Determinants of IFRS Compliance by Canadian Companies

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ABSTRACT

The objective of this paper is to provide evidence on IFRS compliance by Canadian companies. The Canadian Accounting Standards Board (AcSB) required the use of IFRS for publicly accountable enterprises (other than pension plans) beginning on January 1, 2011. Specifically, the authors analyze the determinants of IFRS disclosure compliance for these companies. Canada provides a good setting for their research, because they measure the compliance in the first year of IFRS adoption when some of the companies are still allowed to use U.S. GAAP or local GAAP. They measure compliance by using an updated version of the instrument used in Hodgdon et al. (2009). The authors’ results show that firm size, foreign sales proportion, and U.S. listing are positively associated with the IFRS compliance while the leverage ratio is negatively associated with the IFRS compliance of the sample firms. These results confirm the premise that firms with better information environment and better monitoring tend to comply well with the newly adopted accounting information.

KEYWORDS
Canada, Disclosure, IFRS Adoption, IFRS Compliance

1. INTRODUCTION AND MOTIVATION

The objective of this paper is to provide evidence on IFRS compliance by Canadian companies. The Canadian Accounting Standards Board (AcSB) required the use of IFRS for publicly accountable enterprises (other than pension plans) beginning on January 1, 2011. At the same time, the AcSB has allowed the Canadian companies with a United States (U.S.) listing to use U.S. GAAP for their financial statements.

As of May 2011, 123 countries require IFRS for domestic listed companies (Deloitte, 2011). Prior research claims that IFRS have various advantages over local accounting standards in many countries for several reasons. IFRS can reduce the choice of accounting methods, thus limiting managerial discretion (Ashbaugh and Pincus, 2001; Barth et al., 2008). Second, IFRS increase required disclosures, thereby reducing information asymmetries between firms and their stakeholders (Leuz and Verrecchia, 2000; Ashbaugh and Pincus, 2001). Finally, the harmonization resulting from IFRS adoption increases comparability of firms across markets and countries, thereby facilitating cross-border investment and integration of capital markets (Armstrong et al., 2010; Defond et al., 2011).

These benefits will be achieved only when these standards are implemented correctly. Hope (2003) argues that absent effective enforcement, even the best accounting standards will not lead to any benefits. Several recent studies have measured compliance with IFRS globally and these studies document significant non-compliance with the disclosure requirements of IFRS in many areas (Street and Gray, 2001; Glaum and Street, 2003; Hodgdon et al., 2009). Therefore, we examine whether Canadian companies comply with IFRS. Specifically, we analyze the determinants of IFRS
disclosure compliance for these companies. Canada provide a good setting for our research, because we measure the compliance in the first year of IFRS adoption when some of the companies are still allowed to use U.S. GAAP or local GAAP for some time while the authorities decide when to make IFRS mandatory for all the firms.

We measure compliance by using an updated version of the instrument used in Hodgdon et al. (2009). This analysis is relevant to the Securities and Exchange Commission (SEC) consideration of whether publicly listed firms in the U.S. can be allowed to use IFRS voluntarily before the SEC make it mandatory for all companies. A potential process for voluntary adoption is described in the Proposed Rule (SEC, 2008), which details a Roadmap for consideration of the mandatory adoption of IFRS by U.S. firms.

Our results show that firm size, foreign sales proportion, and U.S. listing are positively associated with the IFRS compliance while the leverage ratio is negatively associated with the IFRS compliance of the sample firms. These results confirm the premise that firms with better information environment and better monitoring tend to comply well with the newly adopted accounting information. These results have important implications for standard-setting bodies in countries like U.S., where the SEC is debating whether to require IFRS for domestic companies. The U.S. is in the midst of designing an enforcement mechanism with a mix of U.S GAAP and IFRS for domestic companies and these compliance and enforcement issues have been at the front of the SEC’s decision on IFRS. Moreover, U.S. listed foreign firms, who prepare their financial statements using IFRS, are no longer required to reconcile with U.S. GAAP. These results focus on the importance of institutional mechanisms for compliance with IFRS.

This paper is organized as follows. In section 2, we review the literature and explore the relationship between IFRS compliance and its determinants. Section 3 derives the research hypotheses. In section 4, we discuss our sample selection, data, and descriptive analyses. Next, in section 5, we present the results of our analyses and provide conclusions and limitations in section 6.

2. LITERATURE REVIEW

Prior research documents substantial economic benefits around mandatory IFRS adoption. Although International standards Accounting Committee (IASC) has been in existence since 1973, research related to the level of compliance with IAS/IFRS disclosure requirements started after the year 1998. Since then, a number of studies have investigated the compliance with international standards and the determinants of companies’ disclosure practices.

Armstrong et al. (2010) investigate the European equity market reaction to 16 events associated with IFRS adoption in Europe. Their results show that there are positive market reactions to events associated with mandatory IFRS adoption. Barth et al. (2008) examine whether application of IAS is associated with higher accounting quality. They test a sample of companies from 21 countries and find that firms applying IAS generally show an improvement in accounting quality between the pre- and post-adoption periods. Liu et al. (2011) investigate the impact of IFRS implementation on accounting quality in China, a market that is disciplined primarily by regulators rather than market mechanisms. Their results indicate that accounting quality improved with decreased earnings management and increased value relevance of accounting measures in China since IFRS implementation. Other benefits include an increase in market liquidity and a reduced cost of capital (Li, 2010), higher information content of earnings (Landsman et al., 2012) and increased foreign investments (Defond et al., 2011). However, despite these evidences of benefits for IFRS adoption, Ahmed et al. (2012) suggest that due to the principles-based nature of IFRS and the lack of implementation guidance, earnings quality

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