International Accounting Standardisation Effects on Business Management during the Global Financial Crisis

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Abstract

This study examined the impact of the adoption of international accounting standards on the management 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 adoption decision model tested if the demand from internal performance evaluations is a factor in businesses decisions to adopt international accounting standards during the global financial crisis situations.

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. This suggests that the increase in the sensitivity of turnover to accounting performance post-adoption is primarily driven by heightened turnover sensitivity to accounting losses.

Keywords: *value based management, accounting standardisation, economic effects, financial crisis, Hungar*.

JEL classification: M11, M41, M48

Introduction

Nowadays, especially during the current global financial crisis, companies in Hungary are striving desperately to remain competitive and achieve sustainable levels of economic development. The highly competitive environment requires companies to create a clear business strategy, and accounting has to be part of this strategy since it helps individual enterprises to achieve their strategic objectives. International accounting standards are new global methods for business information systems and they are able to harmonise financial regimes 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.

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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 also.

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.

The financial crisis is also encouraging more critical examinations of the managerial innovations that have emerged from the audit industry, not least its pursuit of the bureaucratisation of risk in the name of risk management. Coming through a crisis where risks have been real and perceived, increasingly it is coming to be seen that risk management mechanisms do relatively little to facilitate the real management of risk. Adding as they do to costs – and the income of the consultancies involved, by isolating rather than integrating the management of risk, the bureaucratic mechanisms still promoted by the audit firms and their associates provide yet further evidence of the relatively limited understanding that the audit industry has of real time management in action.

Trying to understand the crisis and reflect on its implications also illustrates the dangers of the drift away from the world of accounting practice that has been a characteristic of so much accounting research for the last few decades. Indeed at times it is possible to think that for some there has been a drift away from accounting itself: at the very least there has been a pronounced move towards studying accounting at a distance. As yet this has not been as severe in its implications as for those of our colleagues in finance research where increasing numbers have a very limited appreciation of the complexities of practice and its institutional context. There nevertheless has been a move away from analysing just such complexities and institutional contexts in the accounting area, often in the name of theoretical elegance and methodological rigour. Interestingly this is true for both statistically based capital market studies and a great deal of more critical theorizing. Of course theoretical and methodological issues are of real importance, not least in helping to avoid methodological capture by practice norms, frameworks and ways of looking at the world. But as numerous other social science disciplines illustrate, there are ways of balancing interests in the need for sound and reliable research with genuine interests in the complexities of practice. It really is 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 that have occurred in the influence structures in the world of accounting politics both national and international, of the changing role that accounting plays in the informational environment of organizations and with how accounting changes in relation to shifts in the underlying nature of the socio-economic system in which business operates.

Standardization is the process of developing and agreeing upon technical standards. The standard is a document that establishes uniform engineering or technical specifications, criteria, methods, processes, or practices. Some standards are mandatory while others are voluntary. Voluntary standards are available if one chooses to use them. Some are de facto standards meaning a norm or requirement which has an informal but dominant status. Some standards are de jure meaning formal legal requirements. Formal standards organizations such as the International Organization for Standardization or the American National Standards Institute are independent of the manufacturers of the goods for which they publish standards.

In social sciences, including economics, idea of standardization is close to the solution for a coordination problem, a situation in which all parties can realize mutual gains, but only by making mutually consistent decisions. Standardization implies the elimination of alternatives in accounting for economic transactions and other events. Harmonization refers to reduction of alternatives while retaining a high degree of flexibility in accounting practices. Harmonization allows different countries to have different standards as long as the standards do not conflict. For example, within the European Union harmonization program, if appropriate disclosures were made, companies were permitted to use different measurement methods: for valuing assets, German companies could use historical cost, while Dutch businesses can use replacement costs without violating the harmonization requirements.

