

TECHNICAL ASPECTS COMPARING THE IFRS AND THE US GAAP CONCERNING FINANCIAL INVESTMENT COMPANIES

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Abstract

In the context of current interconnected capital markets, all the investors, regardless their country of origin would be provided with the improvement of the quality and comparability of financial information due to the high quality of some common standards of financial reporting. In order to achieve this, the two bodies, the FASB and the IASB, are working together to reduce the differences between the IFRS and the US GAAP. However, there are some problems observed by the US SIF managers, which fall under their area of work. They are divided in three groups: The lack of essential information expected by the American investors. For example, the IFRS does not impose the presentation of the investments made by an investment company; Different assessment bases for the financial actives and debts in the IFRS, which influences the main indicators for the investors; Presenting relevant information regarding the risks taken by investment funds and the analysis of proneness to these risks.

Keywords: capital markets, investors, financial information, international financial reporting standards

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1. Introduction

Relevant for marketable companies but also for unmarketable or small companies, currently, the International Financial Reporting Standards represent the set of accounting standards accepted by most capital markets in the world. (Farcane, Dima, 2011). They are currently issued by International Accounting Standards Board (IASB) that acts under the surveillance of the International Financial Reporting Standards Foundation. The IASB was founded in 2001 in order to replace the International Accounting Standards Committee (IASC). Many of the standards that are part of the IFRS are known by their old name, International Accounting Standards (IAS), they were issued by the IASC between 1973 and 2000, during its restructuring. Subsequently, in 2001, the IASB adopted all the IAS. Currently, IAS are no longer issued but the ones that already exist keep on being applicable until their replacement of amendments with new standards called IFRS. The IFRS are used by many states in the world including member states of

the European Union, Hong Kong, Australia, South Africa, Singapore and Pakistan. Approximately 100 states require or allow the use of IFRS or have a convergence policy towards them.

2. Material and methods

2.1. Both bodies, IASB and FASB aim at promoting the international convergence of the principles that form financial situations (FS).

By the "Norwalk Agreement", the IASB and the FASB agreed to synchronise their work agendas and to closely collaborate in order to decrease the differences between the IFRS and the US GAAP. FASB and IASB signed an Agreement Memorandum which comprised all the aspects that the two bodies wanted to apply the convergence to.

The main objectives of the IASB are:

Developing a unique set of international standards of quality financial reporting, which are easy to understand and apply and are globally accepted;

- Promoting the rigorous use and application of these standards;
- Taking into consideration the need for financial reporting of the emergent economies and small and medium societies;
- Realizing a convergence between the national accounting standards and the IFRS.

Currently, the set elaborated by IASC/IASB comprises:

The International Financial Reporting Standards issued by the IASB after the convergence with the FASB (there are currently 12 IFRS, only 8 of them being active);

The International Accounting Standards;

- The Interpretations of the Standing Interpretations Committee (SIC) issued before 2001 and the Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) issued after 2001.
- In the United States, the Generally Accepted Accounting Principles (GAAP) are elaborated by the Financial Accounting Standard Board (FASB), a private non-profit organization that was assigned to do this by the USA Security and Exchange Commission (SEC). The SEC has the legal authority to establish the financial reporting standards but, throughout history it chose to rely on the private sector when enforcing that function.

Therefore, the FASB has five essential goals:

- The improvement of the information provided in the financial situations by emphasizing the relevance, reliability, comparability and consistency;
- Updating the standards in order to reflect the changes in the economic environment;
- Putting forward the deficiencies that may occur in financial reporting and that may require the institution of a standard;
- Promoting the understanding of the nature and quality of the information in the financial situations;

- Promoting the international convergence of accounting standards and increasing the quality of financial reporting.

Instead of trying to eliminate the differences among the standards which, in their turn, needed improvement, they decided that the issue of new standards is a better approach. In order to achieve this, they launched a series of short-term projects in various fields:

Table1.

Work fields for the short-term convergence

Assigned to FASB	Assigned to IASB
The option of fair value	Debt costs
Depreciation (together with IASB)	Depreciation (together with IASB)
Income tax (together with IASB)	Income tax (together with IASB)
Real estate investment	Government subventions
Research and development	Shareholding associations
Events subsequent to the reporting period	Reporting operational segments

Source: <http://iasplus.com/restruct/restfasb.htm>.

