



The impact of IFRS on accounting quality: Evidence from Greece

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ABSTRACT

This paper examines the impact of IFRS adoption on the quality of accounting information within the Greek accounting setting. Using a sample of 101 firms listed in the Athens Stock Exchange (ASE) for a period of eight years (2001–2008) we find convincing evidence that the implementation of IFRS contributed to less earnings management, more timely loss recognition and greater value relevance of accounting figures, compared to the local accounting standards. Also, our findings document that audit quality further complements the beneficial impact of IFRS since those companies that are audited by Big-5 audit firms exhibit higher levels of accounting quality. Our findings are robust in regard to different model specifications and after controlling for firm-specific effects like size, risk, profitability and growth opportunities.

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1. Introduction

Effective 2005, all listed companies in the Athens Stock Exchange (ASE) are required to comply with International Financial Reporting Standards (hereafter IFRS). The research questions we address in the present paper are: first, whether IFRS have mitigated earnings management behavior in Greek listed firms; second, whether IFRS influence the relevance of accounting information (earnings and book values) compared to the Greek accounting standards and third, we test whether the adoption of IFRS impacts on the level of reporting conservatism in financial statements.

The primary motivation for this study is to further our understanding of the influence of IFRS on the quality of reported earnings. Overall, IFRS are principle-based standards that are market-oriented and require extensive disclosure in comparison with prior standards, i.e. local generally accepted accounting principles (GAAP). The International Accounting Standards Board (IASB) removed allowable accounting alternatives (which existed in most countries under their respective GAAPs) and required accounting measurements that better reflect a firm's economic position and performance. Based on this, in theory, the adoption of IFRS should significantly restrict the ability to engage in earnings management behavior (upwards or downwards) and increase the overall quality of disclosed information. However,

Barth, Landsman, and Lang (2008) also note that the opposite may be true. For example, limiting managerial discretion relating to accounting alternatives could eliminate a firm's ability to report accounting measurements that are more reflective of the firm's economic position and performance. They also note that if enforcement of these standards is lax, companies could still engage in earnings management.

In the current literature there are two opposing views regarding the influence of IFRS on accounting quality. On the one side, researchers argue that IFRS improve the reliability of financial reporting by limiting opportunistic managerial discretion (Ashbaugh & Pincus, 2001; Barth et al., 2008; Ewert & Wagenhofer, 2005). The contrary view is that the flexibility inherent in IFRS and lax enforcement might provide greater opportunity for firms to manage earnings (Ball, Robin, & Wu, 2003; Breeden, 1994; Burgsthaler, Hail, & Leuz, 2006; Cairns, 1999; Street & Gray, 2002). Recent evidence by Ahmed, Neel, and Wang (2010) suggests that IFRS adoption results in more earnings smoothing, more aggressive reporting of accruals and a reduction in timeliness of loss recognition relative to gain recognition. They attribute this finding to the minimal implementation guidance on IFRS, to managers' incentives to manipulate earnings and to weak enforcement mechanisms.

Similar to conflicting views on the influence of IFRS on accounting quality, as noted above, research on the influence of IFRS on earnings management has also provided mixed results. Van Tendeloo and Vanstrelen (2005) for example, found that earnings management behavior was not significantly different between German companies that adopted IFRS when compared to those that relied on German GAAP. However, these findings are not corroborated by Barth et al. (2008) who, using a sample of 21 countries, concluded that in the post-adoption period firms applying IFRS displayed significantly less

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earnings management relative to the pre-adoption period. Also [Chen, Tang, Jiang, and Lin \(2010\)](#) document that since IFRS adoption the quality of accounting information has increased within the EU in terms of less targeted earnings management, smaller magnitude of absolute discretionary accruals and higher accruals quality. Similar evidence, documented by [Iatridis \(2008, 2010\)](#) in the UK and further verified by [Doukakis \(2010\)](#) in Greece, suggests that IFRS has impacted on the variability and persistence of earnings and a reduction of income smoothing practices, which obviously results in higher reporting quality.

Part of the motivation for this study is to shed further light on these competing views with regard to the efficiency of IFRS in reducing earnings management and improving earnings quality within an accounting framework characterized by a long history of historical-accounting principles. According to [Tsalavoutas and Evans \(2010\)](#), the Greek accounting setting is heavily based on state regulation and on certain rules associated with an increased monitoring cost. There is a close link between taxation and accounting rules which, in turn, creates increased incentives for creative accounting and earnings management practices. [Ding, Hope, Jeanjean, and Stolowy \(2007\)](#) point out that Greece is the country with the highest divergence of issues between its local GAAP and IFRS and that this divergence is closely related to the distinctive culture of this country. [Hofstede \(1980\)](#) argues that Greek accountants prefer to reduce uncertainty by abiding by the rules and [Ballas, Skoutela, and Tzovas \(2010\)](#) and [Tsakumis \(2007\)](#) also document that Greek accounting professionals are “characterized by the acceptance of inequality and a preference for achievement and material success, focusing on the group which they belong rather than on themselves”. Within this cultural framework the introduction of IFRS, which are principle-based standards, is expected to create a breach of this cultural status quo and thus the impact of this new regulation on the quality of published information remains an open empirical question.

