Emerald Insight

Managerial Finance

The effects of International Financial Reporting Standards on the notes of auditors

Eleni Vrentzou

Article information:

To cite this document:
Eleni Vrentzou, (2011),"The effects of International Financial Reporting Standards on the notes of auditors", Managerial Finance, Vol. 37 Iss 4 pp. 334 - 346
Permanent link to this document:
http://dx.doi.org/10.1108/03074351111115296

Downloaded on: 30 January 2016, At: 11:21 (PT)
References: this document contains references to 22 other documents.
To copy this document: permissions@emeraldinsight.com
The fulltext of this document has been downloaded 3215 times since 2011*

Users who downloaded this article also downloaded:

Elisa García Jara, Amparo Cuadrado Ebrero, Rolando Eslava Zapata, (2011),"Effect of international financial reporting standards on financial information quality", Journal of Financial Reporting and Accounting, Vol. 9 Iss 2 pp. 176-196 http://dx.doi.org/10.1108/19852511111173121

Rudy A. Jacob, Christian N. Madu, (2009),"International financial reporting standards: an indicator of high quality?", International Journal of Quality & Reliability Management, Vol. 26 Iss 7 pp. 712-722 http://dx.doi.org/10.1108/02656710910975778

John Goodwin, Kamran Ahmed, (2006),"The impact of international financial reporting standards: does size matter?", Managerial Auditing Journal, Vol. 21 Iss 5 pp. 460-475 http://dx.doi.org/10.1108/02686900610667247

Access to this document was granted through an Emerald subscription provided by emerald-srm:101358 []

For Authors

If you would like to write for this, or any other Emerald publication, then please use our Emerald for Authors service information about how to choose which publication to write for and submission guidelines are available for all. Please visit www.emeraldinsight.com/authors for more information.

About Emerald www.emeraldinsight.com

Emerald is a global publisher linking research and practice to the benefit of society. The company manages a portfolio of more than 290 journals and over 2,350 books and book series volumes, as well as providing an extensive range of online products and additional customer resources and services.

Emerald is both COUNTER 4 and TRANSFER compliant. The organization is a partner of the Committee on Publication Ethics (COPE) and also works with Portico and the LOCKSS initiative for digital archive preservation.

*Related content and download information correct at time of download.

Managerial Finance 2011.37:334-346.

The current issue and full text archive of this journal is available at
www.emeraldinsight.com/0307-4358.htm

The effects of International Financial Reporting Standards on the notes of auditors

Eleni Vrentzou
Ministry of Finance, Athens, Greece
Greek Accounting and Auditing Oversight Board, Athens, Greece and
Department of Accounting and Finance,
Athens University of Economics and Business, Athens, Greece

Abstract

Purpose – This paper attempts to combine the developments in the accounting area with those in the auditing area. More specifically, it presents the effects of International Accounting Standards (IAS) on the auditor findings and report.

Design/methodology/approach – International Standards on Auditing (ISA) are revised in order to be accepted by the European Union as the common and formal auditing standards of the member states. The introduction of IAS has been one of the most significant developments in the history of the financial statements preparation and presentation. The effects of the application of these standards are present both on the valuation of the firm and on the presentation of its "true and fair view". An extended analysis of the financial statements and the auditor reports is conducted.

Findings – The effects of International Financial Reporting Standards (IFRS) on the auditor reports and notes, for the first two years of their formal application, are analyzed. It is realized that the auditor notes and the equity adjustments they propose are positively related to the notes that accompany financial statements before the application of IFRS, whereas they are negatively related to the explanatory notes imposed by IFRS. The different role of the company's notes before and after the application of IFRS and the relevant change of the auditor notes are further examined.

Originality/value – Most of the research focuses on the accounting effects of IFRS. In this study, it is attempted to combine the developments in the accounting area with the developments in the auditing area. ISA are revised in order to be accepted by the European Union as the common and formal auditing standards of the member states. Much research is being developed in this area, although the data available are yet very limited. Most of the research focus is on the accounting effects of IFRS.

Keywords Auditing standards, Accounting, Audit reports, Financial reporting

Paper type Research paper

Managerial Finance 2011.37:334-346.

