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Information Quality – IFRS vs US GAAP

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ABSTRACT :

This study presents a comprehensive comparative analysis of information quality in financial statements prepared under International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (US GAAP). The research focuses on examining how companies' financial statements vary when prepared using these two distinct accounting standards and elucidates the implications for stakeholders. Utilizing a sample of companies from diverse industries, the study employs a rigorous methodology to compare financial statements prepared under IFRS and US GAAP. Through a systematic examination of financial reporting practices, the research highlights the differences in treatment of various accounting items, such as revenue recognition, inventory valuation, and lease accounting, among others. The findings of this study contribute to the understanding of how the choice of accounting standards influences the quality and comparability of financial information provided to users.

Keywords: IFRS, US GAAP, revenue recognition, inventory valuation, financial statement

1. Introduction :

A fundamental aspect of the comparison between IFRS and US GAAP lies in their structural and organizational disparities, often characterized as the dichotomy between principle-based and rule-based frameworks. US GAAP is typically viewed as a rule-based system due to the exhaustive nature of its regulatory guidelines, whereas IFRS embodies a more principles-based orientation. Unlike US GAAP, which adheres to a national set of standards, IFRS adopts a more globally-oriented approach. The dichotomy between principle-based and rule-based frameworks sets the stage for a nuanced exploration of how the adoption of either IFRS or US GAAP influences the quality of reported earnings. Principle-based standards provide companies with more flexibility in applying accounting treatments, potentially leading to greater judgment and interpretation. On the other hand, rule-based standards offer clear-cut guidelines, reducing the room for interpretation but potentially constraining flexibility. The reliability of reported earnings under IFRS and US GAAP hinges on the degree of judgment involved in accounting treatments. While principle-based standards allow for more judgment, they may also introduce greater subjectivity and variability in financial reporting. Conversely, the prescriptive nature of rule-based standards in US GAAP may enhance consistency but could overlook certain economic substance considerations. Transparency is crucial for stakeholders to assess the financial health and performance of a company accurately. Under IFRS, the emphasis on principles-based standards aims to provide a clearer depiction of economic substance, promoting transparency in financial reporting. However, the lack of specific guidelines in some areas may lead to inconsistencies across reporting entities. In contrast, US GAAP's rule-based approach prioritizes consistency but may sacrifice transparency in certain instances due to the rigid application of rules. Consistency across reporting entities is essential for comparability and benchmarking purposes. A comprehensive comparative study between International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (GAAP) is indeed essential for understanding the multifaceted implications of different accounting frameworks. Such a study serves as a cornerstone for evaluating various aspects crucial to stakeholders in today's globalized business environment. Furthermore, the dynamic nature of accounting standards poses a significant challenge for researchers. Accounting standards evolve over time in response to changing business practices, regulatory requirements, and stakeholder demands. The ongoing convergence efforts between International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (GAAP), as well as revisions to existing standards, introduce complexities and uncertainties for comparative studies. Researchers must stay abreast of these developments and continuously update their analyses to ensure relevance and accuracy. Comparative studies between IFRS and US GAAP allow for an in-depth assessment of how each framework influences the quality of financial information reported by companies. This involves scrutinizing the reliability, relevance, and comparability of financial statements prepared under each standard. By identifying differences in recognition, measurement, and disclosure requirements, stakeholders gain insights into how these frameworks shape the presentation and interpretation of financial data.

2. Theory Basis

Agency Theory:

Agency theory provides a framework for understanding the inherent conflicts of interest that arise between principals, such as shareholders, and agents, such as management, within organizations. These conflicts stem from the delegation of decision-making authority by principals to agents, who may pursue their own interests at the expense of shareholders. A comparative study on information quality under International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (GAAP) can illuminate how these accounting standards influence the agency relationship by examining factors such as transparency, accountability, and the alignment of incentives between management and shareholders.

Positive Accounting Theory:

Positive accounting theory, rooted in economic principles, seeks to explain and predict accounting practices based on the economic incentives and motivations of various stakeholders within organizations. A comparative study comparing International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (GAAP) can provide theoretical insights into how these standards reflect underlying economic realities and influence financial reporting decisions.

