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FINANCIAL STATEMENT COMPARABILITY AND HARMONIZATION OF ACCOUNTING STANDARDS:

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ABSTRACT

This paper examines whether accounting standard harmonization increases financial information comparability across countries. Firstly, comparability is defined and linked statistically to firm value within two companies' sequential information sharing framework. Afterwards, the prediction that a company that has not announced earnings responds strongly to the announcement of earnings of a foreign company when the two report under similar rather than separate accounting standards is tested empirically. The evaluation of abnormal volume and price responses for a worldwide sample of companies complements this prediction.

Keywords: Accounting standards, comparability, financial reporting

1. INTRODUCTION

This study aimed at providing an insight into the comparability benefits of financial statements for market participants, inquiring whether accounting standard harmonization attains comparability across nations. Within a transnational-intra-industry data transfer context, I forecast and discover that a company's volume and price reactions towards foreign companies' earnings announcement are considerably higher for companies under similar rather than varying accounting standards. The rationale is that if there is more correlation of the underlying measurement procedures for accounting earning, that is, if there is significant comparability, investors may better capture value-relevant data embedded within the foreign companies' earnings signal. Comparability of financial statement has been considered an essential feature of financial reporting, thus improving the significance of accounting information. From a broader perspective, economic decision-making contrasts alternatives and, accounting literature emphasize that evaluation of financial results cannot be undertaken in isolation. For instance, Libby, Libby and Short (2009, p.714) maintain that evaluating financial information without a comparison basis is not feasible. The significance of financial statement comparability across companies is underscored further within valuation methods such as price multiples that are utilized widely by institutional investors and banks. Consequently, standard setters portray comparability as the core element of financial reporting system. Particularly, comparability constitutes an enhancing qualitative feature of accounting information explored within the initial stage of the joint conceptual framework actualized by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (FASB, 2010; IASB, 2010).

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However, the comparability of financial statements is inherently complex to operationalize and define. Even from a theoretical viewpoint, the impact of comparability on equity valuation is unknown. Some empirical studies have explored compatibility role within diverse contexts including the overall information situation of companies (e.g., De Franco, Kothari & Verdi, 2010;Lang, Maffett & Owens, 2010; Bradshaw, Miller & Serafeim, 2009), adoption of relative performance analysis (e.g., Wu & Zhang, 2010) and mutual fund holdings (e.g., DeFond, Hu, Hung, & Li, 2009; Yu, 2010). Yet the studies offer mixed findings and fail to directly tackle the impact of comparability within equity valuation.

In this paper, a statistical definition for comparability that allows one to motivate the role of equity valuation for comparability within a theoretical framework is proposed. The definition of comparability is dependent on a single descriptive characteristic of an accounting system: GAAP financial statements determine firm value with a margin of error (Christensen, 2010), which is considered accounting standards measurement.1 Financial statement comparability is defined as the relationship that characterize information signals and measurement errors across two companies.

2. LITERATURE REVIEW

2.1 Financial Statement Comparability

While comparability is usually advocated, direct investigation of its impact is nascent. De Franco et al. (2010) created an output-based comparability measure based on the correlations between stock returns and earnings, identifying the similarity with which the accounting systems of two companies translate a company's economic shock. Their study found that the higher the comparability the lower the costs of information acquisition and the overall improvement of the information situation for US companies. Bradshaw et al. (2009) measured comparability using accounting choice commonality and their findings showed that using atypical accounting techniques is linked to massive analyst prediction dispersion and prediction errors. The two studies tested the impact of comparability in one set of accounting standards.

Through mandatory adoption of IFRS adoption, many studies investigated the impact of comparability associated with harmonizing accounting standards and found mixed evidence. Beuselinck, Joos and Van der Meulen (2008) presented initial evidence that mandatory adoption of IFRS does not deliver instant improvement in the comparability of earnings across Europe, particularly with respect to the correlation between cash flow and accruals. In the past few years, Lang et al. (2010) used the De Franco et al. (2010) measure and concluded that there was no increase in accounting comparability for adopters of IFRS compared to a benchmark group of non-adopters. Additionally, they found negative impacts on the companies' information environments, thus suggesting that harmonization of accounting standards does not enhance the ability of analysts to learn from inter-company comparisons.

In contrast, DeFond et al. (2009) created two input-based measures (that is, the reduction in the accounting standards heterogeneity within an industry as well as the rise in peer companies applying similar accounting standards) and evaluated the comparability impacts from the perspective of foreign investors. Their findings showed that post mandatory adoption of IFRS, foreign mutual fund ownership increases for companies, which encounter significant increments in comparability with other companies within the same sector.

