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The transition to IFRS and the value relevance of financial statements in Greece☆

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ABSTRACT

We examine the combined value relevance of book value of equity and net income before and after the mandatory transition to IFRS in Greece. Contrary to our expectations, we find no significant change in the explanatory power of value relevance regressions between the two periods. The coefficients on book value of equity and net income are positive and significant in both the pre-IFRS and post-IFRS periods. However, the coefficient on book value of equity is significantly greater under IFRS, whereas we find some evidence of a decrease in the coefficient on net income. Finally, we find that market participants viewed the extra information provided by reconciliations between Greek GAAP and IFRS for 2004 figures as incrementally value relevant.

1. Introduction

Since January 1st 2005, European Union (EU) publicly traded companies have been required to prepare consolidated accounts on the basis of International Financial Reporting Standards (IFRS).[2] IFRS consider investors as the main users of financial statements (IASC *Framework*, par. 10). They are not 'debt and tax oriented', unlike the accounting regulations in code law countries such as Greece. IFRS are supposed to reflect economic gains and losses in a more timely fashion (Barth, Landsman, & Lang, 2008) and to provide more useful balance sheets than the accounting rules governing most continental European countries (Ball, 2006).

This, and prior evidence that 'shareholder-oriented' accounting regimes have higher value relevance than 'debt-oriented' systems (Ali & Hwang, 2000; King & Langli, 1998) have led to the expectation that accounting figures will become more value relevant in code law countries which 'switch' to a shareholder-oriented system such as IFRS. Considering the value relevance

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[2] Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002. International Accounting Standards (IAS) were issued by the International Accounting Standards Committee (IASC) and adopted in 2001 by the restructured International Accounting Standards Board (IASB), which has since been amending them or replacing them with IFRS.

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of book value of equity and net income as one important dimension of accounting quality (e.g. Barth et al., 2008), the implementation of IFRS in Europe provides a unique opportunity to examine accounting quality, and any changes to this quality, before and after IFRS adoption. Additionally, IFRS 1 (*First-time Adoption of International Financial Reporting Standards*) requires reconciliation statements explaining how the transition from local GAAP to IFRS affected companies' financial statements. Drawing on prior literature indicating the usefulness of reconciliation statements for valuation purposes (e.g. Alciatore, 1993), it is expected that investors value the new information provided in the reconciliation statements.

We address two research objectives. First, we examine the change in the relationship between market values and reported figures before and after the adoption of IFRS by Greek listed companies (value relevance of Greek GAAP vs. IFRS figures). Second, we explore whether adjustments to shareholders' equity, resulting from the adoption of specific IFRS, are incrementally value relevant to the 2005 book values. The majority of these specific IFRS were expected to curtail previous creative accounting practices. Our study is the first to examine both these objectives with reference to Greece with a large set of publicly listed firms.[3]

Meeting these objectives addresses recent calls in the literature for more in-depth single country studies, specifically with regard to the adoption of IFRS (e.g. Schipper, 2005; Weetman, 2006). Focussing on a single country allows us to control for institutional, socio-economic and political factors that affect companies' reporting and stock market participants' investing behaviour and that are difficult to control for in an international comparative study (Ruland, Shon, & Zhou, 2007).

Greece offers an interesting setting because of its distinctive financial reporting regime, culture and socio-economic context. For example, Greece is the country with the highest score for uncertainty avoidance (out of 52) in Hofstede's (1983) study. It has a relatively young and weak accounting/audit profession (Baralexis, 2004), very weak enforcement of accounting regulation (Baralexis, 2004; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998), and creative accounting is common (Baralexis, 2004; Kontos, Krambia-Kapardis, and Milonas in Jones (2011); Spathis, 2002; Spathis, Doumpos, & Zopounidis, 2002).[4] Nevertheless, the Greek stock market has been considered to be a developed market since 2000 (FTSE, 2011; Mantikidis, 2000). Thus, there is not only national but also international interest in the quality of Greek listed companies' financial statements. Finally, Greek GAAP[5] differs significantly from IFRS (Ding, Hope, Jeanjean, & Stolowy, 2007), therefore companies' financial statements should have been affected considerably by the transition to IFRS.

By examining whether accounting quality changes as a result of IFRS implementation in the stakeholder and tax driven accounting environment of Greece, we contribute specifically to the debate on whether shareholder-focused accounting principles are more value relevant than the traditional continental European accounting regulations (e.g. Ball, 2006). This debate reflects on the usefulness of IFRS for investment decisions, given that IFRS consider investors the main users of financial statements. Additionally, by examining the incremental value relevance of the information provided in the reconciliation statements, we explore the usefulness of these mandatory transitional reconciliations as an indication of the market's 'evaluation' of new information. Our findings are in line with those of Christensen, Lee, and Walker (2009) and Alciatore (1993), who indicate that reconciliation statements do convey useful information to investors.

The remainder of the paper consists of four further sections, followed by a conclusion. Section 2 provides the background to the study by reviewing prior literature and the Greek accounting environment. In section 3 the research hypotheses are introduced. Section 4 describes the data employed and the research design. Section 5 reports the empirical findings.

2. Background

2.1. Adoption of IFRS: relative and incremental value relevance

Prior literature relevant to the present paper includes research on both voluntary and mandatory IAS/IFRS adoption. Below we distinguish between single country studies and studies comparing the effect of adoption in several countries.

2.1.1. Single country studies

In the US, Harris and Muller (1999: p. 309) explore the value relevance of Form 20-F reconciliation statements, including reconciliations from IAS. They find 'limited evidence that reconciliations to US GAAP, even under IAS, provide useful information to the market'.

In China, separate markets had been created for domestic and international investors. A-shares were available for purchase only by domestic investors, while B-shares could be acquired by foreign nationals. Companies were required to prepare financial statements for owners of A-shares using local Chinese accounting standards and to owners of B-shares using IFRS (Eccher & Healy, 2000). The two types of shares were traded at different prices. Looking at the relationship between cash flows and

[3] The study of Bellas, Toudas, and Papadatos (2008) examines similar objectives, but uses a very small sample size and window. It also does not examine the incremental value relevance of the individual adjustments reported in the reconciliation statements. Additionally, it does not control for heteroskedasticity, nor carry out sensitivity tests.

[4] We follow Baralexis (2004: p. 440), who defines creative accounting or earnings management 'as the process of intentionally exploiting or violating the GAAP or the law to present financial statements according to one's interests'.

[5] By Greek GAAP we mean codified accounting rules, in particular Law 2190/20 and Presidential Decree (PD) 186/92 (Tax Law-known also as Code of Books and Records) and pronouncements of the Committee of Accounting Standardisation and Auditing (ELTE). This is a narrow definition of GAAP. The term 'GAAP' in other jurisdictions may refer also to professional pronouncement or non-promulgated guidance or practices (cf. Evans, 2004).