Managerial Finance
Vol. 37 No. 4, 2011
pp. 334-346
© Emerald Group Publishing Limited
0307-4358
DOI 10.1108/03074351111115296

1. Introduction

The recent introduction of International Accounting Standards (IAS), in combination to the rest of the European Commission's regulations and Directives and the local legislation that has been adopted during the last five years, have created a new accounting and auditing framework in the member states. The project that started by the introduction of the fourth (78/660/EC) and seventh (83/349/EC) Directives has recently been completed through the full application of IAS and is expected to expand further through the convergence project aiming at global accounting standards. The accounting specialties of some industries were already regulated by specific directives of the European Union, in the same way that they are now regulated by IAS.

The European Regulation 1606/2002 was the first step for the application of common accounting rules providing the ability of common understanding of the financial statement of any member state, by increasing disclosure levels and eliminating adjustments. The recent Directive (46/2006/EC) updating fourth and seventh Directives, as well as a new group of European legislation (Directive 65/2003, 51/2003) provide clarifications and guidelines for the application of the complicated issue of fair value, while expanding at the same time the application of International Financial Reporting Standards (IFRS), to other than listed firms. Recent studies and European projects are developing a suitable set of accounting standards for small and medium enterprises and a commonly accepted threshold for European definition of small and medium enterprises.

It was expected that full application of this new set of financial statements provided by European listed firms will only be accepted if it was also followed by a commonly accepted auditor report. Therefore, the development and application of Directive 43/2006 was the expected development in the auditing area. The further information provided by firms through the new disclosure policies proposed by IFRS make more than necessary the audit and monitoring of the validity and the quality of the information provided. Common auditing rules and procedures are now being developed by the member states, in combination to the directive adaptation procedure. International Standards on Auditing (ISA) are being re-examined and updated in order to be adopted as formal European Auditing Standards.

Although Greek Accounting Standards were significantly different to IFRS, Greek Auditing Standards are mostly an application of the ISA. The adoption of ISA in Greece is therefore an easy going procedure and the relevant authorities (Greek Accounting and Auditing Oversight Board, Ministry of Finance) have already imposed new rules regarding auditing issues and auditors reports. Developments both in accounting and auditing areas are closely related to the job of chartered auditors. In Greece, auditing firms acted as counselors to Greek-listed firms, providing accounting assistance, counseling and auditing to the financial statements during these first fiscal years of IFRS application.

The new role of auditor's report in Greek capital market is analytically examined in this paper. The change of auditors' reports and notes before and after the application of IFRS is analyzed. The firm's report, as a necessary part of the group of the financial statements published according to IFRS, contains much of the information that used to be included in auditors notes. The notes accompanying financial statements according to Greek general accepted accounting principles (GAAP) before the application of IFRS and the new explanatory notes presented afterwards in the firm's report are analyzed and compared. Before the application of IFRS it was realized that some of the firm's notes included important information for misapplication of Greek GAAP. Auditors reports used to refer to these notes in order to present a complete view of the firm's audited financial statements. After the application of IFRS and the currently adopted new auditing rules, it was realized that auditor reports became "clear" and the notes and comments they used to make, they have now disappeared from the financial statements and auditors reports.

It is realized that the main issues raised in the auditor reports before the application of IFRS had to do with the choice of evaluation method, issues related to the liabilities to employees, tax liabilities and provisions. These issues are now analytically presented with extended notes on the annual report, where the management explains the evaluation

Managerial Finance 2011.37:334-346.

method chosen and the criteria for this. Furthermore, references for the liabilities to employees, for the exact amounts of provisions and all the issues regarding tax liabilities and deferred taxation are analytically presented. Provisions development is also analyzed and compared from year to year. This level of information changed the disclosure content of the management's notes and reports. Therefore, it is expected that notes presenting misapplication of the accounting standards are now replaced by all the information presented according to disclosure requirements of IFRS. The notes of the auditor report are further expected to decrease, since the choice of valuation and the definition of tax and employees' liabilities have all been regulated.

In order to examine this, the notes of the firm and of the firm's auditor's before the application of IFRS are quantified and compared to the relevant quantified information after the IFRS application. At the same time, the change of auditing firm before and after the application of IFRS provides useful and relevant information to this research. As it was expected, it is realized that auditor notes are replaced by extensive analysis in the firm's report, accompanied by references for the firm's choices. Moreover, smaller auditing firms seems to be replaced by one of the "big four" auditing firms, after the application of IFRS. It also examined the relationship between management's notes and auditor report notes in the year before the application and the year exactly after the IFRS application.

Since recent development in IFRS focuses to the application of common accounting rules to all firms (non-listed and small-medium enterprises), this paper contributes to the international accounting literature. The information provided by smaller firms is even more limited that what is required by listed firms. Therefore, it is obvious that the future application of IFRS will provide the firm with choices and the ability to analyze the accounting methods applied. The readers and users of the financial statements are then expected to be enhanced in their investments choices.

