The Effects of International Financial Reporting Standards on the Accounts and Accounting Quality of Australian Firms: A Retrospective Study

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Abstract

We examine the effect of Australian equivalents to International Financial Reporting Standards (IFRS) on the accounts and accounting quality of 1,065 listed firms, relying on retrospective reconciliations between Australian Generally Accepted Accounting Principles (AGAAP) and IFRS. We find that IFRS increases total liabilities, decreases equity and more firms have earnings decreases than increases. IFRS earnings and equity are not more value relevant than AGAAP earnings and equity and while adjustments for changes in accounting for provisions and intangibles other than goodwill are value relevant, they weaken associations with market value. Goodwill adjustments improve associations with market value. We also find that the reconciliation note for the earnings adjustments contained no new information.

JEL Classifications: M40, M41

Keywords: IFRS, accounting quality

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1. Introduction

In 2002 the Financial Reporting Council (FRC) claimed that the implementation of Australian equivalents to International Financial Reporting Standards (IFRS) would enhance "the overall quality of financial reporting in Australia" (FRC, 2002). This view was supported by the Australian Accounting Standards Board (AASB) in suggesting that complying with IFRS would not impose significant burdens and costs on entities when compared with the benefits of more relevant and reliable information for users of financial reports (Fenton-Jones, 2003, 53). There was general agreement among commentators, the firms, analysts and the wider community that the introduction of IFRS from 2005 would materially affect Australian firms' financial performance and accounts quality (Buffini, 2005; Clarke and Dean, 2005, Deegan, 2005, 32-35).[1] A study based on interviews of 60 senior financial executives from Australia's top 200 firms reported that the introduction of IFRS would have a significant impact on financial position and earnings. The majority of executives expected earnings to be negatively affected while less than half expected a positive effect on the financial position of their firms (Jones and Higgins, 2006). However, no substantial empirical study has been undertaken to assess the claim that financial statements prepared under IFRS will enhance the quality of financial reporting in Australia or to examine the effects of IFRS on financial performance. In this paper we use a representative sample of listed firms in attempting to fill this gap in the literature.

Our study contributes to the current debate on whether IFRS based accounting numbers are of a different quality to those produced under domestic GAAP in several important ways. First, we examine all listed Australian firms that have available data. Second, the exemptions from applying IFRS to restated earnings and equity are limited to a small number of standards and all firms are required to restate and provide reconciliations from Australian Generally Accepted Accounting Principles (AGAAP) to IFRS upon first-time adoption of IFRS (AASB 1 *First-Time Adoption of Australian Equivalents to International Financial Standards*, para 39).[2] Prior studies use datasets that may not be representative of the full effects of IFRS due to small sample size (e.g., Hung and Subramanyam, 2007) or they may use firms that voluntarily adopt IFRS (e.g., Barth et al., 2005; Bartov et al., 2005), meaning control for self-selection bias is needed. Self-selection bias is not an issue with our dataset because early adoption is not permitted (AASB 1). Third, our large sample size permits an empirical examination of the reconciliation adjustments to IFRS, which has not been reported in the literature. Finally, examining the switch to IFRS for Australia is useful, as similar studies have focused on code law countries such as Germany. In Germany, accounting numbers are more conservative and have different value relevance than accounting numbers produced under common law based countries like Australia (Ali and Hwang, 2000; Ball et al., 2000).

IFRS is applicable for reporting periods beginning after 31 December 2004 and firms are required to restate comparatives and provide reconciliations to IFRS in their notes to the

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[1] Supporting this contention are the shareholder briefings held by some firms (e.g., Telstra and Alinta) to explain the financial impact of IFRS on their accounts.

[2] There are some standards exempt from retrospective application, namely the two financial instruments standards (AASB 132 and AASB 139), AASB 3 *Business Combinations* and the three insurance standards (AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*).

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