With this occasion, the elimination of the incumbency of the reconciliation with the US GAAP. Previously, the US SEC imposed all foreign trading companies that are marketable in the US to create financial situations according to the US GAAP to reconcile FS made according to local standards with the US GAAP. This obligation generated huge expenses to the trading companies that were marketable both in the US and in other countries. Since 2009, the SEC eliminated the obligation of reconciliation with the US GAAP concerning trading companies that prepare their financial situations according to the IFRS. The American societies will still be compelled to abide by the US GAAP.

In April 2008, the two bodies (IASB and FASB) adopted a plan to finish the convergence projects established with the occasion of the Agreement Memorandum. They also took into consideration the need for amending the goals and fields of application of some of the projects. Hence, they were divided in several categories:

Projects that imply fundamental amendments to the IFRS and possibly in the US GAAP

- **Income recognition** – elaborating a standard based on an approach from the client's perspective in order to assess the performance obligation through which the sum paid or payable by the client is appropriated to the components of a transaction. The alternative is an example based on the "fair value" through which the said obligation is assessed at a current "fair value".
- **"Fair value" assessment** – the time to use the "fair value" assessment could not be established. The final price and the initial price were defined and the

way of calculating them was established. Furthermore, there have been changes in the existent standards in order to replace the different terms of assessment used with the initial price and the final price, according to the intention of the existent standard.

- **Consolidation** – a new standard was established in order to consolidate financial situations.
- **Derecognizing** – it was decided to faster replace the aspects on this subject from IAS 39.

<p>Projects for fields that do not need improvements both in the IFRS and FASB standards</p>

- **Presenting financial situations** – the project was limited to the interface of financial situations and a limited amount of appendixes. Hence, there are still differences between the IFRS and the US GAAP regarding which elements are included in the profit or loss account.
- **Financial instruments** – full evaluations at “fair value” will not be applied to all financial instruments.
- **Debts and equity capital** – it has been proposed to adopt the definition of the FASB according to which only the instrument that presents the lowest residual interest in a company is classified as “equity capital”; the other instruments are either debts or actives.

<p>Projects for fields with no current standards – Extractive insurance and industry</p>

<p>Short-term convergence projects</p>

These are:

- Stock gains
- Joint ventures – the IAS 31 replacement is desired
- Profit tax - the IAS 12 replacement is desired

The main issue confronted by the IASB is defining, recognizing and assessing debts. This issue appeared when revising the IAS 37 because there is no agreement regarding defining debts and, therefore, none to recognize or calculate them.

In 2008, the SEC put forward a “Trajectory for the potential use of the IFRS by the American companies”. This document proposed amendments that allow the American companies to use the IFRS since 2010. However, the FASB believed that the respective approach is untimely because the costs and benefits of the different alternatives that reach that goal still need to be studied.

In February 2010, the SEC issued a statement through which it attested again its commitment to the development of a unique set of quality globally accepted

accounting standards. Furthermore, the SEC attested that the IFRS are the best option to be adopted by the American market. The declaration emphasizes the fact that such a change would generate many structural and operational problems. In order to solve these problems, a Work Plan has been established. After its fulfillment and after finishing the convergence projects of the FASB and the IASB, the SEC will again put forward the issue of adopting the IFRS.

2.2. Comparative technical aspects between the IFRS and the US GAAP regarding the financial investment companies

In December 2010, Deloitte's Global Financial Services Industry (GFSI) published the study "Harnessing the forces of change: IFRS for Investment Fund", which puts forward and emphasizes the main differences between the IFRS and the US GAAP that need to be handled when adopting the IFRS in the American market, from the perspective of the managers of these companies. We can divide these differences in two big groups:

- Differences resulting from the different ways of treating financial accounting information – which will be presented in Appendix 1;
- Differences in presenting the financial accounting information – which will be presented in Appendix 2.

These are the main aspects that show the differences between the IFRS and the US GAAP. The two bodies work together in order to eliminate these differences and to perform the convergence process. However, there are some issues noted by the US SIF managers that fall under the specific of their activity. These fall into three categories:

- The lack of essential information expected by the American investors. For example, the IFRS does not require the presentation of the investments made by an investment company;
- Different assessment bases of the financial actives and debts in the IFRS, which influences important indicators for investors;
- Presenting relevant information regarding the risks taken by investment funds and the analysis of the proneness to these risks.

The ICI (Investment Company Institute), an association of American investment companies issued a letter (GFSI, 2010) to the SEC wanting to make sure that the convergence performed will be stronger under these aspects, before asking the investment companies to opt for the IFRS in the elaboration of financial situations. In February 2010, the IFIA (Irish Funds Industry Association) actually proposed the elaboration of a separate set of standards in the IFRS for investment companies. This set should have the following characteristics:

- Assessment principles compatible to the rest of IFRS (with the elimination of some options available in the rest of IFRS);

- A structure of the financial situations that more clearly reflects the nature of the investment funds, insisting upon the value of the net actives and net value per share;
- The presentation of relevant information regarding important risks in investment funds.