This paper also contributes to the relevant literature by presenting the consequences of IFRS application in the auditing area just two years after their adoption. This will help the relevant analysis regarding the application of common accounting rules and the identification of any shortcomings of IFRS application by Greek and other European companies. Finally, the most important contribution of this paper is the examination of the developments simultaneously on two different but highly related research areas, accounting and auditing.

Section 2 presents a literature review presenting previous research on the characteristics of the financial statements before and after IFRS application. Section 3 deals with the hypotheses examined regarding the consequences of IFRS adoption on auditor reports and company's explanatory notes. Then, Section 4 presents proxies of the variables employed in the model, where the model applied, is analyzed in Section 5. Finally, Section 6 presents the results of the research and the paper concludes with Section 7.

2. Literature review

The first effects of IAS were initially examined for the firms that voluntarily adopted these Generally Accepted Accounting Principles, either because their stocks were traded in International Capital Markets, or because they were interested in international investments. A relevant issue raised by Purdy *et al.* (1969) is the different ways that auditor reports could be presented and adjustments be clarified and stressed in their report.

Managerial Finance 2011.37:334-346.

The quality and the audit procedures influence the conclusion of the auditor as well (Neumann, 1968).

Voluntary IFRS adoption provided initially the ability to firms to partially apply IFRS and detect the effects on their financial statements (Street *et al.*, 1999). At that point, IAS were also compared to US GAAP and other local GAAPs (Eggert, 1998). Relevant analysis has also been conducted by International Accounting Standards Committee (1998) and International Accounting Standards Board (2008) themselves in order to improve their efforts for effective standards and smooth transposition to the new accounting age.

The change in disclosure level after IAS application was analyzed by Leuz and Verrecchia (2000) for German firms. Relevant analysis took place before the formal adoption of IAS in other member states as well, in order to pre-define the consequences of their application (Auer, 1998). The comparison was not limited to IFRS effects but was usually combined with the different disclosure level and information content of the company's reports (Alford *et al.*, 1993).

Information provided and firm risk before and after the application of IFRS is also analyzed by Auer (1998). This information provided is conceived by analysts on a different perspective before and after the IFRS application. Analysts use both the information reported by the firm, as well as the auditors report regarding the earnings and the investment strategy of the firm. The disclosure policy and the information content of the compulsory reports define the quality and the usefulness of the financial statements (Francis and Schipper, 1999). The accuracy of analysts forecasts errors are influenced by accounting standards (Ashbaugh and Pincus, 2000; Joos and Lang, 1994), since subjective information is provided in the annual firm's report, depending on the plans and the disclosure policy of the firm. Larger firms face differently the greater information needs and the specific accounting choices implied by IFRS (Ashbaugh, 2000; D'Arcy, 2000).

In the same research framework, Elliot and Philbrick (1990) report different kind of information and measurement methods. Increased levels of disclosure and choices of the management to provide handled information are a result of the IAS application (Leuz and Verrecchia, 2000). Most of the analyses performed in this field have also been examined from the perspective of US GAAP application (Davis-Friday and Rueschhoff, 1998).

3. Hypotheses analysis

Recent researches have developed an information pattern provided by firms following IAS. On the other side, auditors' reports and the content of information in these reports have also been analyzed. The same analysis takes place for the company's report. Gigler and Hemmer (1998) noted that audited information and audited financial statements influence stock prices and the financial markets. In this paper, the combination of the previous researches on the separated areas of accounting and auditing is attempted. The composition of the two types of reports, auditor's and management's is examined and compared. The replacement of auditors' notes by firm's analysis in the accounting report is clarified. The choice of the audit firm is also considered to be a significant factor, in relation to the auditor's opinion and the comments that accompany their opinion.

In this study, it is examined whether the notes on the auditors' reports realized in the financial statements before the IAS application become notes in the firm's report and presented as a choice in the framework of accounting methods allowed by IFRS.

Managerial Finance 2011.37:334-346.

In this way former adjustments to equity and earnings disappear, since the main reasons for these adjustments are not valid any longer. The accounting choices imposed by IFRS provide the ability to the management to choose the appropriate valuation method that should be applied and previous adjustments on valuation issues now require just an IFRS statement for the accounting choice made by the firm. As far as the liabilities to employees and tax liabilities are concerned, we notice that these issues are analytically presented by IFRS and the disclosure required is analyzed. Therefore, these common notes in the auditor's report are all replaced by the relevant information provided in the management report.

