Costing methods between gaap and ifrs

Business

Accounting standards are guidelines that provide a frame work for the proper documentation of financial statements which describe the financial performance of companies without having to learn the financial principles of each company concerned and also enhance comparison between companies. Good accounting standards ensure that proper inventory of a company's assets is documented. Merchandise a company plans to sell its customers represents its inventory.

Coyle (2010) defines inventory as " a company's commodities intended for sale to its customers in the normal course of business. Inventories are considered current assets in that they usually are sold within a year or within a company's operating cycle". There are various inventory accounting methods. The more frequently used methods are First-in, First-Out (FIFO), Last-in, First-out (LIFO), specific identification method and the average cost method. White (2008) wrote that " the method that a company uses to account for its inventory determines the amount of expense recognized for cost of goods sold on the financial statement as well as the value of inventory recognized on the balance sheet". In specific identification method, the accounting measures reveal specific physical flow while the LIFO, FIFO, and weighted average methods consign to assumptions that are made in relation to the flow of inventory through the company.

Generally accepted accounting principles in the U. S., truncated frequently as US GAAP are accounting regulations used for a wide variety of entities to organize, present, and report financial statements including publicly-traded and privately-held companies, governments and non-profit organizations. Commonly US GAAP includes associated accounting law, limited applicable

Accounting structure, regulations and Accounting Standard. Comparable to other countries practicing under the common law system in the belief that the private sector has better knowledge and resources, accounting standards are not unswervingly set by the United States government. Though not written in law, the U.

S. Securities and Exchange Commission (SEC) requires that publicly-traded companies follow the US GAAP in financial reporting. The Financial Accounting Standards Board (FASB) is currently the highest authority in establishing generally accepted accounting principles for public and private companies, as well as non-profit entities. The US GAAP provisions differ fairly from International Financial Reporting Standards (IFRS) in that the IFRS is more principles-based while US GAAP is rules-based. Though SEC set out a timetable for all U. S.

companies to drop GAAP by 2016, with the largest companies switching to IFRS as early as 2009 (The Wall Street Journal, 2008). There are certain costing methods that are currently recognized by GAAP and IFRS. An example of these costing methods is the accounting methods where the cost of inventory under both U. S. GAAP and IFRS commonly entails direct expenditures of getting inventories ready for sale, as well as over-head and other costs attributable to the assembly or procurement of inventory. Another example of costing methods recognized by both U.

S. GAAP and IFRS is carrying value where under U. S. GAAP, with market defined as existing replacements cost inventories are requisite to be stated at the lower of cost or market (LCM). It is expected that the market not

surpass net feasible value or be less than NRV reduced by an allowance for a normal profit margin. While under IFRS, there is no notion of reducing NRV to permit for a standard profit margin.

The result may be considerably changed depending on a retailer's current practice for determining LCM (Consideration for the Retail industry, 2008, p. 5). The tax dilemma is another costing method recognized by the US GAAP. The LIFO costing method leads to elevated acknowledged costs of sales during periods of increasing prices, and in effect reduces chargeable income. Nevertheless, undr IFRS use of the LIFO costing method is overtly not endorsed (Considerations for the Consumer Products Industry, 2008, p. 6).

A number of costing methods currently recognized under IFRS are; Reversal Of Write-Downs, Lease Classification, Reversal Of Impairment Charge, Measurement After Recognition, Depreciation, Method And Component Approach. Some costing methods currently recognized under U. S. GAAP are; Sale-Leaseback Transactions, Lease Expense, Leases of Land and Buildings (Consideration for the Retail industry, 2008). Depreciation as a costing method recognized under IFRS takes into consideration a constituent approach. Under this costing method, assets are split into single units or individual components and depreciated individually over their productive life (Considerations for the Consumer Products Industry, 2008, p.

9). For instance, consider different parts of an automobile/vehicle i. e. tires, chassis, engine etc. each representing a different component of a retail industry and having the ability to depreciate independently of other components.

In this scenario, it is imperative to set up subsidiary ledgers to ensure the proper recording of asset components as individual components. Estimates of useful life and residual value, and the method of depreciation are reviewed at least annually. Generally the cost is allocated, as depreciation expense, among the periods in which the asset is expected to be used. Adjusting the residual value is also feasible. Under IFRS, any changes that produce a variation in anticipation from preceding estimates are reported as an alteration in an accounting estimate.