Institutional Theory:

Institutional theory provides a valuable framework for understanding how institutions, including regulatory bodies, professional organizations, and cultural norms, influence organizational behavior and practices. By analyzing the impact of legal frameworks, regulatory enforcement mechanisms, and cultural norms on financial reporting practices, researchers can elucidate the institutional factors driving convergence or divergence in accounting standards across different jurisdictions. Comparative studies can explore how differences in legal frameworks influence the adoption and implementation of IFRS and US GAAP.

Stakeholder Theory:

Stakeholder theory provides a valuable perspective on organizational ethics by emphasizing the importance of considering the interests of all stakeholders, not just shareholders. By examining factors such as transparency, disclosure practices, and the relevance of financial information to different stakeholder groups, researchers can contribute to our understanding of how accounting standards influence stakeholder relationships and organizational legitimacy.
Transparency and disclosure practices are essential elements of stakeholder theory, as they enable stakeholders to make informed decisions and hold organizations accountable for their actions.

Globalization and Convergence:

Globalization theories emphasize the interconnectedness of economies, financial markets, and regulatory regimes across borders. These theories suggest that as companies expand their operations globally and investors seek opportunities in foreign markets, there is a growing demand for uniformity and consistency in financial reporting practices. Comparative studies can explore how IFRS and US GAAP respond to the imperatives of globalization by promoting harmonization and convergence of accounting standards.

Comparative International Accounting:

This field focuses specifically on comparing accounting systems and standards across different countries. Scholars in this area examine the cultural, economic, and institutional factors that contribute to variations in accounting practices, including the choice between IFRS and GAAP.

3. Literature review

The study in 2017, by Samir M. El-Gazzar suggests that transitioning to a globally recognized accounting framework could streamline operations for multinational corporations and improve the allocation of capital across borders. However, the question remains whether the adoption of IFRS would indeed lead to more comparable accounting information, particularly concerning restatement frequency and its consequences.

In 2012, Steve Lin offers valuable insights into the impact of transitioning from US Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS) on accounting quality. Lin's research, focusing on Germany, a country that underwent such a transition, provides a nuanced understanding of how accounting standards affect financial reporting practices and, consequently, accounting quality.

Published in 2018, Marc Cussatt, in his study offered valuable insights into the evolving landscape of accounting practices. By comparing these transitioning firms with those already utilizing IFRS, it provides a comprehensive analysis of the impact of this shift on various aspects of financial reporting. One noteworthy finding of the study is the observed reduction in conservatism among both groups of firms during the mandatory IFRS period.

Published in 2012, Jeong Bon Kim's study suggests the propensity of firms opting for voluntary IFRS adoption to attract a greater number of analysts. This heightened interest among analysts can be attributed to several inherent advantages associated with IFRS adoption, including the perceived enhancement in transparency, comparability, and consistency in financial reporting practices.

In the 2011 study, Brian M Burnett assess the sheds light on the post-IFRS adoption landscape, revealing intriguing patterns in firms' accounting standard preferences. One key finding of the study is the discernible trend of more Canadian firms opting for U.S. GAAP post-IFRS adoption. This trend suggests that despite the widespread adoption of IFRS globally and in Canada, a significant subset of Canadian firms, particularly those not cross-listed in the U.S., found adherence to U.S. GAAP more appealing or advantageous in the post-transition period.

Published in 2018, Robert C. Ricketts, delves into the impact of the elimination of the reconciliation requirement for analysts covering International Financial Reporting Standards (IFRS) firms, shedding light on the implications for forecast accuracy and forecast dispersion. The findings indicate that once the reconciliation was no longer obligatory for analysts covering IFRS firms, there was no consistent alteration in forecast errors, suggesting that the removal of this requirement did not significantly affect forecast accuracy. However, the study unveils a notable increase in forecast disparity among IFRS firms compared to their U.S. GAAP counterparts following the removal of the reconciliation requirement.