Moreover, the management's notes that accompanied financial statements according to Greek GAAP used to include comments significant for the determination of the "true and fair view" of the company's value. Many of the comments included in these notes implied that adjustments should take place in certain figures of the financial statements that they accompanied. On the other hand, but in the same direction to the auditor's notes, these management's clarifications were significantly decreased after the application of IFRS. The adjustments are no longer required since most of the issues mentioned are now clarified according to the disclosure requirements of IFRS. These comments are now embodied in the annual report and do not imply any adjustments, since they are combined to the different accounting methods allowed. Berger and Hann (2003) realized the limitation of firm's discretion on the information provided after the relevant application of SFAS 131.

The first hypothesis examines the impact of IFRS application to the auditors reports and the issues mentioned and analyzed in their report. The comments of the auditors regarding valuation issues of assets and liabilities are quantified and compared to the relevant comments on the new auditor report after the application of IFRS. Fixed assets and depreciation issues, mentioned in the auditor's report are distinguished to those that influence earnings reported and to those that have an impact on the equity of the firm. The same analysis takes place on any auditor's comments regarding stocks valuation, financial instruments valuation, definition of short- and long-term liabilities, liabilities to employees, deferred taxation issues, and the provisions conducted by the firm. The total number of the auditor's notes before and after the application of the IFRS is therefore examined:

H1. The number of auditor notes that require adjustments to the financial statements is decreased after the justifications in the notes required by IFRS.

This means that the previous auditor notes were substitutes for clarifications and further information.

The second hypothesis examines and analyzes the impact and the ability to present a misapplication of the accounting standard either in the auditor notes (with all the legal consequences) or in the management's report. This analysis takes place both for the year before and the year after the application of IFRS. It is expected that before IFRS application management's notes used to replace auditors comments. The auditor used to mention the notes provided by the firm in his report. The auditor notes are, therefore, expected to be positively related to the company notes. On the other hand, after the application of IFRS, further information is provided justifying accounting choices and defining liabilities of the firm, and therefore eliminating auditor's notes. The company's notes have become actual explanatory notes and not "under cover" auditor's notes.

Managerial Finance 2011.37:334-346.

Managerial Finance 2011.37:334-346.

A control variable in this analysis examines the impact of the change of the audit firm on the auditor's opinion and the number of notes and clarifications included in the auditor's report. The change is analyzed as a change from a smaller audit firm to one of the "big four" audit firms during the fiscal year of IFRS adoption. The relationship between auditor and the management was crucial during the year of IAS application. The auditors are always the final "judges" and accounting counselors before the determination of the figures for the whole set of the financial statements. The specialization of the auditors of larger audit firms and the combination of the rest of the accounting services provided by them, gave motives to companies to choose one of the larger audit firms. These audit firms provide other services on specific accounting areas like valuation issues, provisions and statistical and actuarial analysis, providing any certificates required by the standards. This has been followed by changes to the notes and the comments of the auditor's report. The second hypothesis is divided into two parts, one for the year before the application of IFRS and one for the year after the IFRS application:

H2. The size of auditor adjustments is positively related to the number of notes that imply adjustments, conducted according to Greek GAAP.

This means that the management notes before IFRS application were analyzing auditor notes or preventing adjustments from being presented in the auditor report:

H3. The size of auditor notes that require adjustments is negatively related to the number of the explanatory notes that imply adjustments, conducted according to IFRS.

This means that management notes, according to IFRS, provide all the necessary clarifications preventing any need for auditor notes on their report.

4. Sample and data

The sample used for the examination of the impact of IFRS application on auditor's report consists of all the listed firms in Athens Stock Exchange of large and medium capitalization that belong to the indices of FTSE ASE 20 and FTSE ASE 40. These firms represent about 20 percent of the whole number of listed firms in Athens Stock Exchange and constitute a representative sample of the firms that fully applied IFRS. The years used for the analysis of the effects of IFRS application are the year just before and the year just after the imposition of IFRS, this means the fiscal years 2004 and 2006. The data used for the financial statements of the year 2004 are those published according to Greek GAAP and not the adjusted financial statements prepared for comparison purposes to the IAS financial statements of 2005. The auditor reports referred to the financial statements prepared according to the Greek GAAPs and did not follow yet the new auditor's report form, introduced during 2006.