Conclusions

The importance of the International Standards of Accounting used in the financial management, has its strategic role, which involves participating in taking decisions of general policy (acquisitions, cessions, the use of financial resources) but also an operational role, which refers to the activity of financial management and the financing of the company's operations.

Both organisms, IASB and FASB have as an objective the promotion of international convergence of the principles which are at the basis of the drawing up of the financial situations (FS). Thus, the use of International Standards of Accounting in the financial management has the purpose of ensuring the correct accounting evidence and the necessary financial resources, both for the increase of the value of a company and for the safety of the heritage.

References

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Appendix 1

Accounting differences that may cause an impact on SIF reporting.

Potential differences	IFRS	US GAAP/SEC
Instructions specific to the field	IFRS does not offer special instructions for SIF. In this case, the entities need to apply the IFRS for similar issues, conceptual field, standards of other committees or existing practices of the industry.	There are specific instructions for SIF.
Financial instruments – initial recognition	The transactions concerning financial titles can be registered either on the date of the transaction, or on the date of the clearing (IAS 39).	The transactions concerning financial titles must be registered on the date of the transaction.
Financial instruments - classification	Investments as usually classified as being made in order to be transacted or recognised at "fair value" through the profit and loss (IAS 39).	For SIF, all investments are accounted at "fair value".
Financial instruments - fair value assessment	The fair value is given by the market prices or information. If these are not available, the transaction prices are used to estimate the fair value. Investments are assessed at fair value by <i>bid</i> prices for long positions and by <i>ask</i> prices for short positions. There are details instructions regarding the way of assessment.	The fair value is considered to the final price. Investments are assessed at fair value by different methods and there is a special prerequisite for long or short positions. Usually, the last transaction price on the market is used. There are detailed instructions regarding three accepted assessment approaches.

Potential differences	IFRS	US GAAP/SEC
Financial instruments - fair value assessment	The IAS 39 establishes and describes the field for the fair value assessment.	The SEC companies assess the investments with redeemed costs in financial situations; that cost approximates the fair value. In May 2010, the fair value assessment for SIF was proposed. The ASC 80 establishes the field for the fair value assessment.
Financial instruments - transaction costs	The transaction costs afferent to the investments recognised at fair value by profit and loss are discounted.	The transaction costs are recognised as part of the transaction cost.
Financial instruments - new standards	The IASB published the IFRS 9 Financial Instruments in November 2009. It will be updated in 3 stages. The IASB intends to fully replace the IAS 39 with the IFRS 9 in 2011. The first stage that has been applied since 2013 comprises new requirements regarding the classification and estimation of financial assets, published in 2009. All the financial assets taken into consideration by the IAS 39 will be estimated either at the deemed cost or the fair value. In 2010 the requirements regarding financial debts were added. Most of them have been taken from the IAS 39. There have been some amendments to the assessment at fair value in order to solve the issue of credit risk. The other two stages, regarding the depreciation methodology and the accounting of avoiding risks, still have no application dates.	In May 2010, the FASB issued a proposal regarding the upgrade of accounting standards, called: Financial Instruments Accounting and Revisions for Accounting of Derived Instruments and of Risk-Avoiding Activities. This proposal: - A requirement for SIF to register the investments at fair value instead of the deemed cost; - The discount of transaction costs associated with acquisitions of financial instruments; - The assessment of financial debts at fair value. There still isn't an application date set for these amendments.
Foundation costs	Foundation costs should be discounted when they happen.	Organisation costs should be put as expenses when they are made.

Potential differences	IFRS	US GAAP/SEC
Consolidation	<p>The SIF need to consolidate their investments (including other funds and operational branches) which they control.</p> <p>Control means the capability of controlling financial and exploitation policies of an entity in order to benefit from its activities. The capability of controlling the financial policies does not necessarily imply the right to vote, the significant influence suffices.</p> <p><i>The IASB announced that they will propose that the investment companies be exempt from the requirement of consolidation and to assess their interests in other entities at fair value.</i></p>	<p>The SIF are not required to consolidate operational branches, except for the branches that provide services for them.</p> <p>If a SIF performs its investments by another fund, the latter does not need to consolidate their financial situations, but they need to respect the prerequisites of presenting financial information.</p>
Classifying the investors' property	<p>The shareholder's interest is currently considered as a debt if it is reimbursable by the investor.</p> <p>An amendment to the IAS 33 allowed the consideration as equity capital of some instruments that can be rebought at any time, and of instruments that compel the issuer to deliver a percentage of the net actives of the company.</p> <p>Currently, the IASB is working at the amendment of the IAS 32 standard in order to perform the convergence with the US GAAP</p>	<p>The shareholders' interest is classified as equity capital.</p>
Allocations to the fund shareholders	<p>Allocations are recognised as transactions in equity capital and presented in the Amendment Situation in the equity capitals.</p> <p>Allocations are considered to be financing costs if the afferent instruments are recognised as financial debts.</p>	<p>Allocations are recognised as transactions in the equity capital and presented in the Amendment Situation of net actives.</p>