1. Previous related international literature review

The International Accounting Standards Board (IASB) has planned to develop a uniform and understandable global accounting convergence (Easton, 2006), and the IASB's plan has resulted in more than 100 countries world-wide now requiring, permitting or adopting International Financial Reporting Standards (IFRS) (Epstein, 2009). This growing acceptance of IFRS has also influenced emerging economies (Ball, Robin and Wu, 2003). Beke (2010a:49) asserted that "the purpose of the use of international accounting information systems is that similar transactions are treated the same by companies around the world, resulting in globally comparable financial statements". These findings have led many authors to conclude that global comparability will be driven by factors other than the accounting standards. In particular, most authors point to either regulatory oversight or capital market pressures (Burgstahler, Hail and Leuz, 2006).

Researchers have suggested that the best approach to assessing the applicability of IFRS is to evaluate the convergence process in emerging markets (Jones and Higgins, 2006, Cordazzo, 2008). However, the process of adoption has been the subject of limited research, since researchers themselves have suggested that it would be better to use national case studies to analyse the adoption of IFRS in individual nations. Examples of this are Callao-Jarne-Lainez (2007) in Spain, Cormier-Demaria-Lapointe-Teller (2009) in France, Lantto and Sahlström (2009) in Finland, Iatridis and Rouvolis (2010) in Greece, Peng and Smith (2010) in China and Beke (2010b) in Hungary also.

The research undertaken in the form of national case studies will develop guide-lines on best practice in the implementation of IFRS in order to assist developing countries and countries with economies in transition to succeed in their efforts to harmonise their national accounting rules and practice with international requirements

Earlier literature shows that the level of the capital market orientation of the financial environment also follows the differences in accounting systems internationally. Examples of this are found when the Common Law accounting systems of the USA and the UK are compared with Code Law-based systems of many Continental European countries (see, for example, La Porta, 1998).

Earlier studies show that, in Code Law countries (e.g., in Europe) the capital provided by banks tends to be more important than in Common Law countries e.g., the USA and Canada) where firms are mainly financed by a large number of private investors (Barth et al., 2004). Therefore, information asymmetry between capital providers and the company is likely to be resolved in Code Law countries by providing accounting information to the capital providers by means of high-quality, public financial reporting (e.g. Beke, 2011a).

Previous studies also show that the adoption of IFRS improves the accounting quality of publicly traded companies in Europe (Daske and Gebhardt, 2006). Overall, the adoption of IFRS seems to benefit investors, especially in countries which resemble Code Law clusters and where the information needs of investors were not the primary interest of standards setters.

Additionally, many papers examine the properties of accounting information across different accounting regimes. Overall, these studies indicate that similar accounting methods are applied very differently around the world. However, Beke (2011b) remarked that "the unified accounting information system will probably lead to new types of analysis and data – with the possible additional integration of new indicators from the practice of certain countries".

The purpose of the use of international accounting methods 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, looking at accounting standards as consistently by firms, we see that they are changeable since they depend on the varying economic, political, and cultural conditions in one state. Accounting standard-setters and regulators around the globe are planning to harmonise accounting standards with the goal of creating one set of high-quality rules to be applied world-wide (Whittington, 2008).

2. Methodology and results

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 2000 - 2004 and the post-adoption 2006 - 2010. 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.

The adoption decision models are expanded relying Nobes (2006) researches and test if the demand from internal performance evaluations is a factor in businesses decisions to adopt international accounting standards under the global financial crisis situations. It is estimated in the following logistic regression model (1) after the prior literature (Wu and Zhang, 2009):

$$\begin{aligned} \text{Prob [Adopt=1]} = \text{Logit } (&a_0 + a_1 \text{Close\_Held}_0 + a_2 \text{Labor\_Prod}_{-1} + \\ &+ a_3 \text{RET}_{-1} + a_4 \text{ROA}_{-1} + + a_5 \text{Size}_{-1} + a_6 \text{Lev}_{.-1} + \\ &+ a_7 \text{Growth}_{-1} + a_8 \text{Foreign\_Sales}_{-1}) \end{aligned} \qquad (1)$$

Where:

Close Held: Percentage of closely held shares at the end of event year (event year of 2009 for the management turnover and employee layoffs analyses),

Labour Prod: Labour productivity (sales per employee) minus the median labour productivity.

RET: Annual raw stock return.

ROA: Return on Assets, accounting earnings is defined as net income before extraordinary items.