Mary E. Barth, in her study in 2012, suggests firms domiciled in common law jurisdictions, characterized by well-established legal frameworks and robust enforcement mechanisms, exhibit a higher degree of comparability with U.S. firms following IFRS adoption. Common law countries typically place greater emphasis on principles-based accounting standards and rigorous enforcement of financial reporting requirements, fostering a conducive environment for convergence with U.S. accounting norms.

Ran Ron Barniv (2015) study embarks on a comprehensive exploration of the ramifications and evolutionary trajectory of potential International Financial Reporting Standards (IFRS) adoption on U.S. financial analysts. Employing a natural experiment methodology, the research endeavors to offer valuable insights for academia, regulatory bodies, and standard setters, shedding light on the implications of IFRS adoption for U.S. analysts and other sophisticated users of financial information.

Mary E.Barth in 2007, undertakes a comprehensive comparison of accounting quality between firms adhering to International Accounting Standards (IAS) and those following U.S. Generally Accepted Accounting Principles (GAAP), aiming to elucidate the efficacy of IAS in mitigating earnings management, enhancing loss recognition, and bolstering value relevance relative to US GAAP.

Ilse Maria Beuren in 2008, revealed noticeable percentage differences in these indicators due to varying accounting treatments mandated by the respective standards. Such differences are not unexpected, given the contrasting philosophies and methodologies underlying IFRS and US GAAP.

Published in 2008, Joanne Horton revealed a significant shift towards global harmonization in financial reporting. Proponents of this move argue that it enhances information quality and comparability, facilitating more informed decision-making by investors and other stakeholders.

The study by Sofiee Van Der Meulen in 2005, presents empirical findings regarding attribute variances between earnings under U.S. GAAP and IFRS for a selection of new-economy firms during an economic downturn. We assess two market-driven earnings attributes - value relevance and timeliness - along with two accounting-driven earnings attributes - predictability and accrual quality.

Published in 2019 by Zaini Embong, aims to assess whether the adoption of International Financial Reporting Standards (IFRS) enhances financial information quality at the national level. It fills a gap by comparing the effects of IFRS adoption across countries and accounting frameworks. Findings reveal that financial information quality improves after IFRS adoption, with a stronger impact observed in countries with rules-based accounting systems compared to principles-based ones.

Smith L. Murphy (2012), in his study compares U.S. GAAP and IFRS, finding minor differences in actual financial statements. The global shift to IFRS is significant, with over 100 countries requiring its use for public companies. In the U.S., convergence with IFRS has been ongoing since 2002. The SEC may adopt IFRS as early as 2015, emphasizing its importance for financial professionals.

Published in 2014, Li Li Eng, examines whether accounting figures reported under International Financial Reporting Standards (IFRS) by firms cross-listed in the United States (ADRs) are comparable to those under U.S. GAAP. Findings show no significant differences in value relevance, timeliness, and accrual quality between the two standards. This supports the SEC's policy allowing foreign firms listed in the U.S. to use IFRS without reconciliation to U.S. GAAP.

4. Research Design and Research Methodology

Statement of problem

The global harmonization of accounting standards has been a topic of extensive discussion and debate in recent years. While International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP) in the United States serve as two primary frameworks guiding financial reporting practices worldwide, significant disparities exist between these standards, particularly in the realm of revenue recognition.

Research Gap

Despite the extensive literature available on the comparison between International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP) in the United States, there remains a notable research gap in understanding the nuanced implications of the coexistence of these standards for multinational corporations (MNCs) operating in diverse jurisdictions. While numerous studies have investigated the differences in accounting treatments between IFRS and US GAAP, limited attention has been given to the practical challenges encountered by MNCs in managing financial reporting processes, compliance requirements, and decision-making frameworks in environments where both sets of standards are applicable.

Objectives of Study

- To compare the disclosure requirements of IFRS and US GAAP and assess their impact on information quality.
- To understand the perceptions and preferences of users of financial statements, such as investors, analysts, and regulators, regarding the information quality under IFRS and US GAAP.