The data used derives from the published, audited financial statements, for the fiscal years 2004 and 2006. The auditors' reports were then analyzed and all their comments were classified initially into those that have an impact on the financial statements figures published by the firm and into those that provided information or estimation of the auditor. Then, these significant notes were divided into those that influence equity and those of general form or of undefined amount. In this way, it was estimated the number of auditor's notes, as well as the quantified impact of these notes on the firm's equity.

Furthermore, the notes that accompany financial statements conducted according to Greek GAAP were also analyzed and categorized in the same way as those of the auditors. The difference is that these notes included a lot of clarifications for the company's investment policy, financial decisions and other issues. These notes were also quantified and defined as equity notes and clarification notes. The same was then applied to the explanatory notes of the financial statements conducted according to IFRS.

It was of course realized that these notes were further analyzed in management's report. The management reports prepared according to IFRS were then examined for the year 2006 and all the information that was previously presented in the Greek notes that accompanied the financial statements, were also identified in the new IFRS report. It was of course realized that no adjustments were any longer implied in the company's report. No misstatement or partial application of a standard was present in this report, since this is not allowed according to IFRS. The standards adoption requires a clear statement of full application, in contrast to Greek GAAP, where it was common to find comments on partial or subjective application of some standards.

The audit firm of each financial year was realized by the published auditor report. In this way it was realized which company changed audit firm and those that turned to one of the "big four" audit firms were discriminated.

All the data were gathered by the published financial statements and auditors reports presented on the official web sites of the firms.

5. Research design – data

In order to analyze the consequences of the adoption of IFRS through the explanatory notes on the auditor reports, a regression model is developed. It examines the relationship between the change on the number of the auditor notes and the change on the number and the amount of adjustments indicated in management notes. This change is examined between the year before the adoption of IFRS and after IFRS adoption. The change on the audit firm is also included as a control variable in this model. The regression model used is the following:

$$CHAUD_i = \beta_0 + \beta_1 CHAUDF_i + \beta_2 CHNOTES_i + \beta_3 CHNOTES_EQ_i$$

where:

- CHAUD — the change in the number of auditor notes in their report between the year $t-1$ (the year before IFRS application) and $t+1$ (the year after IFRS application);
- CHAUDF — the change between the years $t-1$ and $t+1$ of the audit firm from a smaller one to one of the "big four";
- CHNOTES — the change in the number of the explanatory notes and the new role of the explanatory notes according to the requirements of IFRS; and
- CHNOTES_EQ — the change in the amount of equity adjustments proposed by the notes that accompany financial statements according to Greek GAAP, adjusted for the total equity of each firm.

The change on the number of the auditor notes is examined by comparing the number of auditor notes that require adjustments to be made on the financial statements

Managerial Finance 2011.37:334-346.

in order to present the "true and fair view" in the year $t - 1$ and $t + 1$, where t is the year of IFRS first time application. The audit reports of the firms for the year 2004, before the application of IFRS and for the year 2006, after the application of IFRS, are analyzed and all the notes that imply adjustments to the financial statements are included in the analysis.

Then, the change of the audit firm reflects the decision of the Generally Assembly to change form one of the smaller audit firms to one of the "big four". A dummy variable takes the value of one when the firm decides to change auditors and zero otherwise. The number of management notes that accompany the financial statements and require adjustments to the figures presented are gathered and compared between the years 2004 and 2006. Finally, the notes that refer specifically to adjustments on the firm's equity are analyzed and quantified. The equity adjustments required before and after the application of IFRS define the variable of CHNOTES_EQ. These figures are adjusted by the total equity of the firm.

The second regression model developed is distinguished into two parts. The first one examines the relationship between auditor notes and management notes for the year before the application of IFRS and the second one examines the same relationship, after IFRS application. The first regression model is the following:

$$AUD_EQ_i = \beta_0 + \beta 1CHAUDF_i + \beta_2 NOTES_EQ_i + \beta_3 NOTES_i$$

where, AUD_EQ are the quantified auditor notes that require adjustments to the equity of the firm. CHAUDF is the dummy variable that depends on the change of the audit firm, as described above. The variable NOTES_EQ examines the size of the adjustments on the equity proposed by the management, where NOTES represents the number of explanatory notes provided by the firm, and which require adjustments to the financial statements. This is initially applied for the data of 2004. Then, the same model is also applied for the data of the year 2006:

$$AUD_EQ_i = \beta_o + \beta 1CHAUDF_i + \beta_2 NOTES_EQ_i + \beta_3 NOTES_i$$

The variables used are the same as those described above for the year 2004. The audit reports and the notes that accompany the financial statements are taken by the published sets of the financial statements presented on the web sites of the firms.

