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The International Journal of Accounting 45 (2010) 356–374

The
International
Journal of
Accounting

Development of accounting in Poland: Market efficiency and the value relevance of reported earnings[☆]

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Received 17 July 2008

Abstract

This paper outlines the evolution of the information environment surrounding the Warsaw Stock Exchange in Poland. Like other transition economies, Poland needed to develop accounting regulations to support privatization. We trace changes in financial reporting regulation from 1994, through the adoption of IFRS and corporate governance codes, to the crisis of 2007–2008. The effect of these developments is then evaluated empirically by testing the relevance of earnings of listed corporations from 1997 to 2008 to corporate value. We show that the stock exchange was weak-form efficient during this period and estimate regressions for value relevance of earnings to corporate value. We find positive evidence of such relevance but no improvement in the strength of the relationship over time.

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Keywords: Transition economy; Information content; Market efficiency; Value relevance

1. Introduction

Transition economies face the challenge of creating financial markets and developing relevant regulation at a rapid pace. This paper focuses on the Republic of Poland, which began its economic transition in 1989. Over the next 20 years, Poland carried out successful

[☆] We appreciate helpful comments from participants of the international research seminar at Warsaw University, participants of EAA 2007 Annual Congress and two anonymous reviewers.

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privatization, established a vibrant stock market, and joined the European Union. Rapid economic transition and development left little time for accounting regulations and practices to evolve from an initial fiscal reporting function to a source of relevant economic information for investors. Accounting regulation underwent deep modifications every five years, bringing it ever closer to International Accounting Standards. This clear succession of new regulation allows us to test empirically to what extent development and harmonization of accounting regulations added to the relevance of reported accounting numbers to stock market valuation of corporate equity. The results of our study are relevant for other economies in transition, which attempt to develop their financial markets. There are relatively few studies that examine the value relevance of accounting numbers in such economies, and our research provides an insight into the effects that new regulations have on the information environment.

In this paper, we identify and describe milestones in accounting regulation in Poland and then empirically analyze the effects of these changes on the relevance of accounting earnings to the valuation of corporate equity. [Section 2](#) begins with a brief history of the Warsaw Stock Exchange and then presents the stages of development in Polish accounting from the first accounting regulation to adoption of International Financial Reporting Standards and corporate governance codes of good practice. In [Section 3](#), we empirically evaluate the effects of these developments by testing value relevance (association between stock returns and reported earnings) over three stages of development identified in [Section 2](#). The sample is comprised of 856 year-firm observations of non-financial companies listed on the Warsaw Stock Exchange between 1997 and 2008. We perform market efficiency tests, which show that weak-form market efficiency was maintained throughout this period. In [Section 3.3](#), we develop an unexpected earnings model; and in [Section 3.4](#), we estimate regressions. Results provide evidence of the significant value relevance of earnings for the whole sample. However, we find no evidence of improvement in that relevance over time.

2. Development of the stock market and accounting in Poland

2.1. The Warsaw Stock Exchange

The Polish capital market is still relatively young, as are other markets in Central and Eastern Europe. Even though the history of the Warsaw Stock Exchange dates back to 1817, it was not until 1991 that the stock exchange took on the form and function that we see today. With the transformation of Poland from a communist state to a democracy in 1989, the Polish government began major economic reforms. Since one of the main requirements for transition to a market economy was privatization, a well-functioning capital market was required. In 1990, Poland signed an intergovernmental agreement with France to create a stock exchange in Warsaw ([Jermakowicz & Gornik-Tomaszewski, 1998](#)). The Warsaw Stock Exchange (WSE), founded by the State Treasury as a non-profit joint-stock company, opened its first trading session on April 16, 1991. The first decade of the WSE's operations is well described by ([de la Rosa, Crawford, & Franz, 2004](#)). During the first session, only five companies were listed, but subsequent years showed steady growth in the number of companies listed at the exchange, and there were 374 in 2008

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