Scope of The Study

The study involves a comparative study of standard setters, standard setting process, accounting standards and disclosure compliances under the selected accounting standards. These accounting standards are compared and contrasted with US-GAAP and IFRS. Disclosure requirements under these accounting standards are identified and then compliance with these requirements is measured by computing Disclosure Compliance Index under all three accounting regimes.

Limitations of the Study

- The sheer complexity of accounting standards can make it challenging to isolate specific factors that influence information quality, as various factors may interact in complex ways.
- IFRS and US GAAP are used in diverse economic environments with different legal, regulatory, and business structures. Variations in economic environments can influence the relevance and reliability of financial information produced under each standard, making it challenging to generalize findings across jurisdictions.
- Despite efforts to standardize accounting practices, there can be variability in how companies interpret and apply IFRS and US GAAP.

Method of Data Collection:

Secondary Data Collection: This comparative analysis includes data procured from Indian Companies, i.e., Satyam and Infosys, which prepare financial statements using three different accounting regimes viz Indian GAAP, US-GAAP and IFRS for producing their financial reports. An Indian company registered at New York and London stock exchanges will have to prepare its financial statements using Indian accounting standards, US-GAAP and IFRS. We gather data by including all companies within our sample countries that align their financial reporting standards from IFRS to US GAAP, spanning their years 2004 to 2006.

Instrument for data collection:

Literature reviews, case studies and financial reports of multinational corporations operating under both standards, financial statement analysis, and regulatory documentation scrutiny will provide quantitative and qualitative insights into the differences, compliance requirements, and disclosure practices associated with dual reporting

5. Data Analysis and Interpretation

Table 1 **(Rs in Cr)**

	SATYAM		INFOSYS	
	2006-07	2007-08	2006-07	2007-08
NET PROFIT				
I-GAAP	1404.74	1687.89	3856.00	4659.00
US-GAAP	1344.58	1668.00	3830.00	4620.00
IFRS	1346.83	1687.20	3835.00	4622.00
SHAREHOLDERS' EQUITY				
I-GAAP	5752.60	7239.20	11259.00	13791.00
US-GAAP	5909.01	8977.69	11710.00	15648.00
IFRS	5848.67	7202.80	11710.00	15648.00

What is clear from the Table 1 is - amount of net profit as well as shareholders' equity is a different amount under each accounting regime for the years 2006-07 and 2007-08. From the figures of net profit, it can be observed that US-GAAP gives the least amount of Net profit (Rs. 1,344.58 crores for Satyam for the years 2006-07 when profit reported under I-GAAP is Rs. 1,404.74 crores and profit reported under IFRS IS Rs. 1,346.83 crores for the same year). Indian GAAP gives the highest amount of Net Profit Rs.3,856 crores for Infosys for the year 2006-07 when the reported profit under US-GAAP is Rs. 3,830 crores and Rs, 3,835 crores under IFRS for the same year. US-GAAP rules are considered to be the strictest of the three accounting rules compared here.

Table 2 **($ in mm)**

EARNING ATTRIBUTES	**REPORTED USING IFRS ($mm)**		**REPORTED USING US-GAAP ($mm)**	
	MEAN	MEDIAN	MEAN	MEDIAN
NET INCOME	4,420.00	3,092.00	5,394.00	2,858.00
TOTAL ASSETS	2,00,707.00	48,591.00	1,88,187.00	49,124.00
TOTAL LIABILITIES	1,54,351.00	20,793.00	1,55,296.00	23,996.00
SHAREHOLDERS' EQUITY	43,912.00	15,437.00	33,926.00	15,438.00
EPS (BASIC)	14.68	1.93	7.39	1.67
EPS (DILUTED)	13.97	2.02	7.64	1.76

Table 3 **($ in mm)**

EARNING ATTRIBUTES	**DIFFERENCE (MEAN)**	**DIFFERENCE (MEDIAN)**
	US GAAP - IFRS	US GAAP – IFRS
NET INCOME	974.00	(234.00)
TOTAL ASSETS	(12,520.00)	533.00
TOTAL LIABILITIES	945.00	3,203.00
SHAREHOLDER EQUITY	(9,986.00)	1.00
EPS (BASIC)	(7.29)	(0.26)
EPS (DILUTED)	(6.33)	(0.26)