6. Results

The examination of the relationship between the change in the number of auditor notes and the change in the company's explanatory notes that accompany financial statements, before and after the IAS application, is initially presented.

It is obvious from the results of the first regression model in Table I that, as expected, there is a positive and significant relationship between the change in the number of the notes for adjustments proposed by the auditors and the change in the number of adjustments implied in the company's notes that accompany financial statements. The decrease in the size and the number of the company's notes is followed by a decrease in the number of the auditors' notes. The content of the auditor report changes and investors are enhanced for their investment choices (Bailey *et al.*, 1983).

As described above, the explanatory notes have a new "disclosure role" after the application of IAS. The notes are no longer substitutes or explanations and justifications on auditors' comments, but they are explaining the company accounting methods

Managerial Finance 2011.37:334-346.

choices and analyze the transactions and results in each fiscal year and the changes from one year to the other. This means that there are no longer adjustments required in order for "the true and fair" view of the firm to be presented. This, in turn, means no auditor notes and no management's adjustment notes. The positive relationship is verified by the descriptive statistics (Table V), where it is realized that there are no longer auditor's notes in their reports and at the same time no management notes implying adjustments required. The same positive sign was found for the significant relationship between the change in the number of the auditor notes and the change in the equity adjustment requirements and proposed in the explanatory management's notes. The adjustments on equity proposed by managements have decreased, exactly the same as what has happened with the auditors comments. The relationships described above were found to be significant at 10 percent level.

The *H2* is examined through the next regression model and separately analyzed for the fiscal years of 2004 and 2006.

Table II describes the positive and significant relationship found between the auditor notes that contain adjustments on equity and the management's equity adjustments proposed in the notes that accompany the financial statements. The audit findings are initially presented by the management of the firm in the notes that accompany the financial statements and they are translated into equity that should be adjusted. Then the auditor, either explains these notes or provides emphasis points in the audit report "that true and fair view" is achieved after taking into consideration the adjustments implied in the explanatory notes. There were cases that the adjustment proposed by the auditor was of a much greater size than that implied in the management's notes.

Table I. Results of testing *H1*: the impact of IFRS disclosure requirements on the auditors report

$$CHAUD_i = \beta_0 + \beta_1 CHAUDF_i + \beta_2 CHNOTES_i + \beta_3 CHNOTES_EQ_i$$

β_0	CHAUF	CHNOTES	CHNOTES_EQ	Adj. R^2
-1.603 $(-5.494)^{*}$	-0.236 (-0.452)	0.211 $(1.817)^{*}$	1.990 $(1.731)^{*}$	0.07

Notes: Significance at: $^{*}p$-value < 0.10, and $^{**}p$-value < 0.05; changes are examined for the year before ($t-1$) and the year after IFRS application ($t+1$); where: CHAUD is the change in the number of auditor notes in their report between the year $t-1$ and $t+1$; CHAUDF is the change between the years $t-1$ and $t+1$ of the audit firm from a smaller one to one of the "big four"; CHNOTES is the change in the number of the explanatory notes and the new role of the explanatory notes according to the disclosure requirements of IFRS; and CHNOTES_EQ is the change in the amount of equity adjustments proposed by the notes that accompany financial statements according to Greek GAAP, adjusted for the total equity of each firm

Table II. Results of testing *H2*: the relationship between the adjustments proposed by the auditor and the adjustments implied in the company's report for the year 2004

$$AUD_EQ_i = \beta_0 + \beta_1 CHAUDF_i + \beta_2 NOTES_i + \beta_3 NOTES_EQ_i$$

β_0	CHAUF	NOTES	NOTES_EQ	Adj. R^2
-0.148 (-1.268)	0.170 $(1.723)^{*}$	0.277 (1.094)	0.070 $(3.122)^{**}$	0.12

Notes: Significance at: $^{*}p$-value < 0.10, and $^{**}p$-value < 0.05; where: AUD_EQ is the equity adjustments included in the auditor report; adjusted for the total equity of the firm, CHAUDF is the change of the audit firm from a smaller one to one of the "big four"; NOTES is the number of company's notes that require adjustments; and NOTES_EQ is the quantification of these notes adjusted for the total equity of each firm

Managerial Finance 2011.37:334-346.