Wu and Zhang (2010) proposed changes within financial reporting comparability by changing how relative performance evaluation (RPE) is used. They found a post-adoption increment in RPE use on the basis of foreign peers accounting data, consistent with mandatory adoption of IFRS increased companies' comparability in Europe.

This study is unique from the aforementioned studies on two aspects. Firstly, comparability impacts within the context of equity valuation are investigated and a simplified theoretical framework which formalizes the motivation is provided. Improved comparability is defined through a correlation increment between measurement errors associated with accounting standards and its correlation to firm value within an information transfer environment is demonstrated. Secondly, this paper explores a rare institutional aspect of country-level mandatory adoption of IFRS to delineate the impact of comparability from impact of accounting standards' reporting quality.

3. METHODOLOGY AND DATA

Because detecting transnational information transfer is complex compared to domestic (local) transfer of information (Firth, 1996), selection of the sample constitutes an essential issue. Notably, information transfer impacts have a likelihood of existing solely for identifiable subset of companies instead of the sample of all companies (Foster, 1981). Consequently, sampling procedures, which seek to increase the ability to detect transnational information sharing, are employed.

Two different samples for the change evaluations and level evaluations from a company-year panel dataset are constructed. The panel dataset is gathered at the intersection of /B/E/S (for analyst prediction data) for all non-U.S. companies, Datastream (for volume and price data) and Worldscope (for financial information). The sample covers companies with fiscal years ending after or on January 1, 2011, through December 31, 2017.

4. ANALYSIS

Table 1, Panel A shows average values of non-announcing companies' abnormal price responses to earnings announcement by voluntary adopters over the four-year period prior to and four years following mandatory adoption of IFRS. For the treatment group, non-announcing companies' price responses rose considerably from 0.0002 - 0.0036; a 0.0034 increase is considered statistically significant (t-stat = 5.05). Within the same duration, non-announcing companies in the benchmark category also encountered a rise from 0.0006 - 0.0008; however, the increment was statistically insignificant. The variation-within-variations of 0.0032 is considered statistically significant through tests, which compare averages of company –pair-year variations across both groups (t-stat = 3.82). Moreover, while an insignificant variation between the benchmark and treatment groups prior to mandatory adoption of IFRS, following mandatory adoption of IFRS, non-announcing companies' price responses for the treatment group are considerably higher (by 0.0028) compared to that of the benchmark group (t-stat = 3.93).

Table 1: Changes Analyses around the IFRS Mandate: Price Reaction

		2011-2014	**2015-2017**		
		Pre-Mandatory Adoption (a)	Post-Mandatory Adoption (b)	Difference (b) -(a)	t-stat
Firm 1:Voluntary Adopters Firm 2: Mandatory Adopters	(i)	0.0002 n=5,556	0.0036 n=6,766	0.0034***	5.05
Firml: Voluntary Adopters Firm2: Non-Adopters	(ii)	0.0006 n=3,426	0.0008 n=5,249	0.0002	0.23

Panel A: Univariate CAR2 Comparison

5. CONCLUSION

This study investigated accounting standard harmonization enhanced the comparability of financial statements, considered an increment in the relationship between measurement errors across two companies' information signals. This question was jointly tested using forecasts from modified HV model, that the correlation escalated a non-announcing company's volume and price reactions to foreign companies' earnings announcement. Through connection of comparability to information transfer, the study has demonstrated that harmonization of accounting standards enhances transnational transfer of information, and comparability serves as the direct mechanism.

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Muin uddin Ahmed joined School of Business of North South University (NSU) as a Lecturer in September 2014. MUIN received his B.Sc. in Accounting in 2005 from Minnesota State University Moorhead and joined Howrey LLP Law firm, Washington DC, USA in 2006. Howrey LLP was a prestigious antitrust, IP and Litigation firm which started in 1956 and dissolved in 2011. MUIN was there till 2009 and went to work for Catholic Charities in Washington DC where he worked for few years as a consultant. MUIN joined Hoda Vasi Chowdhury & Co after coming back to Bangladesh. While working at Catholic Charities, MUIN have received his MBA in Finance. Mr. Muin has lived over 12 years in US and started working as a lecturer at NSU School of Business in Sept' 15. MUIN was a Phi Theta Kappa scholar and volunteer for American Marketing Association during his undergrad. His research interests are corporate and nonprofit governance.

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