During the analysis of financial data from European Union (EU) firms listed on the New York Stock Exchange (NYSE) for the years 2005 and 2006, it was found that these years represented a unique period. EU firms were required to present financial statements using two distinct standards: International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (GAAP). The average net income reported under IFRS was $4,420 million, while under GAAP it was $5,394 million, indicating that net income reported under GAAP appears to be higher. However, the median net income value was higher under IFRS, at $3,092 million compared to $2,858 million under GAAP. The only statistically significant difference observed was in the mean earnings per share between IFRS and GAAP, with no significant differences found in median values for any items.

Table 4 **($ in mm)**

	2006		2005		2004	
(in $ mm)	MEAN	MEAN %	MEAN	MEAN %	MEAN	MEAN %
NET INCOME (IFRS)	2,971.00	100.00%	2,180.00	100.00%	1,628.00	100.00%
NET INCOME (US GAAP)	2,664.00	89.70%	1,983.00	90.96%	1,635.00	88.30%

Table 5 **($ in mm)**

	2006		2005		2004	
(in $ mm)	MEDIAN	MEDIAN %	MEDIAN	MEDIAN %	MEDIAN	MEDIAN %
NET INCOME (IFRS)	969.00	100.00%	521	100.00%	477	100.00%
NET INCOME (US GAAP)	797.00	82.00%	513	98.46%	454	88.30%

It shows that in 2005 the mean is $2,180 million and the median is $521 million. These companies are big, as expected since they are listed on American exchanges as well as in their home countries. Similarly, the net income reported is significantly greater in the year 2006 and 2004. GAAP net income is lower than IFRS by 9.0% in 2005. Similarly, GAAP net income is lower than IFRS by 11.70% and 10.3% in the years 2004 and 2006, respectively.

Table 6 **($ in mm)**

	2006		2005		2004	
(in $ million)	US GAAP	IFRS	US GAAP	IFRS	US GAAP	IFRS
Mean	16,739.00	15,936.00	12,970.00	11,825.00	11,913.00	10,263.00
Median	5,001.00	5,17500	4,364.00	4,269.00	3,624.00	3,838.00
Avg Ratio (US GAAP to IFRS)	1.11		1.10		1.15	

Table 6 indicates that the average ratio of GAAP equity to IFRS equity deviates significantly from 1.0, suggesting that opting for either measure may lead to disparate conclusions. The variance cannot be attributed to differing growth opportunities based on whether they are measured by US GAAP or IFRS. Rather, the evident explanation lies in the distinct measurement of assets and liabilities between the two standards.

No.	**Particulars**	**I-GAAP**	**US-GAAP**	**IFRS**
1	Vertical Balance Sheet begins with	Liabilities	Assets	Assets
2	First group in Vertical Balance Sheet	Shareholders' Fund	Current Assets	Non-Current Assets
3	Order of liquidity for Assets	Increasing	Decreasing	Increasing
4	Redeemable Preference Share shown as	Share Capital	Debt	Debt

5	Convertible Debentures shown as	Debt till conversion	Debt	Partly Debt, Partly Equity
6	Asset Measurement	Cost	Cost	Fair Value
7	Expenses classification in Income Statement	By function or nature	By function	By function or nature
8	Separation of results from continuing and discontinued operations	Not required	Required	Required
9	Extraordinary items in income statement	Recognised	Recognised	Not recognised

