International Accounting Standardization in the Changing Economic Environment

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ABSTRACT This study aims at measuring the differences between the national rules and the international methods by countries, then the valuing and analyzing their effects on the changing economic environments. International accounting standards are new, innovative global methods for business information systems and they are able to harmonise financial regime both world-wide and in Hungary also. The increased globalisation of markets, the complexity of commercial trading and the concentration of business in global competition have led to a still greater need for international harmonisation.

This study examined the impact of the adoption of international accounting standards on the economic performance of businesses listed on the Budapest Stock Exchange in Hungary. The financial data are taken from accounts published on the Budapest Stock Exchange and in the Hungarian Business Information database. The results show that those businesses which have adopted international standards achieved higher and statistically significant positive coefficients than those following local accounting rules. We found that larger firms (those with more leverage, higher market capitalization and substantial foreign sales) were more likely to have adopted international accounting standards

KEYWORDS standardization, harmonization, globalization, economic effects, Hungary.

Introduction

Today, and especially during the current global financial crisis when companies in Hungary are striving desperately to survive, international accounting standardization does help individual companies to achieve their strategic objectives. International accounting standards are relatively new, globally applied tools in the business information systems and can make a serious contribution to harmonising financial statements. Our highly competitive environment requires enterprises to create a clear business strategy, and accounting needs to be part of this process, both worldwide and in Hungary also. The increased globalisation of

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markets, the complexity of commercial trading and the concentration of business in global competition have led to an ever-increasing need for international harmonisation.

Attempts to understand the crisis and to reflect on its implications also illustrate the dangers of the drift away from the world of accounting practice which has been a characteristic of so much accounting research over the last few decades. It is extremely important to understand how accounting has become implicated with the creation of new financial practices, with objectifying and simplifying the increasingly complex financial transactions that have emerged from an ever expanding investment in financial engineering. Equally significant is the need for a more informed understanding of the changes which have occurred in the influence structures in the world of accounting politics (both national and international) and of the changing role which accounting plays in the informational environment of organizations

In today's business environment, companies need to take every advantage they can to remain competitive. Global competition, rapid innovation, entrepreneurial competitors, and increasingly demanding customers have altered the nature of competition in the marketplace. This new competitive environment requires companies' ability to create value for their customers and to differentiate themselves from their competitors through the formulation of a clear business strategy. Business strategy must be supported by appropriate organizational factors such as effective manufacturing process, organizational design and accounting information systems too.

Modern business environments are increasingly competitive and dynamic. International competition through e-commerce and demand-based supply chain management dominate business. It is important for companies to develop coherent and consistent business strategies and to utilize management accounting tools to support strategic planning, decision-making and control. To integrate business strategies with various management accounting tools, first companies need to identify which business they are in. It is essential to identify products and services, customer types, geographical markets, and delivery channels. It is useful to match the strategic business unit (SBU) with the related business unit strategy. An SBU is a company department or sub-section which has a distinct external market for goods or services that differ from another SBU. A business unit strategy is about how to compete successfully in particular markets. It is important to focus on a certain segment, such as environmentally friendly cars in the automobile industry or internet and phone banking in the retail banking industry.

International Financial Reporting Standards (IFRS) are accounting principles or methods (i.e. 'standards') issued by the International Accounting Standards Board (IASB), an independent organisation based in London. They were intended to be a set of standards which, ideally, would apply equally to financial reporting

by public companies worldwide. Between 1973 and 2000 international standards were issued by IASB's predecessor organisation, the International Accounting Committee (IASC), a body established in 1973 by the professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, Netherlands, the UK and Ireland, and by the United States. During that period the IASC's principles were described as 'International Accounting Standards' (IAS). In April 2001 the rule-making function was assumed by a newly reconstituted IASB, at which point the IASB re-labelled its rules as 'IFRS'. Nonetheless, it continues to recognise the previous rules (IAS) issued by the old standard-setter (IASC). The IASB is better funded, better staffed and more independent than its predecessor, the IASC, but there has, in fact, been considerable degree of continuity over the years in terms of standpoint and in actual accounting standards.

Historically, standardization of the international accounting principles has tended to follow the integration of the markets served by the accounts. For example, the move to unified national accounting in the US in the early 20th century followed the integration of the national economy. Similarly the present impetus for global accounting standards follows the accelerating integration of the world economy. Without the common accounting standards the cross-border portfolio and direct investment my be distorted, the cross-border monitoring of management by shareholders obstructed, and the cross-border contracting inhibited and the cost of these activities may be needlessly inflated by complex translation (Meeks and Swann 2009).

