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A comparison of value relevance of accounting information in different segments of the Chinese stock market

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Abstract

This paper investigates the difference in the value relevance between the accounting information prepared and audited under the Chinese GAAP for A-share investors and under the international accounting standards (IAS) for B-share investors in the Chinese stock market. The study reports three primary findings. First, accounting information influences the pricing process in both the A-share market and the B-share market. Second, the accounting information in the B-share market is more value relevant than that in the A-share market, as expected. Finally, the value relevance level of accounting information in the A-share market was low in earlier years, peaked in 1996, and then decreased due to changes in the disclosure environment. However, the value-relevance level of accounting information in the B-share market had no substantial changes. Using a constant sample, control variables on firm features, and measures of traders' behavior, we obtain robust results. These findings have implications for policymakers on recent moves toward replacing local GAAP with the IAS.
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Keywords: Value relevance; Accounting information; Market segmentation; IAS; Chinese GAAP; Emerging markets

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1. Introduction

In this paper, we investigate the difference in the value relevance of accounting information in the A-share and B-share Chinese stock markets.[1] Consistent with recent studies in the literature (e.g., Chang, 1999; Core, Guay, & Buskirk, 2003; Francis & Schipper, 1999; Kothari & Shanken, 2003), we define the value relevance of accounting information as the ability of accounting numbers to summarize the information underlying the stock prices. Our paper compares the value relevance of accounting information prepared under international standards for international investors with that under domestic accounting standards for domestic investors. Specifically, we conduct cross-sectional analysis on the difference between the A-share market and the B-share market, and annual cross-sectional analysis on the variation of value relevance of primary accounting information over time.

The relative value relevance of accounting information in the A-share and B-share markets, which are prepared and audited, respectively under the Chinese generally accepted accounting principles (Chinese GAAP) and the international accounting standards (IAS), has implications for the recent moves toward the IAS replacing local GAAP. A-shares and B-shares are two types of public shares in China. A-shares are denominated in RMB and issued only to Chinese citizens, while B-shares are denominated in U.S. dollars on the Shanghai Stock Exchange or in Hong Kong dollars on the Shenzhen Stock Exchange and issued only to foreign residents before year 2001.[2] Both A-shares and B-shares convey equal rights to the same company though they are different in terms of ownership (Fung, Lee, & Leung, 2000). However, A-share investors receive accounting information prepared under the Chinese GAAP and audited by local CPA firms, while B-share investors receive accounting information prepared under the IAS and audited primarily by international accounting firms. This diversity exists even for the firms issuing both A-shares and B-shares. Therefore, Chinese emerging markets provide a unique environment that allows us to examine whether accounting information issued by the same company and prepared and audited under the IAS has higher value relevance than that prepared under local GAAP.

This paper is motivated by recent research in the value-relevance literature and developments in stock markets and accounting practices in China. In accounting literature,

[1] The basic reason for excluding H-shares in our study is that companies listed on the Hong Kong Stock Exchange are required to prepare their financial statements under Hong Kong accounting standards. Thus, the inclusion of H-shares could blur the implication of our study regarding the relative advantage of implementing IAS or domestic GAAP. Besides, the Hong Kong Stock Exchange has more developed trading mechanisms than the domestic Chinese exchanges. However, as a sensitivity test, we also include the H-shares in our sample. The results of combining B-shares and H-shares were not qualitatively different from the results of using only B-shares.

[2] Since February 19, 2001, B-shares have been sold to domestic investors who have foreign currency accounts. However, the market segments still remain because (1) the foreign-currency market is administered by the China Bank, the only place individuals could trade authorized amounts; (2) foreign investors have little access to the A-share market, and they still receive the accounting information prepared and audited under IAS. The major purpose of the paper is to investigate the role of Chinese GAAP vs. IAS regarding the value relevance of accounting information, but not the role of market segmentation.

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