In addition, Greece presents a unique economic environment which differs significantly from other code-law countries. Greece is a bank-oriented capital market, a fact which aligns corporate reporting towards the protection of the creditors, while managers pay less attention to minority shareholders ([Ballas et al., 2010](#)). Contrarily, IFRS are accounting standards which focus more on the needs of investors rather than the creditors. Therefore, considering the countervailing cultural and economic environment of Greece, the adoption of IFRS by the Greek government introduced several provisions which shake the established accounting practices of the last 25 years, such as increased levels of disclosure, the issues covered by accounting rules and the broadened role of corporate boards in evaluating accounting values. Whether the adoption of IFRS improved accounting quality within this distinctive environment remains an issue which warrants further investigation.

Furthermore, the quality of accounting information is closely related to the quality of the external audit. [Tsalavoutas and Evans \(2010\)](#) document that large multinational audit firms (Big-5) enjoy greater independence from their clients in Greece and have greater experience and resources for implementing IFRS, and of course face greater reputation costs or litigation risks. These characteristics contribute towards higher quality audits. [Caramanis and Lennox \(2008\)](#) documented that within a weak legal enforcement environment (such as in Greece), the auditor's effort to ensure accounting quality is motivated by reputation costs and since Big-5 audit firms face greater litigation costs they also produce higher quality audits. Furthermore, a recent study by [Tsalavoutas \(2011\)](#) suggested that Big-5 audit corporations act as monitoring mechanisms contributing to increased transparency, better quality financial statements and higher levels of compliance with IFRS. Thus, our study adds to a growing body of literature since it examines if and how the quality of reported accounting information is influenced in any way by the implementation of IFRS, taking into consideration the quality of audit. We provide

additional evidence to the ongoing debate about international accounting standards and accounting quality.

Our sample comprises of 101 firms listed in the ASE covering an eight-year period from 2001 until 2008 where 25 had voluntarily adopted IFRS prior to the initial enforcement in 2005 and the remaining 76 adopted IFRS when mandatorily enforced. We examine whether accounting information during the post-IFRS period (2005–2008) exhibits less earnings management, more timely loss recognition and higher value relevance, when compared to the relative amounts during the pre-IFRS period (2001–2004). After controlling for firm-specific characteristics such as size, growth opportunities, risk and audit quality we found that the adoption of IFRS contributed to less earnings manipulation (lower magnitude of discretionary accruals), more timely loss recognition and greater value relevance of earnings and book values, compared to the local accounting standards. Also, our findings document that audit quality further complements the beneficial impact of IFRS since those companies that are audited by the Big-5 multinational audit firms exhibit higher levels of accounting quality compared to their non-Big-5 counterparts.

2. Greek accounting standard setting and IFRS

An extensive amount of research has examined the value relevance of accounting information within countries under different accounting regimes. [Hope \(2003\)](#) argues that the quality of financial accounting information depends on both the quality of accounting standards and the regulatory enforcement, since even the best accounting standards are inefficient if not enforced adequately.

The Greek accounting system dates back to 1835 when the first independent Greek Republic was established after almost 400 years of Ottoman occupation. At that time the French commercial code was translated into Greek and adopted in order to serve as the basis of Greek commercial law. The companies act law was introduced in 1920 and modified in 1955 and it still exists now to a great extent. Accounting regulation in Greece was imposed by the government and specifically by the Minister of Economics and Finance. However, in 1988 the National Accounting Council was established in order to be entrusted with the issuance of more detailed regulations. In contrast to other countries, the Greek National Accounting Council had limited decision making authority and its function was clearly advisory to the government. Before the council could express an opinion it had to follow a process of consultation with the Economic Chamber of Greece which could be very time-consuming ([Ballas, 1994](#)).

In June 2003, the National Accounting Council was abolished and in its place the government established the Board of Accounting Standards which forms one division of the Committee of Accounting Standards and Control (along with the Board of Quality Control and the Executive Committee). The Board of Accounting Standards is governed by a five-member board of directors and its main responsibility is to provide consultative services on issues of accounting standardization regarding Greek accounting standards and the codification of IFRS. Also, it has the authority to publish directives regarding the implementation of Greek GAAP and IFRS and also clarifications on some technical accounting issues. These advisory decisions need to be approved by the Committee of Accounting Standards and Control before they are proposed to the Ministry of Economics for final approval ([Ballas et al., 2010; Dimitropoulos & Asteriou, 2009](#)).

Additionally, before 1991 the ASE was an unregulated stock market and the only supervision performed was once again by the Ministry of Economics. As a result, until that period the accounting regulations promoted financial disclosure for tax purposes only, since the stock market was unregulated and investment interest was quite limited. Furthermore, the overall setting was primarily used as an instrument of government policy — most notably tax policy, but also wage and pricing policy ([Ballas et al., 2010](#)).

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