The purpose of the use of international accounting standards is that a single set of standards ensures similar transactions are treated the same by companies around the world, resulting in globally comparable financial statements. However, using the accounting standards consistently by firms we will find that they are changeable, because they are depend on the varying economic, political, and cultural conditions in one state. Accounting standard-setters and regulators around the globe are planning to harmonize accounting standards with the goal of creating one set of high-quality accounting rules to be applied around the world (Whittington 2008).

The application of international financial reporting standards (IFRS) will allow greater comparison of international financial results. More sources and reports will be available to a greater audience of analysts to follow trends in countries where previously due to different regulations and thus different reports these were less meaningful. The unified financial reporting system will probably lead to new types of analysis and data, furthermore with the possible integration of new indicators from the practice of certain countries.

Literature review

International accounting literature provides evidence that accounting quality has economic consequences, such as costs of capital (Leuz and Verrecchia, 2000), efficiency of capital allocation (Bushman and Piotroski, 2006) and international capital mobility (Guenther and Young, 2002).

Epstein (2009) compared characteristics of accounting amounts for companies that adopted IFRS to a matched sample of companies that did not, and found that the former evidenced less earnings management, more timely loss recognition, and more value relevance of accounting amount than did the latter. This study found that IFRS adopters had a higher frequency of large negative net income and generally exhibited higher accounting quality in the post-adoption period than they did in the pre-adoption period. The results suggested an improvement in accounting quality associated with using IFRS.

Botsari and Meeks (2008) found that first time mandatory adopters experience statistically significant increases in market liquidity and value after IFRS reporting becomes mandatory. The effects were found to range in magnitude from 3 to 6% for market liquidity and from 2 to 4% for company by market capitalization to the value of its assets by their replacement value.

Daske et al. (2007) also found that the capital market benefits were present only in countries with strict enforcement and in countries where the institutional environment provides strong incentives for transparent filings. In the order of the IFRS adoption countries, market liquidity and value remained largely unchanged in the year of the mandate. In addition, the effects of mandatory adoption were stronger in countries that had larger differences between national GAAP (General Accepted Accounting Principles) and IFRS, or without a pre-existing convergence strategy toward IFRS reporting.

The increased transparency promised by IFRS also could cause a similar increase in the efficiency of contracting between firms and lenders. In particular, timelier loss recognition in the financial statements triggers debt covenants violations more quickly after firms experience economic losses that decrease the value of outstanding debt (Ball and Shivakumar, 2005; Ball and Lakshmann, 2006).

Accounting theory argues that financial reporting reduces information asymmetry by disclosing relevant and timely information for example Frankel and Li (2004). Because there is considerable variation in accounting quality and economic efficiency across countries, international accounting systems provide an interesting setting to examine the economic consequences of financial reporting. The European Union's (EU) movement to IFRS may provide new insights as firms from different legal and accounting systems adopt a single accounting standard at the same time. Improvement in the information environment following change

to IFRS is contingent on at least two factors, however. First, improvement is based upon the premise that change to IFRS constitutes change to a GAAP that induces higher quality financial reporting. For example, Ball et al. (2006a) found that the accounting system is a complementary component of the country's overall institutional system and it is also determined by firms' incentives for financial reporting. La Porta et al. (1998) provide the first investigation of the legal system's effect on a country's financial system. The results suggested that common law countries have better accounting systems and better protection of investors than code law countries.

Other factors associated with financial reporting quality include the tax system (Daske and Gebhardt, 2006), ownership structure (Jermakovicz et al., 2007, Burgstahler et al., 2006), the political system (Li and Meeks, 2006), capital's structure and capital market development (Ali et al., 2000). Therefore, controlling for these institutional and firm-level factors becomes an important task in the empirical research design. As a result of the interdependence between accounting standards and the country's institutional setting and firms' incentives, the economic consequences of changing accounting systems may vary across countries. Few papers have examined how these factors affect the economic consequences of changing accounting standards. For example, Pincus et al. (2007) found that accrual anomaly is more prevalent in common law countries. Maskus et al. (2005) found that accounting quality is associated with tax reporting incentives. Exploration of the interaction between these factors and the accounting information system can provide insights into differences in the economic consequences of changing accounting principles across countries.

