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Global Comparability of Financial Reporting Under IFRS

Does Comparability Enhance Value Relevance of Earnings Across Countries?

Springer

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Preface[1]

The globalization of financial markets worldwide has progressively pushed toward a parallel globalization of accounting information. Therefore, during the last fifty years categories of preparers, users, and regulators have devoted their efforts in supporting the global comparability of financial reporting aiming at favoring the comparison of corporates' financial performances at a cross-country level. In the same vein, IASB, national standard setters, and jurisdictions have participated in, and given momentum to this process. Moreover, academic research has followed this process and tried to build a theoretical framework to address the related issues, to assess the impact on preparers, users, and regulators, while defining hindrances and obstacles for the comparability of financial reporting especially in an IFRS environment (De Luca & Prather-Kinsey, 2018).

There is general agreement about the fact that accounting information comparability is an enhancing qualitative characteristic of financial reporting. Recipients of accounting information (users) can identify and understand similarities and differences among companies' performances and items. Therefore, basing on this function, comparability is fundamental in triggering the usefulness of accounting information and financial reporting. Consequently, users thoroughly support their decision-making process on comparisons among firms. Moreover, as capital flows almost completely at a global level and investment diversification is increasing, comparability plays a prominent role among all the other qualitative characteristics of financial reporting.

To provide an example of the current scenario of possible comparability issues at an international level, we present a situation of a potential investor's three investment options in the telecommunication industry, all cross-listed or listed in the German capital market. We consider two foreign companies, namely Chunghwa

[1] Although the research has been carried out jointly, Chapters 1, 2, and 3 of this book are attributable to Francesco De Luca, while Chapter 4, and 5 are attributable to Francesco De Luca and Ho-Tan-Phat Phan.

Telecom Ltd. from Taiwan, and Swisscom AG from Switzerland, and one domestic company, namely Deutsche Telekom. They are all similar in size (i.e., market capitalization) and book-to-market ratio and use the same set of accounting standards, IFRS, for their consolidated financial statements.

This potential investor may believe that the financial reports of all three companies are comparable since all state some form of compliance with IFRS. This example is helpful to understand the potential complexities that affect comparability of these companies' financial reports relative to *adoption*, *application,* and *enforcement* of IFRS.

First, each company is in a country that has adopted a different version of IFRS. Taiwan (Chunghwa Telecom Ltd.) adopted IFRS as endorsed by the Financial Supervisory Commission of the Republic of China (FSC) (T-IFRS) where the timing of revenues may differ from that reported under IFRS as published by the IASB. For example, one of the differences between T-IFRS and IFRS stems from the timing of the recognition of income from sales of products and services. Under T-IFRS, Chunghwa's revenue from selling the prepaid phone cards is recognized at the time the card is sold by the Taiwan Company. Instead, under IFRS 15 paragraph 39 by IASB, an entity shall "*recognize revenue over time by measuring the progress towards complete satisfaction of that performance obligation*." As such, revenue of Chungwa from prepaid phone cards would be deferred at the time the sale of the card is made, and instead recognized as revenue over the time as consumed. Moreover, even if Chunghwa's management commentary provides a synthetic disclosure of this different treatment by simply highlighting the net impact on net income and equity, the revenues of Chunghwa are not categorized separately for prepaid phone card sales, leaving the investor uncertain as to the amounts of associated differences in revenue recognition timing between T-IFRS and IFRS.

Thus, comparing T-IFRS with IFRS financial reports may request deeper and further analyses that increase complexity for investors when the recognition of some revenue categories differs for Chunghwa from Taiwan as compared to companies applying IFRS as published by IASB like Swisscom AG from Switzerland.

Comparable application may be impaired not only when comparing T-IFRS with IFRS reported earnings, but also impaired when converting from companies' differing home country language to the host country's language. For example, Chunghwa Telecom Ltd. translated its Chinese financial reports to English. Swisscom AG and Deutsche Telekom translated their German financial reports to English. Translation to English can be influenced by the translator.

It follows that comparability in IFRS financial reporting is a multifaceted characteristic of accounting information and the outcomes of a wider or global adoption of a single set of accounting standards are not a guarantee in itself to maximize comparability. Differences in *adoption*, *application*, and *enforcement* of IFRS across legal jurisdictions still affect and could hinder comparability of accounting information.

Currently, over 165 countries have adopted International Financial Reporting Standards (IFRS), but this adoption appears to be not consistent across legal jurisdictions. Some have adopted IFRS with a lag, others with carve-outs or carve-ins and some require IFRS for their foreign registrants only.

Moreover, their principle-based nature leaves room for differing application of IFRS across nations and contexts. Firms could apply full-IFRS (as issued by the IASB) when preparing their annual reports or they can simply assess their compliance with IFRS. Besides, application of IFRS implies judgment, and this could be affected by several factors across legal jurisdictions. For example, regarding this aspect, Prather-Kinsey et al. (2018) found that the term "control" is interpreted differently conditional upon management's work location, and whether from a rules-based vs principle-based accounting standards background.

