GLOBAL ACCOUNTING STANDARDS AND EQUITY CAPITAL

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ABSTRACT

Globally investing in equity capital requires an investor to understand financial reports prepared using different accounting standards than those used by the home country because of the current diversity in accounting principles. Uniformity in accounting principles would not only improve understandability of the financial statements, but also access to equity capital because of comparability of financial results. Other researchers have shown that countries that have converted their local GAAP to the international financial reporting standards have experienced improved access to equity capital. The current study examines the effect of adopting international financial reporting standards by investigating which company types/industries are mainly impacted. The full version of this paper will be published separately.

INTRODUCTION

The purpose of the current study was to examine how different company types were impacted by using International Financial Reporting Standards (IFRS) regarding investments in equity capital for the Australian companies between 2002 and 2008. Australian adopted the IFRS in 2005. The main objective of this quantitative study is to examine the unknown impact of replacing local GAAP with IFRS.

It is costly and difficult to evaluate financial results of different companies from other countries to assess investment opportunities when those countries use other accounting standards (White, 2007). Because the accounting systems are globally diverse, companies are required to reconcile financial results to the host country accounting standards to facilitate comparability of financial information which results in additional cost to the investors and the companies (Johnson, 2009). The International Accounting Standards Board (IASB) established IFRS with the aim to establish global uniformity in accounting standards for the ease of financial results comparability to facilitate investments in equity capital.

The original study was conducted as part of a doctoral dissertation program requirement for the author.

Brief IFRS History

The harmonization process to establish one set of International Accounting Standards (IAS) started more than 30 years ago because of the existing global diversity in accounting standards set by each country (Al -Shiab, 2008). This was echoed in 2001 by Volker, the former chairman of the International Accounting Standards Commission Foundation Board of Trustees and the United States Federal Reserve Board before the capital markets subcommittee: it makes sense that similar economic transactions are accounted for in the same manner in today's rapidly globalizing world. Establishing IFRS would provide consistency in financial reporting enabling investors to globally compare investment alternatives which would improve capital markets competitiveness. Implementation of IFRS would increase transparency which is consistent with the agency theory regarding improved transparency and disclosures that positively impacts firm value for investors. It is now common for many emerging economies to voluntarily adopt either U.S. GAAP or IFRS to make their capital markets more attractive to foreign investors.

Global Investing

United States investors who decide to globally diversify their investment portfolio cited accounting standards diversity as a deterrent in their investment decisions due to increased financial information processing costs. Because IFRS are high-quality, global accounting standards, they have been supported by the FASB in the

United States due to investors' demand for global uniformity in accounting standards that would produce comparable financial information that is useful for making investment decisions in equity securities.

Prior researchers using different research designs and data sources found that global equity investments increase in the year of IFRS implementation. The implication of IFRS adoption in a country is that it would reduce information processing costs which would improve access to equity capital investments by investors. It is therefore, expected that more investors will invest following such a change resulting in increased trading volumes for each company type. This expectation is feasible if the IFRS adoption results in improved comparability of financial results, reduced cost of capital, reduced information asymmetry, and improved financial informative disclosures.

H0 There is no difference in the proportion of company types and related trading volume of the Australian Securities Exchange (ASX)-traded companies that were cross-listed on a foreign exchange before (2002 to 2004) and after (2006 to 2008) the implementation of the IFRS in 2005.

METHODOLOGY

To determine the impact on company types of changing from local GAAP to IFRS, a quantitative research method was used on the cross-listed Australian firms and trading volume for the cross-listed companies between 2002 and 2008. The research questions involved a comparison of financial data between the pre-IFRS (2002–2004) and post-IFRS (2006–2008) periods with 2005 as the event year. Thus, time was an independent variable with the pre-IFRS period compared to the post-IFRS period.

Data and sample

The individual companies were used as the unit of analysis for this study, with the population of interest consisting of all Australian companies listed on the ASX. The sample included all the ASX the companies listed as of January 1, 2002, which were still listed on the ASX as of December 31, 2008. Company types were aggregated into nine broad categories as shown in Table 1.

Assumptions and Limitations

It is assumed in the current study that the archival data used for the study from the ASX (2012) databases were reliable and valid for the purposes of this study. The ASX database is the official securities exchange in Australia and therefore the data are assumed to be reliable. The limitation of this study was that the ex post facto research design did not allow for causal conclusions to be drawn (Black, 1999). Variables such as company size were not examined in this study because the focus was on company type in the context of the pre-IFRS and post-IFRS implementation period and the related trading volumes.

Data Collection and Analysis

The research questions of this study were: To what extent, if any, does company type affect the proportion of ASX-traded companies that were cross-listed on a foreign exchange before and after the implementation of the IFRS and their related trading volumes? Tests were performed to test the null hypothesis that there was no difference in the proportion of companies that were cross-listed prior to IFRS and after IFRS implementation, and their related trading volumes.

The dependent variable was the change in the average daily trading volume for each company between the pre-IFRS period and the post-IFRS period. The independent variables were cross-listing group, company type and trading volume. For cross-listing group, three groups were compared: (a) Those that were not cross-listed at any point between 2002 and 2008; (b) those that were cross-listed at any point between 2002 and 2004 (prior to 2005 IFRS implementation); and (c) those that were not cross-listed between 2002 and 2004 (prior to 2005 IFRS implementation), but were cross-listed at any point between 2006 and 2008 (after the 2005 IFRS implementation).

TEST RESULTS

Based on the tests that were performed for all company types, there was a higher proportion of companies that were cross-listed after IFRS implementation than prior to IFRS implementation, but this difference was not statistically significant in all cases.

	Frequency	Percentage
Table 1		
DESCRIPTIVE STATISTICS FOR COMPANY TYPE		
Financials (including banks, diversified financials, insurance, and real estate)	178	15.3
Computers (including software services and technology hardware/equipment)	72	6.2
Utilities and energy	157	13.5
Retail (including consumer durables and apparel, retailing, and food, beverage, and tobacco)	82	7.1
Services (including consumer services and commercial/professional services)	67	5.8
Medical (including pharmaceuticals, biotechnology, and life sciences and health care equipment and services)	102	8.8
Capital goods and materials	434	37.4
Media and telecommunications services	45	3.9
Transportation (including automobile and components)	24	2.1
Total	1161	100.0

Summary

The answer to the first research question was that company type had a minimal effect on the proportion of ASX-traded companies that were cross-listed on a foreign exchange before and after the implementation of the IFRS. The results regarding the second research question indicated that company type did have an effect on the trading volume on the ASX-traded companies that were cross-listed on a foreign exchange versus those that were not cross-listed on a foreign exchange before and after the implementation of the IFRS.

CONCLUSION

The purpose of the study was to determine the impact on accessing equity capital when IFRS are implemented. Results indicated that there was a difference in the proportion of company types of ASX-traded companies that were cross-listed on a foreign exchange before (2002 to 2004) and after (2006 to 2008) the implementation of

the IFRS in 2005, with a higher proportion of companies being cross-listed after the IFRS implementation. Results also indicated that there were differences in the trading volume by company type of ASX-traded companies that were cross-listed on a foreign exchange versus those that were not cross-listed on a foreign exchange before (2002 to 2004) and after (2006 to 2008) the implementation of the IFRS in 2005.

The findings from this study were based only on Australian company types, and it cannot be assumed that the results would apply to companies in other countries that have, or will in the future, implement the IFRS. Further research may be needed to extend the study to companies in other countries.

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