Prior researches for example, Meeks and Meeks (2002) have raised substantial doubt regarding whether a global accounting standard would result in comparable accounting around the world. But differences in accounting practices across countries can result in similar economic transactions being recorded differently. This lack comparability complicates cross-border financial analysis and investment. In the researches of Iatridis and Rouvolis (2010) are some evidence of earning management (e.g. reducing of transition costs and information asymmetry, benefits of investors in investment strategy). They showed how firms that operate in a non-common-lax countries (e.g. Greece), which is stakeholder-based respond to international accounting standards adoption as compared to shareholder-based systems (e.g. United Kingdom).

No matter how similar the accounting standards in different countries are, there will be slight or even bigger differences in the way they are applied by companies due to the differences in the economical, political and cultural environment. Prior researches have raised substantial doubt regarding whether a global accounting information system would result in comparable accounting around the world. But differences in accounting practices across countries can result in similar economic

transactions being recorded differently. Chatterjee (2006) presented in his study how cultural differences can affect accounting practices is that in the countries which are characterized with small power distance and weak uncertainty avoidance accounting measures are more likely to be used as an indicator of a manager's performance than as a measure of the effectiveness of policies and procedures prescribed for them. Various researches draw the conclusion that countries having different cultures have also different accounting rules and practices.

Methodology

The purpose of this study was to measure the differences between national rules and the international methods, evaluating and analysing their effects on the economic environment. This survey also includes information on how international accounting standards have been affected by the global economic crisis. To examine decisions made by companies to adopt IFRS, we created a sample comprising Budapest Stock Exchange (BSE) companies who adopted IFRS in Hungary in 2005. For the purpose of research, the pre-adoption period was 2004 and the post-adoption 2006. The final sample consists of 65 companies who adopted IFRSs and 260 Hungarian firms using local accounting rules. The specific samples are of conventional shareholder companies with Hungarian headquarters who employ an average of more than 50 people.

The financial data are taken from accounts published on the Budapest Stock Exchange and in the Hungarian Business Information database. In our sample, the firms are classified as either 'following international standards' or as 'using national accounting rules"

Basically, we used a qualitative comparative approach, but to identify the results of our research, we elaborated three hypotheses:

H1: Balance Sheet indices deteriorated - especially in respect of solvency and prosperity after adopting IFRS.

H2: Heavy losses tend not to be infrequent after IFRS adoption decisions.

H3: Business management has higher value relevance after the post-adoption period.

Accounting methods and balance sheet effects

This set of analyses measures how Hungarian enterprises have been affected in terms of business performance by IFRS. The logistic regression models employed are (1,2):

$$RR_{i,t} = a_0 + a_1\, Size_{i,t} + a_2\, Dividend_{i,t} + a_3\, Growth_{i,t} + a_4\, Profitability_{i,t} + \\ + a_5\, Liquidity_{i,t} + a_6\, Leverage_{i,t} + e_{i,t}. \quad (1)$$

$$PA_{i,t} = a_0 + a_1\, Size_{i,t} + a_2\, Dividend_{i,t} + a_3\, Growth_{i,t} + a_4\, Profitability_{i,t} + \\ + a_5\, Liquidity_{i,t} + a_6\, Leverage_{i,t} + e_{i,t} \quad (2)$$

Where:

$RR_{i,t}$ = dummy variable, indicating the regulatory system,
- $RR_{i,t}$ = 1, financial numbers are reported by IFRS,
- $RR_{i,t}$ = 0, financial numbers are reported by National GAAP,

$PA_{i,t}$ = dummy variable, indicating the post-adoption effects.
- $PA_{i,t}$ = 1, financial numbers are reported by IFRS in 2005
- $PA_{i,t}$ = 0, financial numbers are reported by IFRS in 2004.

Size: Natural logarithm of market capitalization:
- NAVSH: Net asset value per share
- RESSFU: Reserves to shareholders' funds

Dividend:
- DIVCOV: Dividend cover
- DIVSH: Dividend per share
- DIVYI: Dividend yield.

Growth:
- MVBV: Market value to book value

Profitability:
- EPS: Earnings per share
- NPM: Net profit margin
- ROCE: Return on capital employed

Liquidity:
- CFM: Cash flow margin
- CUR: Current ratio
- OCF: Operating cash flow scaled by total assets
- QUI: Quick ratio
- WCR: Working capital ratio

Leverage:
- DEBTE: Debt to equity
- DSFU: Debt to shareholders' funds
- CGEAR: Capital gearing

$e_{i,t}$ = the error term.

