Free research paper on ifrs and us gaap

Business, Company

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Task

Introduction

Accounting is a very important subject both to the followers of the profession and also to all institutions that carry on business. For any financial statements to make sense they must be prepared in a standardized manner, allowing for quick comparison between the financials of a company in different periods, the company and other players in the industry, a company in different countries etc. This requires the adoption of standards that will allow for this to be possible.

The International Accounting Standards Board prepares and issues the International Financial Reporting Standards (IFRS) that have been widely adopted by accountants the entire world over. The US Generally Accepted Accounting Principles is also used in some parts of the world and especially the United States. Over the years, there have been concerted efforts to bring a convergence of these two sets of standards for the uniformity of financial statements so as to meet user needs (Jeffers, et al 2010)..

While these efforts have borne a lot of fruits as has been witnessed over the years, there are still several fundamentals differences that exist between the two sets of standards that have affected materially, the way financial statements are prepared under these two standards. This paper seeks to outline these differences in both income statements and the balance sheets prepared under these two financial reporting frameworks. The advantages and disadvantages of using IFRS to the end users will also be explored.

Income Statement

The major differences between these two sets of standards in the income statement are:

Financial periods required-under GAAP, comparative financial periods are a requirement however, a single year may be presented in certain circumstances. Public companies income statement must cover three years period up to the balance sheet period. Under IFRS, comparative information is required to be presented in respect of the previous period on all amounts disclosed in the income statement (Nandakumar, et al, 2010).

Layout-no general requirement for the layout under GAAP however, public companies have to follow the detailed regulations in S-X. Under IFRS, while IAS 1 doest give a specific layout, it includes a list of minimum items that must be included in the income statement. These requirements are less prescriptive than in S-X under the GAAP.

Classification of expenses-Companies presenting their information under GAAP are required to classify their expenses based on function e. g. cost of sales, administrative costs, selling and distribution costs etc, while in IFRS, entities may present financial statements based on either function or nature e. g. salaries, finance costs, depreciation charges, water and electricity expenses etc. however, if a function is selected, the components of the function must be explained clearly in the notes to the financial statements.

Under GAAP, extraordinary items are permissible but under limited circumstances while in IFRS, extraordinary classification is not permissible though unusual items if any may be segregated

Under GAAP, other comprehensive income items can be presented in a separate statement that is combined with the income statement or the statement of changes in equity while under IFRS framework; other comprehensive incomes are presented in a separate statement of comprehensive income and are never relegated to the statement of changes in equity as is the case in GAAP.

Balance sheet

In IFRS, an entity is supposed to show current and fixed assets, current and noncurrent liabilities as distinct line items on the front area of the balance sheet except in cases where presenting liquidity provides more absolute and justifiable information. In such a case, all short-term and long-term assets and obligations are shown in their order beginning with the most liquid. In any case, there is no set format of a balance sheet and management in most cases uses judgment . In the minimum however, IFRS must require the items below on the surface of any balance sheet (Stephen G & Norbert 2010).

Asset- property, Plant and equipment, investment property, biological assets, financial assets, other investments in equity method, current assets such as trade receivables, stocks, cash and its equivalents etc.

Liabilities and equity-components of liabilities which include issued capital from the sale of shares and other inputs of the shareholders equity, minority interests, current and differed tax liabilities, financial liabilities and other payables etc.

Under the US GAAP, it is generally shown as the total assets that balance with the total liabilities plus the shareholders equity. Items on the surface of the balance sheet are the same as those in IFRS, but usually presented in a declining liquidity order.

In IFRS balance sheet- the current/noncurrent distinction is needed except in cases where liquidity is more important. Incase this distinction is made; assets will fall under current if they are owned for sale or for consumption in the normal activities of business. Assets and liabilities are both categorized as current if they are anticipated to be realized in a time period of 12 months.

Under the US GAAP, the management may decide either to classify assets and liabilities as either current and non current since there is no standards requirements under this framework.

Offsetting assets and obligations-under IFRS; assets and obligations cannot be counterbalanced and are presented as separate line items for instance; a debt cannot be offset against a creditor in the period. They have to be clearly shown as debtors and creditors and cannot be netted off. Under GAAP, only the net effect is presented in the financial statements as they are allowed to net off the assets and liabilities with the exception of derivatives (Stephen& Norbert, 2010).

Under IFRS, minority interests are shown as an item of equity while under the US GAAP; minority interests can never be shown as a component of equity.

Advantages of using IFRS to the end user

Financial statements are prepared with the end user in mind so as to enable them to be able to make informed decisions on the basis of these financial statements. Some of the users of financial statements are shareholders, the governments, employees, regulatory bodies, managers etc. All these users have unique information needs that have to be met through properly prepared financial statements (www. iasplus. com).

IFRS provides a framework for the preparation of financial statements that are useful to all stakeholders. Some of the advantages of using IFRS for the preparation of financial statements using IFRS are outlined below.

A user of financial statements prepared using IFRS is able to compare the business performance with other foreign institutions whose statements are also prepared using IFRS. Companies with subsidiaries in countries where they are required to prepare their financial statements using IFRS may be required to adopt IFRS for consolidation purposes. A company that must raise capital abroad may be required to prepare the statements according to IFRS. This enables the end user to be able to make sound financial decisions based on these financial statements (Barry &Epstein., 2010).