There was no case realized that the opposite estimations were conducted. The positive effects of the explanatory notes imposed by IFRS were reflected on the analysts' forecasts as well, according to Ashbaugh and Pincus (2000).

This regression model verifies also that there is a positive and significant relationship between the auditor adjustments in equity and the change of the audit firm from a small one to one of the "big four", in view of the preparation of the financial statements according to IFRS. It was expected by the firms that more experienced auditors in IFRS were required in order for the financial statements to be prepared and audited according to the new standards. The year 2004 was a year that IFRS were not applied, but it was the year of adoption, before the application of IFRS that took place in 2005. This means that during 2005 the figures of the financial statements of 2004 were adjusted for comparison purposes. The auditors' international experience and assistance was significant at this year.

The last regression model examines the second part of the *H2*.

The results presented in Table III imply that as expected in *H3*, the relationship between the equity adjustments proposed by the auditors to the explanatory notes presented after IFRS application is significant (at 5 percent level) and negative. The role of the management notes is no longer to substitute or repeat the auditor comments, but there are explanatory notes regarding accounting methods, valuation issues, liabilities analysis and further disclosure issues. Therefore, the further notes provided in the managements report, the less the auditors' comments, since all disclosure issues are covered and no misapplications of IFRS are identified. This is a consequence of IFRS regulation not allowing any exemptions from their full application. It was actually realized that auditor notes were only presented in the audit report, since the explanatory IFRS notes had to fulfill the disclosure role of explaining the figures of the financial statements and not to influence the auditors' oversight. The different role of the company's notes depending on the different GAAPs applied was also realized by Choi and Levich (1992).

6.1 Descriptive statistics

The descriptive statistics are presented in Tables IV and V.

The descriptive statistics reveal that the equity adjustments referred on the auditor's report, as well as the adjustments mentioned in the managements notes are much higher in the year before the application of IFRS Foundation (2004), compared to those of the year following the application of IFRS Foundation (2006). It is already analyzed that most of the adjustments were based on valuation and accounting methods preferred by the firm during the years before IFRS application. IFRS require justified accounting choices, retained in the future and analyzed in the explanatory IFRS notes. The same

Table III. Results of testing *H3*: the relationship between the adjustments proposed by the auditor and the adjustments implied in the company's report for the year 2006

$$AUD_EQ_i = \beta_0 + \beta_1 CHAUDF_i + \beta_2 NOTES_i + \beta_3 NOTES_EQ_i$$

β_0	CHAUF	NOTES	NOTES_EQ	Adj. R^2
0.006 (0.653)	−0.006 (−0.505)	0.070 (0.661)	−0.018 −(3.010)**	0.15

Notes: Significance at: *p-value < 0.10, and **p-value < 0.05; where: AUD_EQ is the equity adjustments included in the auditor report, adjusted for the total equity of the firm; CHAUDF is the change of the audit firm from a smaller one to one of the "big four"; NOTES is the number of company's notes that require adjustments; and NOTES_EQ is the quantification of these notes adjusted for the total equity of each firm

Managerial Finance 2011.37:334-346.

Year 2004	NOTES_EQ	AUD_EQ	AUD	NOTES
Mean	0.081*	0.195*	2.119*	1.203
Median	0.001*	−0.044*	2.000*	1.000
SD	0.181	0.365	2.348	1.257
Min.	0.000	−2.218	0.000	0.000
Max.	1.000	0.013	7.000	4.000
$n = 60$				

Notes: Significant at: $^{*}p$-value < 0.10; AUD_EQ is the equity adjustments included in the auditor report, adjusted for the total equity of the firm; NOTES is the number of company's notes that require adjustments and NOTES_EQ is the quantification of these notes adjusted for the total equity of each firm; and AUD is the number of auditor's notes that require adjustments to the financial statements

Table IV.
Descriptive statistics for the variables employed in the model

Year 2006	NOTES_EQ	AUD_EQ	AUD	NOTES
Mean	0.010	0.009*	0.610*	0.593
Median	0.000	0.000*	0.000*	0.000
SD	0.048	0.002	0.794	0.797
Min.	0.000	0.000	0.000	0.000
Max.	0.333	0.256	3.000	3.000
$n = 60$				

Notes: Significant at: $^{*}p$-value < 0.10; AUD_EQ is the equity adjustments included in the auditor report, adjusted for the total equity of the firm, NOTES is the number of company's notes that require adjustments and NOTES_EQ is the quantification of these notes adjusted for the total equity of each firm, and AUD is the number of auditor's notes that require adjustments to the financial statements

Table V.
Descriptive statistics for the variables employed in the model

Managerial Finance 2011.37:334-346.

direction to the amount of equity adjustments was followed by the total number of auditor notes and management notes for the years before and after IFRS application as presented in Tables IV and V. It should also be mentioned that a total of 17 firms preferred to change their audit firm, from a small one, to an international one belonging in the group of the "big four". This change represents approximately a 28 percent change of audit firm in the sample examined.

