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Discussion

Discussion of "Attribute differences between U.S. GAAP and IFRS earnings: An exploratory study"

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1. Introduction

Using firms listed on the German Neuer Markt, Van der Meulen, Gaeremynck, and Willekens (henceforth MGW) investigate whether there are significant difference in four attributes of earnings between firms that apply U.S. GAAP and firms that apply IFRS (or IAS). In my opinion, this study provides a timely investigation of an issue of considerable interest to both regulators and academics. Currently about 100 countries either require or allow the use of IFRS for their domestic publicly listed corporations. In the near future, we will likely only have two accounting standards worldwide: IFRS and U.S. GAAP.[1] Given the adoption of IFRS around the world and the relative lack of evidence on effects of such adoption, the authors do not have to try hard to motivate their study.

MGW have made several improvements to the paper following their presentation – and my discussion of their paper – at the *International Journal of Accounting* Conference in Paris. Consequently, my discussion here will be relatively brief and will focus on a few selected issues.

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[1] Whether such a "convergence" to one or two accounting standards is optimal or not is hard to say. It is my feeling that the decision to require IFRS – and thus abolish domestic GAAPs – around the world has been mostly based on "faith" rather than on solid evidence suggesting an overall gain to society (see also Ball, 2006).

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2. Relation to literature

In my opinion, MGW complement the extant literature on differences between IFRS and U.S. GAAP.[2] That is, there are several prior studies that examine the quality of financial reporting across countries. Similarly, there are prior studies that focus on the German market but which either use small sample sizes or focus on information–asymmetry outcomes rather than earnings attributes. Since quite a few studies examine IAS versus U.S. GAAP, the main contribution of this study likely lies in its focus on one market, Neuer Markt, as well as its investigation of several (not just one or two) earnings attributes.[3] Focusing on one market is a strength because it holds many institutional factors constant (see, however, my comments below regarding differential enforcement). On the other hand, it also significantly limits the sample size (which, as explained below, turns out to be important in this setting), and limits the generalizability of results.[4]

3. Use of R^2 as a test metric and the Cramer test

At the conference, I raised the question of *why* the authors have chosen to focus on differences in R^2s between two samples of firms. In my opinion, this choice has few (if any) advantages and several important disadvantages. Suffice to say that it is very difficult to compare R^2 across different groups of firms (which explains why we do not see such tests often in research papers). The authors do not provide any discussion of why they have made this choice. An alternative would be to instead focus on differences in coefficient estimates. Using such an approach, they could pool all observations and easily test for differences between the two groups using interaction terms.[5]

Similarly, even ignoring the inherent difficulties involved in comparing R^2s across samples, the Cramer test used for testing differences in R^2 between samples is an unusually *weak* test metric. In particular, the Cramer test is extremely sensitive to the number of observations included in the tests. This fact is important for the current paper because MGW want to be able to conclude that there "are no significant differences" between the

[2] In their literature review, MGW discuss research on 20F reconciliations at some length. Such research is of relevance to regulators (i.e., the SEC), but the limitation of these studies is that they only examine firms already listed, whereas regulators may care even more about foreign firms that are not currently listed on the domestic exchange. In addition, the reconciliation stream of literature tends to focus on incremental value relevance (or information content, depending on the type of study) of additional, required U.S. GAAP disclosures. Such research does not directly address which GAAP system is "best." Instead, it tests whether there is any *additional information* conveyed in having extra information disclosed (a subtle but important difference often overlooked in the literature).

[3] Readers should note that there are other papers that investigate differences between IAS and U.S. GAAP using German firms. For example, Bartov, Goldberg, and Kim (2005) examine value–relevance differences, Van Tendeloo and Vanstraelen (2005) study earnings–management differences (i.e., "abnormal accruals" differences), and Leuz (2003) focuses on differences in bid–ask spreads and trading volume.

[4] In addition, the sample period is marked by declining firm performance. "Value relevance" tests do not perform particularly well during such periods.

[5] At the conference I made several specific comments on the four earnings attributes. For example, I do not understand why the authors use the R^2 from the Dechow and Dichev model when other studies use the standard deviation of the residuals from this model. Furthermore, I am not quite sure how different the test of "timeliness" is from the test of "value relevance."

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