Accounting in a Globalised World

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Just like how the world is split between the metric and imperial measurement systems, the world is divided in accounting standards between the International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (GAAP). Unfortunately, conversion and comparability between the two accounting systems are not as easy and straightforward as with the measurement systems.

Accounting has a very long history, dating back hundreds of years when a Franciscan monk named Luca Pacioli invented double-entry bookkeeping.

With unprecedented economic growth, companies took the lead in modernising financial reporting. After the US stock market crash of 1929, many market participants felt that insufficient and misleading accounting and reporting had inflated stock prices.

The resulting pressures on the accounting profession in the US for accounting standards led to the establishment of the Generally Accepted Accounting Principles (GAAP). Today, US GAAP, issued by the US-based Financial Accounting Standards Board (FASB), is the accounting standard for US publicly-listed companies and is required by the US Securities and Exchange Commission.

Meanwhile, European regulators created an international body, which eventually became the International Accounting Standards Board (IASB), to establish international accounting standards. The standards issued by the IASB are designated as International Financial Reporting Standards (IFRS).

Over 110 countries in the world have accepted IFRS as the globally accepted standard for accounting. This group includes Singapore, where full convergence of the Singapore Financial Reporting Standards (SFRS) with IFRS is effective from 1 January 2018, with the Singapore Financial Reporting Standards (International) or SFRS(I) issued by the Accounting Standards Council (ASC).

Some countries, such as Japan, allow voluntary adoption of IFRS. China continues to amend its Chinese Accounting Standards so that its principles are increasingly in line with IFRS, in effect.

IFRS vs US GAAP

While there are similarities between the IFRS and US GAAP, there are also significant differences, which perhaps explains why the two accounting standards co-exist side by side. After all, the metric vs imperial system for measurements, and the right-hand vs left-hand side driving system still persist.

However, unlike the metric and imperial systems, IFRS and US GAAP are not so easily convertible from one to the other, and unlike left- and right-hand driving, they are not binary.

The greatest similarity between the two accounting standards is that both are based on double-entry accounting. Both standards use an income statement, a balance sheet and a statement of cash flow. Both prepare financial statements on an accrual basis, meaning revenue is recognised when it is realised or realisable. When dealing with cash and cash equivalents, both methods are essentially the same.

Key Differences Between IFRS and US GAAP		
Item	**IFRS**	**US GAAP**
Statement of Profit or Loss, and Comprehensive income	No prescribed statement of profit or loss, and comprehensive income format exists. Entities are required to present items included in other comprehensive income that may be reclassified into profit or loss in future periods separately from those that will not be reclassified.	All items included in other comprehensive income are subject to recycling.
Expenses	Expenses may be presented either by function or by nature (whichever provides information that is reliable and more relevant.)	Expenses may be presented either in single-step format (all expenses classified by function), or multiple-step format (separate operating and non-operating activities).
Balance sheet (offsetting of assets and liabilities)	Right of setoff is a debtor's legal right, by contract or otherwise.	Setoff is improper unless a right of setoff exists.
Inventory	First-in, first-out (FIFO) and weighted average allowed; Last-in, first-out (LIFO) not allowed.	Either FIFO, LIFO or weighted average cost can be used.
Consolidation	Principles-based model: the consolidation must reflect the structure, i.e. whether there is sufficient control, risks and benefits between parties.	Two-tier rules-based model: Voting rights and a qualitative analysis of power over significant activities and exposure to potentially significant losses or benefits.
Non-Financial (Intangible) Assets	Uses a one-step impairment test. Reversal of impairments, other than goodwill, is permitted.	Requires a two-step impairment test and measurement model. Reversal of impairments is prohibited.
Acquired intangible assets	Recognised only if asset will have a future economic benefit which can be reliably measured.	Capitalisation depends on both the type of acquisition (asset acquisition or business combination) as well as whether the asset has an alternative future use.
Internally-developed intangible assets	Classified into research phase costs (expensed) and development phase costs (capitalised).	Both research costs and development costs are expensed as incurred.

The biggest difference is that IFRS is principle-based while US GAAP is rule-based. With IFRS, there can be different interpretations of the same transactions. With US GAAP, there is a strict set of rules for preparing financial statements and disclosures.

At a more granular level, there are differences in virtually every aspect of financial reporting. The table, "Key Differences Between IFRS and US GAAP" summarises some of the main ones.

Convergence of IFRS and US GAAP

In an ideal accounting world, we would have a single accounting standard. The world would be much simpler if the IFRS and US GAAP were to converge.

In October 2002, the IASB and FASB started work on just that, only to abandon the effort 10 years later. To date, only one converged standard, Revenue from Contracts with Customers, has emerged.

In 2013, the IFRS Foundation established the Accounting Standards Advisory Forum (ASAF) to improve cooperation among worldwide standard setters. The US FASB is one of the members of the ASAF.

Hopefully, the convergence of the two standards will eventually happen although this is not likely in the near future. Meanwhile, accountants and even non-accountants will need to be financially bilingual in order to understand, interpret and reconcile financial reports prepared under the other standard. ■