BY
Dr Wayne Bartlett CPA

Rules versus principles: GAAP or IFRS?

Dr Wayne Bartlett CPA, asks whether the project to explore bringing US GAAP and IFRS closer together has been a waste of time.

Wayne Bartlett CPA, is an experienced public financial management specialist with experience of working in over thirty countries. He is heavily involved in CPA Ireland's IPSAS work chairing the CPA Ireland IPSAS advisory board as well as being lead author on the ipsasacademy.net developed with CPA Ireland and Nelson Croom.

The debate concerning the convergence of US GAAP and IFRS seems to have been with us forever. In fact, it has been ongoing formally since 2002. In that year, a project was launched involving the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) to explore ways that the two different frameworks could be brought closer together. Now the project is coming to an end and significant gaps still remain. So, has it all been a waste of time?

Progress so far

Looking at what has been done under the auspices of the project, it would not be fair to say that nothing has been achieved. For example, the recent release of IFRS 16, the new Standard on leasing, was the result of a close collaboration between IASB and FASB. The effects of those changes are far-reaching. Many current or former students will have been brought up on an accounting diet that teaches us that finance leases are on-balance sheet and operating leases are not. That is all about to change with the update to IFRS 16. Now all leases will be on-balance sheet, regardless of whether GAAP or IFRS is being applied.

The significant thing here is that both boards agree that all leases should appear on the balance sheet, regardless of whether they are finance or operating in nature. This is a major, indeed fundamental, amendment to the current approach. They also agree on the definition of a lease and how leases should be measured. The impact is huge. A recent IASB Press Release estimated that listed companies using IFRS or GAAP have $3.3 trillion worth of leases, 85% of which have not appeared on the balance sheet in the past. So the impact of this change is potentially, without a hint of hype, dramatic.

Joint approaches have also been used on other accounting issues. The changes to IFRS 15 on *Revenue Contracts with Customers* are less far-reaching than those on leasing. Indeed, they do not introduce any new principles and are more of a clarification update. But they arise as a result of the work of what is known as the Transition Resource Group (TRG). This was set up as an initiative between the two boards. Clearly a lot of good work has gone on and much progress has been made in terms of cooperation and agreeing some major technical issues together.

So, what's the problem?

Given all this good stuff, the reader might be starting to wonder if there is really a problem or not after all? There are certainly some 'soft' issues that get in the way of further convergence. National pride might just be a factor; human nature can sometimes get in the way of accounting logic and technical consistency. But actually there is a deeper issue going on here which is likely to act as a barrier to real convergence for some time to come. And that is quite simply GAAP and IFRS have a fundamentally different approach, one might even go as far as to say a very different view of the world.

IFRS is all about principles. General principles are developed in each of the individual Standards and it is often left to the discretion – or 'judgement' - of those who apply the principles when preparing the financial statements as to how to apply them in practice. This discretion can lead to extensive disclosures being included in the financial statements. These are required because users of the financial statements need to understand what is going on when comparing one organisation's results with another. They need to know what assumptions have been made regarding the key accounting transactions reflected in the financial statements. This flexibility may be good in some ways but in others it means that users have to possess a good degree of specialist knowledge to fully understand what is happening.

There is a much greater degree of prescription in GAAP. It is much more of a rules-based regime than IFRS. There are also some significant technical differences remaining between the two frameworks. For example, under IFRS development costs should be capitalised if certain criteria are met but with GAAP they are always expensed in the year they are incurred. When thinking of consolidation issues there are also key differences in approach. Under IFRS, a control approach is used to decide whether an entity's results should be consolidated with those of another controlling entity or not; with GAAP a 'risks and rewards' approach to consolidation is employed. There are other differences too, so there is still a lot to be done to bring the two frameworks into line on some key points.

The coverage of GAAP

Looking closely at the GAAP framework for the first time you will quickly see the differences from IFRS. There is a very methodical design behind GAAP with connected Standards (known as Accounting Standard Codifications or ASCs) grouped together. For example, all ASCs in the '300' group relate to assets whilst the '600' group deals with ASCs on revenue. This neat and tidy organisation contrasts markedly with the random numbering scheme applied to IFRSs, which are merely numbered in a chronological sequence depending on which one happens to be issued next. It is a nice little reminder of the arguably greater discipline behind the rules-based approach advocated by GAAP.

Dig down to the next level behind these high-level groupings and this is where we find a real difference in the detail. The '900' group of ASCs relate in general to what are described as Industry/Unique Topics. These include some fascinating items – ASC 924 on 'Casinos' or ASC 926 on 'Films' for example. These are obviously quite specialist areas of limited application to many people but very important for those who are involved in those specific industries.

Of course, there are other more generic ASCs too. ASC 840 on Leases is the GAAP equivalent of IFRS 16 and ASC 606 – Revenue from Contracts with Customers – is the equivalent of IFRS 15. There are also ASCs on generic important subjects which have no direct IFRS equivalent. For example, ASC 310 on Receivables or ASC 440 on Commitments have no direct opposite number in the IFRS framework though some of the areas in them are referred to in elements of individual IFRSs.

What of the future?

Currently (according to official marketing stats from IFAC, the International Federation of Accountants) some 113 countries have adopted or are in the process of adopting the IFRS framework. However, the USA is not one of them. There is little sign of IFRS becoming mandatory for US companies, even listed ones, in the near future; the appetite to do so is simply not there. At the time of writing this, a new American president has just been inaugurated whilst closer to home BREXIT is creating its own uncertainty. There seems to be to some extent a kickback against globalisation in some countries at least. Whilst it is certainly far too early to say that it will go away – it won't – there may be a slowing down in the rate of change as something of a retrenchment takes place.

This may be reflected in the process of 'globalising' accounting and reporting standards. This would mean that differences between GAAP and IFRS are likely to be with us for a while yet. In the meantime, those who are involved in doing business with large American companies – and that would certainly involve a number of people in Ireland – will need to be conversant with US GAAP and its rules and approaches for some time yet. It seems likely that the need for GAAP rules to be well known amongst the accounting community in Ireland is likely to become even more important in the future than it is now.