**Accounting Quality**

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| **Question** | **Sainsbury's** | **Kroger** |
| *Audit quality:* is the firm violating standards or committing fraud? | Clean audit report in all years under review; use of Big 4 auditor (PwC in 2015, then EY); change of auditor in 2016 helps to guarantee auditor independence; note general concerns about audit regulation in the UK during period under review | Clean audit report in all years under review; PwC have been the company's auditor since 1929; although they are a Big 4 firm, this does raise questions over auditor independence |
| *GAAP application quality:* is the firm using standardised accounting to manipulate reports? | Key accounting policies are as follows: * Revenue recognition - generally straightforward due to use of Point-of-Sale systems; calculation of deferred revenue in respect of Nectar Points is an area of subjective judgement but the groups policies are compliant with IFRIC 13
* Supplier arrangements - a complex and material area but, again, the group's accounting policies appear reasonable
* Valuation of banking assets and liabilities - requirements of IFRS appear to have been closely followed
 | Key accounting policies are as follows:* As with Sainsbury's, revenue is generally recognised at point of sale. Note that (as permitted under US GAAP) Kroger does not book deferred revenue in respect of loyalty points earned
* Supplier arrangements - policy seems reasonable and should produce a result in line with that of Sainsbury's

Note that Kroger changed its accounting policies re goodwill impairments and deferred tax in 2017 and revenue recognition in 2018. Frequent changes in discretionary accounting policies are seen as a sign of poor accounting quality |
| *Business transaction timing quality:* is the firm manipulating business to accommodate the accounting? | The following possible risk areas were checked:* Revenue recognition - possible risks over deferred revenue re Nectar Points and sale-or-return transactions; however, accounting policies in these areas seem fine
* Depreciation policies are in line with those across the industry
* Policies re impairment of financial assets due from banking customers are in line with IFRS 9
 | The following risk areas were checked:* As noted above, US GAAP does not require the booking of deferred revenue in respect of loyalty points earned - this is a potential revenue timing issue
* Depreciation policies are broadly comparable with Sainsbury's and other industry players
* Use of LIFO inventory valuation is a potential transaction timing issue
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| *GAAP quality:* is standardised accounting deficient? Local vs IFRS vs US GAAP. | Sainsbury's prepares its accounts under IFRS, whereas Kroger uses US GAAP; both frameworks are widely recognised to be of high quality. There are a number of key differences between IFRS and US GAAP. The following differences are considered important in the retail sector * Treatment of PPE - IFRS allows either use of the historic cost convention or a revaluation model, whereas US GAAP allows only the historic cost convention; however, Sainsbury's chooses to use the historic cost convention in any case
* Inventory - LIFO inventory valuation is prohibited under IFRS but allowed under US GAAP. Kroger chooses to apply LIFO, which seems inappropriate for a company trading in perishable goods
* Leases - IFRS 16 did not apply during the period under review, meaning the US GAAP and IFRS treatments were broadly comparable

With the exception of the loyalty card issue noted above, revenue recognition requirements under IFRS and US GAAP are now broadly similar. |
| *Disclosure quality:* are disclosures adequate to analyse the business? | Disclosures are of a high quality, enabling the reader to obtain a detailed understanding of the business and its associated risks, the accounting policies and the audit process | Disclosures are US GAAP compliant. However, US disclosure requirements are not as thorough as those under IFRS and this limits the reader's ability to analyse the business |