These changes also have a direct effect on the depreciation taken on the asset, as the elevated values would result in higher depreciation and vice versa. If there is a considerable change in the expected pattern of consumption of the future economic benefits of the assets, the method shall be altered to reflect the changed pattern (Considerations for the Consumer Products Industry, 2008). According to Dohnal (2009), tangible assets should be grouped according to their anticipated “ useful lives.” i. e.

the number of years expected to fully exhaust the asset’s value. A depreciable property’s basis is the total investment in it. Often this is the price paid for it, however, improvements made upon it are also considered. The transition to IFRS as a single set of globally accepted accounting standards is considered to be inevitable. Latest developments put forward that reporting using IFRS will be adopted by most public companies within the U. S.

and around the globe given a few years. This conversion when achieved could lead to obligatory transition to IFRS. According to IFRS’s Consideration

for the Retail industry (2008), “ the use of a single, widely accepted set of high-quality accounting standards would benefit both the global capital markets and U. S. investors by providing a common basis for investors, issuers and others to evaluate investment opportunities and prospects in different jurisdictions” (p. 3).

The IFRS is understood to have the potential to best afford the common podium on which Companies can report and investors can compare financial information. The proposed transition to IFRS was put forward by the SEC with a proposed roadmap highlighting several milestones. The proposal highlights that potential issuers are expected to prepare their financial statements in accordance with IFRS as issued by the IASB. Issuers opting to file IFRS financial statements with the SEC would be expected to do so in an annual report but would be unable to file financial statements for the first time with the SEC in a proxy information statement, quarterly report or registration statement. However, savings, employee stock purchase and smaller reporting companies as defined by the SEC are excluded from the definition of an “ IFRS issue” and therefore would be unable to adopt IFRS early.

Despite the similarities between the IFRS aand the U. S. GAAP, some significant differences still exist. Some examples are the specific prohibition by the IFRS of the use of the last-in, first-out (LIFO) costing method. Provision of the ability to reverse inventory write-downs, reverse long-lived and indefinite-lived impairment charges, revalue fixed assets is also accredited to the IFRS.

Efficient internal controls, improved transparency and uniformity of financial information, further proficient use and accessibility of global resources, basic cross-border M transactions, further access to capital, and opportunities for enhanced cash management and income tax scheduling are some of the derivable benefits from this transition. According to the Global Powers of retailing (2008) report, slow growth in many mature markets and not-to-be-missed-opportunities in emerging markets, particularly China, India and Russia, are powerful driving forces of globalization in the retail world today (p. 9). The transition from the GAAP to the IFRS however poses some challenges. A significant amount of dedication of specialized resources is required for appropriate analyzing and plan execution. Assessing and creation of policies with a universal perception of the processes and goals of the whole organization is required of the companies undergoing this transition, implementation of suitable information systems and effective processes and training of the appropriate people in the organization is also required (Consideration for the Retail market, 2008, p.

5). The FASB and IASB have made momentous efforts to integrate the content of IFRS and U. S. GAAP. The majority of the key differences have been resolved.

However significant differences do linger. According to IFRS's Consideration for the Retail market (2008), some examples are: IFRS does not permit Last-In First-Out (LIFO) as an inventory costing method. IFRS uses a single-step method for impairment write-downs rather than the two-step method used in U. S. GAAP, making write-downs more likely.

IFRS has a different probability threshold and measurement objective for contingencies. IFRS does not permit curing debt covenant violations past year-end. IFRS guidance concerning revenue recognition is less extensive than GAAP and contains comparatively little industry-specific instruction. IFRS allows the revaluation of assets in certain circumstances. IFRS requires capitalization of development costs, when certain criteria are met. Conceivably the greatest difference amid IFRS and U.

S. GAAP is that IFRS provides a reduced amount of overall detail and industry-specific guidance. The enormity of the task facing international accounting standard setters should not be underestimated. The aim of achieving synchronized financial reporting across the globe using a solitary set of high quality accounting standards is a responsibility of massive magnitude and intricacy. The conversion of accounting standards raises questions about how U. S.

regulators will operate under an IFRS structure but subsequent to Europe's triumph in implementing IFRS, there has been improved impulsion in the U. S. to blend U. S. and international accounting standards.

This has resulted in listed companies and readers of financial statements to now have to endure a high level of change and improbability on top of the ' regular' or premeditated convergence activities. This has caused sensitive concerns regarding the cost of compliance and probable delays to the convergence schedule. In spite of the setbacks that may exist in the transition from U. S. GAAP to IFRS, there is no denying the fact that the advantages greatly overwhelm the disadvantages that may be.

Also, with suitable financial systems that proffer elasticity in basic coding structures, scope and reporting, the transition from GAAP to IFRS can be considerably less intimidating.