Likewise, the enforcement of IFRS varies across legal jurisdictions as some jurisdictions have strong legal enforcement while others have weak legal enforcement (La Porta et al., 2006). Of course, differing enforcement of IFRS leads to reduced comparability of financial reports.

As previously stated, comparability improves the quality of accounting information, and this leads to an improved information environment and allocation of resources. However, in the context of pursued international convergence of accounting standards following the spreading of globalization phenomena, there are still many bumps on the road to comparability achievement. Therefore, while much part of the literature has widely dealt with the quality of accounting information under the perspective of relevance, reliability, transparency, earnings quality, comparability characteristic needs to be deeply investigated especially at company level in a way to provide some evidence of the decision usefulness of financial reporting comparability.

To this end, this book aims to make the point of previous studies about comparability of financial reporting in a global perspective by firstly analyzing the pushes and the obstacles that characterized the path toward a global set of accounting standards, the establishment of the IASB, the convergence project with the US FASB as well as the current role of several supranational (like EU) and international (like IOSCO) organizations and bodies in pursuing the globalization of accounting information.

We also intend to complement this background analysis with an empirical analysis on a sample of cross-border listing companies that could provide new insights about value relevance of comparability of corporate earnings at company level in the cross-country investors' perspectives. In these perspectives, the empirical analysis is also directed to provide further insights about the role of Big Four auditing services in possibly enhancing the comparability of earnings.

The study provides an original contribution to the current debate about comparability of financial reporting under IFRS. In addition, our results could also have practical implications in helping companies to meet investors' expectations through company-level choices such as the auditing services of a Big Four firm.

The remainder of this book proceeds as follows: Chapter I delves into the definition of comparability of accounting information as a driver of financial reporting quality. To this end, literature contribution is analyzed and the path toward the establishment of a possible global set of accounting standards is also retraced across the last decades. Chapter II is devoted to the analysis of the current situation of IFRS adoption, application, and enforcement across the world. A critical review of previous studies about the IFRS adoption benefits and limitations is also developed. Then, Chapter III analyzes the role of Auditing in Global Comparability of financial reporting as, to some extent, companies try to supplement country-level deficiencies of mandatory regulatory enforcement by voluntary firm-level structures such as the choice of auditor service. Lastly, Chapter IV provides a cross-country empirical analysis on IFRS-based financial reports. Conclusion Section provides a summary of the evidence of both theoretical and empirical analyses brought throughout the previous chapters.

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Contents

List of Abbreviations and Acronyms

ACCTSTD	Accounting Standard
AJEXDI	Cumulative Adjustment Factor Ex-Date
ANOVA	Analysis of variance
ASAF	Accounting Standards Advisory Forum
ASC	Accounting Standards Codification
BM	Book-to-Market ratio
BVPS	Book value per share
CASC	China Accounting Standards Committee
CBL	Cross-Border Listed
COMPACCT	Comparability index
CONM	Company Name
CSHOI	shares outstanding
CURCD/CURCDD	reporting currency of fundamental data
CVM	Brazilian Securities Commission
DF	Degree of freedom
EC	European Commission
EFRAG	European Financial Reporting Advisory Group
EPS	Earnings per share
EU	European Union
EXCNTRY	Exchange Country
EXCNTRY	Stock Exchange Country Code
FAF	Financial Accounting Foundation Trustees
FASAC	Financial Accounting Standards Advisory Council
FASB	Financial Accounting Standards Board
FCAG	Financial Crisis Advisory Group
FIC	country of incorporation
FIC	ISO Country Code-Incorporation
FIFO	First In, First Out
FSB	Financial Stability Board
FSC	Financial Supervisory Commission

FSC	Financial Services Commission
FYEAR	Fiscal Year
GAAP	general accepted accounting standards
GASB	Governmental Accounting Standards Board
GDP	Gross domestic product
GVKEY	Global Company Key
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFRIC	IFRS Interpretations Committee
IFRS	International Financial Reporting Standards
IID	Issue ID
IOSCO/OICU-IOSCO	International Organization of Securities Commissions
ISO	International Organization for Standardization
ISP	internet service provider
ITAC	Investors Technical Advisory Committee
JFSA	Financial Services Agency of Japan
LID	linear information dynamics
LIFO	Last In, First Out
MMOU	Multilateral Memorandums of Understanding
MOF	Ministry of Finance
MVPS	Market value per share
NA GROUP	North America Group
OECD	Economic Cooperation and Development
OLS	Ordinary Least-Squares
PCAOB	Public Company Accounting Oversight Board
PRCCD	close market price at the calendar year end
PRIMISS	Primary security
PRIROW	Primary Issue-Global
RSS	residual sum of squares
SD	standard deviation
SE	standard error
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SIC	Standard Industry Classification Code
SME	Small and medium-sized enterprises
T-IFRS	International Financial Reporting Standards ratified by Taiwan government
TEG	Technical Expert Group
US	The United States of America
USD	U.S. dollar
VAR	Variable
VIF	variance inflation factor
WRDS	Wharton Research Data Services