Accounting methods and P&L effects

This part of our research examined whether firms determine small positive profits rather than large losses. .Our analysis employed the next model (3):

$$RR_{i,t} = a_0 + a_1 Profitability_{i,t} + a_2 Dividend_{i,t} + a_3 Growth_{i,t} + \\ + a_4\, Size_{i,t} + a_5 Liquidity_{i,t} + a_6 Leverage_{i,t} + a_7 SP_{i,t} + a_8 LL_{i,t} + e_{i,t} \quad (3)$$

Where:

$SP_{i,t}$ = dummy variable indicating a measure of small positive profits.
$SP_{i,t}$ = 1 if net profit scaled by total assets is between 0 and 0.01,

$SP_{i,t}$ = 0 otherwise.

$LL_{i,}$ = dummy variable indicating a measure of timely loss recognition.

$LL_{i,t}$ = 1 if net profit scaled by total assets is less than - 0.20,

$LL_{i,t}$ = 0 otherwise.

3.3. Accounting methods and value relevance

The first value relevance test is an OLS regression of share price on book value per share and net profit per share (4).

$$P_{i,t} = a_0 + a_1 BVPS_{i,t} + a_2 NPPS_{i,t} + e_{i,t} \quad (4)$$

Where:

$P_{i,t}$ = Total market value of equity deflated by number of shares outstanding,

$BVPS_{i,t}$ = Total book value of equity deflated by number of shares outstanding,

$NPPS_{i,t}$ = Total net profit deflated by number of shares outstanding.

The second value relevance test is an OLS regression of profits on stock returns (5).

$$NPP_{i,t} = a_0 + a_1 AR_{i,t} + e_{i,t} \quad (5)$$

Where:

$NPP_{i,t}$ = Net profit divided by beginning of year share price,

$AR_{i,t}$ = Annual stock return at year-end.

The third value relevance test measured the association between IFRS-based book value and net profit figures, then stock returns (6).

$$AR_{i,t} = a_0 + a_1 BVPS_{i,t} + a_2 BVCHA_{i,t} + a_3 NPPS_{i,t} + a_4 NPCHA_{i,t} + e_{i,t} \quad (6)$$

Where::

$BVCHA_{i,t}$ = Variable indicating the change in corporate book value following the transition to IFRS,

$NPCHA_{i,t}$ = Variable indicating the change in corporate net profits following the transition to IFRS.

Findings

The results of hypotheses H1 are reported in Table 1.

Table 1 Accounting method effects

Denomination	National GAAP-using firms		IFRS adopted firms	
	Mean	Std. deviation	Mean	Std. deviation
DIVSH	0,0846	0,1986	0,1557	0,2106
DIVYI	17,5764	19,8721	22,8705	25,4457
MVBV	5,8152	7,8125	2,5478	8,1547
NPM	-0,2945	4,5412	-0,1031	7,4581
EPS	0,1987	1,0561	0,1897	1,5061
ROCE	0,2008	0,3051	-0,0081	0,6401
OCF	3,8812	15,4421	4,8512	16,8041
CUR	1,9911	6,9105	2,9814	3,1125
CFM	0,8029	2,3126	-0,0408	1,5974
DEBTE	1,9843	2,3566	2,3099	2,1577
CGEAR	0,3454	0,2325	0,8714	0,3115
DSFU	0,3258	0,1353	0,5469	0,8540

Source: Author's own constructions

It can be seen in Table 1 that the average index of dividend per share (from earnings after tax) is higher at companies which had already adopted IFRS than in others. However, the relative average value (DIVYI) contains a high deviation (the deviation value is almost 30 in respect of companies using IFRS).

The companies applying the National Accounting Rules earn more than double (5,8152) in terms of growth (measured by market value to historical value of assets) than do other firms. In this sense the IFRS-adopting companies' average index is much lower.

The companies examined had a negative average net profit value (loss) in both groups in the period covered, although the return on equity and the average return on capital employed gave better results for National Accounting Rules users. The latter index showed a declining tendency (-0,0081) at companies which adopted the IFRS.

The National Accounting Rules-using companies' average indices measuring solvency (OCF, CUR, CFM) and leverage were higher than the others. Cash Flow,

for instance, decreased (-0,0408) at IFRS-adopting companies, although around the relative average value of Operating Cash Flow on assets the deviation is quite high (between 15 and 17). As the indebtedness of companies using National Regulations was lower, the leverage indices (DEBTE, CGEAR, DSFU) were better than in those companies which had adopted IFRS.

To summarise, we can state that Balance Sheet indices deteriorated especially regarding solvency and prosperity after the adoption of IFRS.