Size: Natural logarithm of market capitalization.

Lev: Leverage, defined as long-term debt divided by total assets.

Growth: Sales growth, current year's sales change divided by prior year's sales

Foreign Sales: Foreign sales divided by total sales.

The dependent variable *Adopt* is equal to 1 for adopting firms and 0 otherwise. All the independent variables are measured around event year 0. This model includes year and industry dummy variables.

We included lagged variables on businesses performance (RET_{-1} and ROA_{-1}), firm size ($Size_{-1}$), leverage ($Lev_{.-1}$), growth ($Growth_{-1}$) on the right-hand side of the regression model and I expected the coefficients on firm size, leverage and growth to be positive. I also included foreign sales as a percentage of enterprise total sales ($Foreign\_Sales_{-1}$). I expected these variables to have positive signs.

The regression results are reported in Table 1. In Table 1 the coefficients estimates, standard errors, and the marginal effects are reported in columns (1) to (3), respectively.

Table 1. Logistic analysis of accounting standards adoption decision

Analysis	Estimate	Standard Error	Marginal Effects*
$Close\_Held_o$	-0.00445	0.0026**	-0.64%
$Labor\_Prod_{-1}$	-0.00005	0.0003 **	-1.08%
RET_{-1}	-0.11341	0.1447	-0.30%
ROA_{-1}	-0.56092	0.7148	-0.31%
$Size_{-1}$	+0.26595	0.0461***	4.21%
Lev_{-1}	+1.30047	0.4882***	1.12%
$Growth_{-1}$	-0.28834	0.2021	-0.50%
$Foreign\_Sales_{-1}$	+1.20857	0.2301***	3.08%

(**Source***:* Author's own construction)

,* Indicate that a coefficient is significantly different from zero at the 10 percent, 5 percent, 1 percent levels, respectively (one-sided tests for coefficients with predictions and two-sided tests for those without a prediction)

*Marginal effects measure the changes in the predicted probability from a one standard deviation increase from the mean for a continuous variable and form 0 to 1 for an indicator variable with the other variables measured at the mean.

The $Close\_Held_0$ has a negative coefficient, -0.00445, and significant at the 0.05 level. The percentage of closely held shares can also vary with business' incentives to access the capital market as more closely held business may have lower demand for external capital. This is the reason why the research controls for various factors related to business financing needs in the regression model.

The coefficient on *$Labor\_Prod_{-1}$* is -0.00005 negative as expected and significant as the 0.05 level. The marginal effect indicates that a one standard deviation increase in labour productivity reduces the likelihood of adoption by 1.08 percent. Regression has reasonable predictive power with a *Pseudo* R^2 of 32 percentages.

It was expected that the coefficients on the percentage of closely held shares ($Close\_Held_0$) and labour productivity (industry-adjusted sales per employee, ($Labor\_Prod_{-1}$) variables to be negative, because prior researches suggested that these variables associated with disclosure incentives have predictive power for the adoption decision (e.g. Zeff, 2006). The control variables signed that larger businesses, those with higher leverage, with more substantial foreign sales are more likely to adopt international standards. We found that Close_Held are consistent with compensation contracting demands affecting business decisions to adopt international accounting standards.

The marginal effect suggest that a one standard deviation increase in the percentage of closely held shares decreases the adoption likelihood by 0,64 percent, or 5 percent of unconditional adoption probability of 20 percent (65/325). This supports a greater demand for more informative and conservative accounting earnings due to economic performance evaluations at more widely held by businesses stimulating to adopt international accounting standards.

Conclusions

This research paper investigates the effects of international accounting standardisation on management decisions, business performance and economic environment. As we predicted that businesses face a better need for informative measures of enterprises performance to facilitate internal performance evaluation, therefore a higher probability of international standards.

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.

Discussions

After the measuring some economic effects of accounting standardisation on business management and achieving some results the author decided that we need to continue this analysing process using interdisciplinary methods also, because it can be reach the whole real picture of globalized unified financial statements. We would like to advise them for researchers and practitioners to employ these methods and measure their effects on different management functions.

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