Appendix 2

Differences in presenting the information by the SIF

Potential differences	IFRS	US GAAP
Names of the financial situations	<ol style="list-style-type: none"> 1. Audit 2. Profit and loss account 3. Amendment situation in equity capitals (or the Situation of Amendments to the Net Actives of reimbursable stock shareholders) 4. Treasury Flux Situation 	<ol style="list-style-type: none"> 1. Active and Passive Situation (net active), which comprises and investment inventory 2. Operation situation 3. Situation of Amendments to the Net Actives or the Situation of changing the partners' /members' capital 4. Treasury Flux Situation
Comparisons	The IFRS demands information for two years about the audit, the profit and loss account, the situation of amendments to the equity capitals and the situation of treasury fluxes. If a retrospective policy is applied or if some actives have been reclassified, a new audit is required.	No two-year information is required, except for the situation of amendments to the net actives for the SEC funds or funds under other regulations.
Investments	It is not mandatory to present an investment inventory. Nevertheless, according to IFRS 7, the presentation of the credit and market risk shall be required.	It is required to present an investment inventory (even a condensed one). The SEC marketable funds must present all investments performed. A condensed investment inventory must elaborate all investments and individual positions that represent more than 5% of the net actives and all the investments made by the same issuer.
Profit per share	This is required from closed investment companies. The requirement to offer information regarding the profit per share refers to the funds whose shares can be considered as capital instruments.	Does not apply.

Potential differences	IFRS	US GAAP
Financial instruments – presenting information	<p>Every class of actives and passives need a separate presentation.</p> <p>The IFRS demands information regarding the financial instruments owned by an entity either individually or the entire calls of instruments. The IFRS also demands the presentation of information regarding risk management.</p>	<p>In the case of marketable funds, every class of actives and passives need a separate presentation. This requirement does not apply to private funds.</p> <p>In the case of instruments that derive from private funds that represent more than 5% of the net actives, it is required to present an investment inventory: number of contracts, due dates, added appreciation/depreciation. The marketable funds need to separately present detailed information on each derived instrument.</p>
Profit and loss accounts	<p>The IFRS does not require a special format, although the expenses can be presented by their function or nature.</p> <p>Interest income afferent to fixed income financial titles do not necessarily need to be separated from profit/loss.</p>	<p>They are presented in one or multiple stages. The expenses are presented by their function.</p> <p>The US GAAP requires the separate presentation of investment incomes (quotas and interests) for investment funds.</p>
The profit/loss made or not from investments	<p>The IFRS does not specify if the net profit (loss) and the net amendment in the unperformed appreciation /depreciation need to be presented separately in the case of investments that are assessed at fair value by profit and loss.</p>	<p>The net profit (loss) and the net amendment in the unperformed appreciation / depreciation need to be presented separately.</p>
The situation of treasury fluxes	<p>This is required for all funds. It is allowed to use both the direct method and the indirect one. There are differences in its presentation when compared to the US GAAP.</p>	<p>Under certain conditions, an investment company may be exempt from presenting this situation. Both methods are allowed.</p>

Potential differences	IFRS	US GAAP
Authorising financial information	Information regarding the person authorising the financial situation and the authorisation date is required.	The management needs to provide the date of assessment of subsequent events and if that coincides with the issue date. They also need to provide the date when the situations will be available.
Information regarding risks	The IFRS 7 requires information regarding the nature and size of the risk exposure of the financial instruments, including credit risk, liquidity risk, interest risk, market risk and currency risk. In the case of market risk, a sensitivity analysis will be performed.	The US GAAP demands qualitative and quantitative information regarding the goals of the investment society in keeping and using derived instruments.
Financial information per sectors	It is required to present financial information per sector for all the entities whose capital and debt instruments are transacted in the stock market.	It not required for funds.