAAP conversion to IFRS on transfer pricing method, financial reporting, income taxes, and global transfer pricing strategies of American MNCs.

Sanko and Koldovskyi (2017) discussed the fundamental differences between U.S. GAAP and IFRS and impact of conversion. Author mentioned that due to cross border business operations, parent company needs to translate financial statements of subsidiary into consolidated financial statement. Based on discussion, it is concluded that it is necessary to converse and harmonize IFRS and U.S. GAAP into a single set of Global Accounting Standards to solve many of the world's financial reporting problems.

Buesa, García and Tarancón (2020) conducted a study to compare the cyclical behavior of IAS 39, IFRS 9 and U.S. GAAP and found that IFRS 9 is less procyclical than the previous regulation (IAS 39) but more procyclical than U.S. GAAP. The reason is as per IFRS 9, one year provision under stage 1 for expected losses is required but full provision for lifetime expected losses is required as per U.S. GAAP which leads to higher provisions during the upswings phase of the financial cycle

Lucchese and Carlo (2020) conducted a study to understand the inventory treatment under IFRS and U.S. GAAP. To find out the difference, three different cases were analyzed by considering simplification, comparability, cost formula employed and value measurement theories. Inventories are evaluated by using LIFO under U.S. GAAP but this method is not allowed under IFRS. The authors suggested that replacement cost is the best estimate for Net realizable value (NRV) of raw material

Saleha, Rashidb & Suwaid (2020) conducted a study to find the impact of U.S. GAAP and IFRS differences related to revenue recognition and measurement; inventory valuation methods; extraordinary items; and the presentation of income and balance sheet statements on the financial reports of U.S. companies. Based on the discussion, fundamental differences are found that could affect the reported financial statements during the movement from the U.S. GAAP to the IFRS.

Conclusions

Based on literature review (part 1), it is found that corporation adopting U.S. GAAP convert and present their financial statements as per IFRS as well to provide detail information to the investors. In KPMG, 2017 study it is mentioned that investors and shareholders are looking for consistent and reliable financial statements and adoption of IFRS by corporations increase investors confidence as it's easy for investors to understand. U.S. GAAP are considered complex than IFRS. Fajardo, 2016 also mentioned that adopting IFRS rather than conversion will help corporation to reduce cost and time associated with conversion process. Adoption of IFRS will provide quality information to the investors around the world which will support the world capital market.

Different studies are done to present the fundamental differences between U.S. GAAP and IFRS as mentioned above in part 2. Due to fundamental differences, reported net income and ratios varies of the two financial statements prepared by following U.S. GAAP and IFRS.

This paper findings are based on 27 research papers only. As accounting standards are changing due to change in current economic situations, there is a large scope for the future studies based on U.S. GAAP and IFRS differences and impact of those difference on the investors.

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