IFRS are internationally understood unlike US GAAP that are used mostly in the in the United States , IFRS are usually more globally understood so an end user will find it easier to understand financial statements prepared using IFRS than any other financial reporting frameworks.

The end user is also able to understand the performance of the company in regard to other international players and also understand how the company is able to compete with other players in the world by the use of the IFRS prepared financial statements.

Disadvantages of using IFRS

The end user may find the use or the new IFRS confusing and difficult to understand due to the use of the GAAP for a long time. Non accountants for instance may have difficulties understanding financial statements prepared using the new IFRS.

End users may find the huge costs involved in the adoption and preparation of financial statements using IFRS unjustifiable expenditure to the organization and may not find it relevant to the company.

End users usually experience a lot of uncertainty in the evaluation of financial standards. This is because, IFRS allow managers to exercise a lot of judgments in their decision on what to report in the financial statements and this is likely to lead to errors and misstatements in the financial statements.

There isn't much enforcement in IFRS as there is in GAAP which has several organizations watching over accounting rules. There is no global organization such as SEC that watches these standards. This may lead to fraudulent financial statements that may be misleading to end users (Stephen & Norbert, 2010).

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Balance sheet for General Motors

According to IFRS

Adopted from: http://finance. yahoo. com/q/bs? s=

GM+Balance+Sheet&annual

Period Ending

Dec 31, 2010

Dec 31, 2009

Assets

Current Assets

Cash And Cash Equivalents

22, 301, 000

36, 596, 000

Short Term Investments

5, 555, 000

134, 000

Net Receivables

10, 504, 000

9, 295, 000

Inventory

12, 125, 000

10, 107, 000

Other Current Assets

2, 568, 000

3, 115, 000

Total Current Assets

53, 053, 000

59, 247, 000

Long Term Investments

8, 197, 000

-

Property Plant and Equipment

19, 235, 000

19, 217, 000

Goodwill

31, 778, 000

30, 672, 000

Intangible Assets

11, 882, 000

14, 547, 000

Accumulated Amortization

-

-

Other Assets

14, 445, 000

12, 048, 000

Deferred Long Term Asset Charges

308, 000

564, 000

Total Assets

138, 898, 000

136, 295, 000

Liabilities

Current Liabilities

Accounts Payable

45, 541, 000

41, 859, 000

Short/Current Long Term Debt

1, 616, 000

10, 221, 000

Other Current Liabilities

-

355, 000

Total Current Liabilities

47, 157, 000

52, 435, 000

Long Term Debt

9, 142, 000

5, 562, 000

Other Liabilities

31, 587, 000

36, 064, 000

Deferred Long Term Liability Charges

13, 021, 000

13, 279, 000

Minority Interest

979, 000

708, 000

Negative Goodwill

-

-

Total Liabilities

102, 718, 000

108, 048, 000

Stockholders' Equity

Misc Stocks Options Warrants

-

6, 998, 000

Redeemable Preferred Stock

-

-

Preferred Stock

10, 391, 000

-

Common Stock

15, 000

15, 000

Retained Earnings

266, 000

(4, 394, 000)

Treasury Stock

-

-

Capital Surplus

24, 257, 000

24, 040, 000

Other Stockholder Equity

1, 251, 000

1, 588, 000

Total Stockholder Equity

36, 180, 000

21, 249, 000

Net Tangible Assets

(7, 480, 000)

(23, 970, 000)

Currency in USD.

Income statements for General Motors

IFRS

Adopted from: http://finance. yahoo. com/q/is? s=

GM+Income+Statement&annual

Period Ending

Dec 31, 2010

Dec 31, 2009

Total Revenue

135, 592, 000

104, 589, 000

Cost of Revenue

118, 944, 000

112, 195, 000

Gross Profit

16, 648, 000

(7, 606, 000)

Operating Expenses

Research Development

-

-

Selling General and Administrative

11, 564, 000

13, 417, 000

Non Recurring

-

-

Others

-

-

Total Operating Expenses

-

-

Operating Income or Loss

5, 084, 000

(21, 023, 000)

Income from Continuing Operations

Total Other Income/Expenses Net

1, 751, 000

129, 638, 000

Earnings Before Interest And Taxes

6, 639, 000

109, 804, 000

Interest Expense

1, 098, 000

6, 122, 000

Income Before Tax

5, 541, 000

103, 682, 000

Income Tax Expense

672, 000

(2, 166, 000)

Minority Interest

(331, 000)

(396, 000)

Net Income From Continuing Ops

6, 172, 000

104, 821, 000

Non-recurring Events

Discontinued Operations

-

-

Extraordinary Items

-

-

Effect Of Accounting Changes

-

-

Other Items

-

-

Net Income

6, 172, 000

104, 821, 000

Preferred Stock And Other Adjustments

(1, 504, 000)

(131, 000)

Net Income Applicable To Common Shares

4, 668, 000

104, 690, 000

Currency in USD.