The results of model (3) are reported in Table 2.

Table 2 Small Profit or large Losses

Denomination	IFRS adopted firms	National GAAP- using firms
SP	-1,194**	0,451
LL	2,581*	1,324

Sourse: Author's own constructions

* at 10% level significance, **at 5% level significance..

The data in the Table 2 prove that the companies which had already adopted IFRS were less willing to hide profit in the P&L. Account when it was low, and by doing so, the probability of reporting a small profit (SP) was significantly negative (-1,194) in their case.

Further, we can state that neither did they did tend to hide a large loss. The latter statement is a consequence of the positive and high value of the coefficient of LL (2,581). It is specific for National Accounting Rules-using companies to favour reporting smaller profits (0,451) and avoid large losses being reported in P&L Account - which is possible when using accrual-based accounting. The results of value relevance models are summarized in Table 3.

Table 3 Accounting methods and value relevance

Denomination	Coefficients	
	National GAAP-using firms	**IFRS adopted firms**
NPPS	2,041**	3,025**
BVPS	0,547**	1,354**
AR	2841,145**	3694,124*

Denomination	Coefficients	
	National GAAP-using firms	IFRS adopted firms
BVCHA	0,1941**	0,2941*
NPCHA	0,0182**	1,3541
R^2	0,689	0,799
*Statistical significance at 10% level, **Statistical significance at 1% level.		

Source: Author's own construction

Our H3 assumption, namely that the information system of companies who adapted IFRS shows a higher value relevance than other national accounting rules-user companies, is proved by the data of Table 3.

The first test of value relevance gave a result for earnings after tax/share (EPS) coefficient (3,025) and for book value of equity/share (1,354) which is significantly (at 1 %) positive and higher at IFRS-adopting companies than at others. These companies also had more profitable, higher correlation coefficients of financial indices (R2 = 0,799).

The second test of value relevance gave similar results since the coefficient of Return on Equity (ROE) is also significantly (at 10 %) positive and higher (3694,124) at companies which have already adopted IFRS.

The coefficient of Book Value Change (1,3541) produced turned out significantly more positive at IFRS-adopting companies according to the third test of value relevance. These results obviously prove that the companies which adopted IFRS have an orientation towards a reporting policy based on greater reliability and more realistic evaluation. However, the index presenting the change of Net Profit (NPCHA) was also positive (but not significantly) at these companies (1,3541).

Conclusion

In today's business environment, companies need to take every opportunity they can to remain competitive. Global competition, rapid innovation, entrepreneurial competitors, and increasingly demanding customers have altered the nature of competition in the marketplace. This new competitive environment requires companies to be able to create value for their customers and to differentiate themselves from their competitors through the formulation of a clear business strategy. Business strategy must be supported by appropriate organizational factors such as an efficient manufacturing process, organizational design and harmonised accounting information systems also.

The present impetus for global accounting information system follows the accelerating integration of the word economy. The application of international financial reporting standards will allow greater comparison of international financial results. The unified accounting information system will probably lead to new types of analysis and data; furthermore, with the possible integration of new indicators from the practice of certain countries.

The accounting information system differences matter even to financial analysts who specialize in collecting, measuring and disseminating business information about the covered companies suggests that there are potential economic costs, associated with variation in national rules across countries. Besides, it is very important task for managers and researchers the valuation and analyzing the effects of international accounting standards on the business environment, especially their contribution to harmonization and globalization. While a large body of this study is devoted to understanding the causes and consequences of the adoption of international accounting standards, researcher' attention has thus, far focused almost exclusively on the informational benefits for the business environments, like evolution of business turnover, employees and the management performance.

We noted that the Balance Sheet indices deteriorated, especially regarding solvency and prosperity after adoption of IFRS. The results show that those businesses which have adopted international standards achieved higher and statistically significant positive coefficients than did those following local accounting rules. We found that larger firms (those with more leverage, higher market capitalization and substantial foreign sales) were more likely to have adopted international accounting standards. Among these firms, lower profits are declared less frequently - possibly indicative of the quality of earnings management. Companies which had adopted IFRS also provided higher quality and value relevant accounting information systems. The results show that those enterprises which have adopted international standards achieved higher and statistically significant positive coefficients than those following local accounting rules. As a further consequence of IFRS adoption, corporate policy and requirements became gradually more clear and transparent – in the same way as the application and implementation of the standards became more user-friendly.

The author recommends international business researchers to employ these methods and to measure their effects on practical management functions.

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