In US balance sheets, current assets are listed before non-current assets, with all assets arranged in descending order of liquidity (cash first). Conversely, IFRS and Indian Generally Accepted Accounting Principles (I-GAAP) balance sheets organize assets in increasing liquidity order, and Indian balance sheets begin with liabilities, with shareholders' funds listed under liabilities. Both IFRS and US balance sheets categorize assets and liabilities as current and non-current. However, in Indian balance sheets, loans or borrowed funds are not divided into current and non-current categories. Additionally, mandatory redeemable financial instruments issued as shares are classified as debt under both US and IFRS balance sheets but as share capital under Indian balance sheets. Convertible debentures are considered debt until conversion under I-GAAP and US-GAAP, whereas under IFRS, they are treated as partly debt and partly equity from the date of issue. Asset measurement differs among standards, with US and Indian GAAP valuing assets at historical cost, while IFRS relies more on fair value. US-GAAP combines costs by function, while IFRS and I-GAAP allow cost combinations by nature or function. The by-nature format groups costs as total purchases, wages, depreciation, etc., while the by-function format categorizes costs by stage of production, administrative costs, selling and distribution costs, etc. The by-function format enables the calculation of gross profit, whereas the by-nature format does not. Regarding income statements, US-GAAP segregates income from continuing operations, results from discontinued operations, extraordinary items, and cumulative effect of accounting changes. In contrast, IFRS does not recognize any item as extraordinary. I-GAAP acknowledges extraordinary items and mandates their separate presentation to allow clear perception of their impact on current profit or loss.

6. Summary of Finding, Recommendation, Conclusion

Summary of Findings:

Initially, our examination focused on comparing net income under International Financial Reporting Standards (IFRS) with that under US Generally Accepted Accounting Principles (GAAP). In 2004, the difference at the "bottom line" level was minimal for the average company. However, by 2005, this variance had surged to 9%.

Despite the potential for substantial and frequent differences among firms, the actual number of items contributing to such disparities remains relatively limited. Typically, for any given firm, it's observed that five or fewer differences encompass the entire GAAP-IFRS reconciliation process. In spite of the data that provides a comprehensive list of reconciling items, it's noteworthy that only a select few carry substantial weight significant enough to influence decision-making contexts. This implies that while there may be numerous differences in the treatment of various accounting standards, the impact of these differences on financial outcomes is often concentrated in a few key areas.

Recommendation:

It's crucial to employ a longitudinal approach, spanning multiple years, to capture the evolution of differences between the two standards over time. This longitudinal analysis enables a nuanced understanding of how discrepancies may fluctuate, offering insights into potential trends or patterns.
Secondly, the study should adopt a multi-dimensional perspective, considering not only the quantitative aspects but also qualitative factors such as the impact on financial reporting transparency, comparability, and decision usefulness. This holistic approach provides a more comprehensive evaluation of the implications of adopting one standard over the other.

Furthermore, given the global nature of financial markets, the study should incorporate a cross-country comparison, examining how the adoption of IFRS versus US GAAP influences financial reporting practices and outcomes across different jurisdictions. This comparative analysis enhances the generalizability of findings and facilitates a deeper understanding of the broader implications of accounting standard convergence or divergence.

Conclusion

Our analysis extends beyond merely comparing the alignment of IFRS net income with GAAP. We delve deeper into the comparability of IFRS over the years 2004, 2005, and 2006. Notably, during this period, there were no substantial alterations to US GAAP, thereby enabling us to attribute any discrepancies in reconciling items to changes in IFRS standards.

By scrutinizing the evolution of IFRS from 2004 to 2006, we aim to discern trends and patterns in its convergence with US GAAP. This comparative analysis offers valuable insights into the pace and extent of harmonization between the two accounting regimes. The adoption of IFRS by the EU in

2005 represented a significant step towards achieving global accounting harmonization. This move signalled a shift towards a more principles-based approach to financial reporting, in contrast to the rules-based framework inherent in US GAAP. Consequently, it sparked interest among stakeholders in assessing the degree of convergence between these two dominant accounting standards. Our examination encompasses various dimensions of financial reporting, including income recognition, asset valuation, and disclosure requirements.

Analysing these aspects across both IFRS and US GAAP, we aim to provide a comprehensive assessment of their comparability and alignment. One key focus of our analysis is the reconciliation of net income between IFRS and GAAP. This entails identifying and quantifying the differences in income recognition, expense treatment, and other relevant factors. By isolating these reconciling items, we can ascertain the extent to which IFRS aligns with GAAP in terms of net income reporting

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