7. Conclusion

We are experiencing the first effects of the recent application of IFRS in the financial statements of the listed firms in the European Union. The impact of the accounting principles presented in this set of accounting standards was very important and much different than the specific accounting rules followed until now according to Greek GAAP. It is yet too early to be able to capture the whole image of the effects of IFRS application, but the first two formal financial years of their application have already useful conclusions to present.

During the first two years of IFRS application, as well as during the adjustment year of 2004, it was already realized that the readers of the financial statements will receive a higher quality set of financial statements due to higher disclosure requirements. The information presented and accompanying the financial statements was completely different than that limited and selectively presented according to Greek GAAP.

The auditor report also became completely different in form and content as a consequence of both the application of IFRS and the new auditing rules (International Standards of Auditing).

This research is a first step to join the new accounting and auditing issues and come to some useful conclusions through the examination of the first impacts of these new standards. It is examined whether the application of IFRS with all the accounting methods proposed and the disclosure requirements, have influenced the content and the comments of the auditor reports. It was actually realized that auditor notes dealt mainly, before the application of IFRS, with valuation issues, employee and tax liabilities estimations, as well as provisions estimation. The accounting choices that were allowed by IFRS, the disclosure requirements and the specific rules applied for the estimation of employees' liabilities and deferred taxation have eliminated the need for auditor comments. The management notes changed to informative comments, without covering or substituting auditor's notes and adjustments need.

The analysis presented in this paper verified the relevant expectations. It was realized that the impact of IFRS application was less adjustments requirements in the managements notes, as well as in the auditors reports. The number of the adjustments was followed by less effect on equity manipulation and earnings management. The number of notes and adjustments of the management was positively related to the number of auditor reports in the year before IFRS application, This is no longer valid since the disclosure requirements of IFRS turned management notes to totally explanatory notes, since the management has accounting options in order for the "true and fair view" of the financial statements to be presented.

This paper contributes to the relevant literature by presenting the first impact of IFRS on Greek companies and more specifically, the quality of the financial statements as verified by the auditors. The role of the big audit firms is analyzed and the relationship between management and auditors through their reports is analytically presented.

This first step of IFRS effects examination could be followed by relevant analyses examining more analytically the quality of the information presented and accompanying the new financial statements. Other effects of IFRS on the figures of the financial statements could also be examined when the several fiscal years of IFRS application are completed. The parallel development of International Financial Standards and the International Standards of Auditing would contribute to the relevant accounting and auditing literature. The effects of these new standards could be further analyzed to all Greek-listed firms, after their full application. Extension of the research to other European countries and relevant comparisons should follow.

References

Alford, A., Jones, J., Leftwich, R. and Zmijewski, M. (1993), "The relative in formativeness of accounting disclosures in different countries", *Journal of Accounting Research*, Winter, pp. 183-223 (Supplement).

Ashbaugh, H. (2000), "Non-US firms' accounting standards choices", *Journal of Accounting and Public Policy*, Vol. 20 No. 2, pp. 129-53.

Ashbaugh, H. and Pincus, M. (2000), "Domestic accounting standards, international accounting standards and the predictability of earnings", *Journal of Accounting Research*, Vol. 39.

Auer, K. (1998), "Der Einfluβ des Wechsels vom Rechnungslegungsstandard auf die Riskopameter von schweizerischen Aktien", *Zeitschrift fur betriebswirtschaftliche Forschung*, Spring.

Managerial Finance 2011.37:334-346.

Bailey, E., Bylinski, H. and Shields, M. (1983), "Effects of audit report wording, changes on the perceived message", *Journal of Accounting Research*, Vol. 21.

Berger, P. and Hann, R. (2003), "The impact of SFAS 131 on information and monitoring", *Journal of Accounting Research*, Vol. 41.

Choi, F. and Levich, R. (1992), "International accounting diverisity and capital market decisions", *Handbook of International Accounting*, Wiley, New York, NY.

D'arcy, A. (2000), "The degree of determination of national accounting system – an empirical investigation", *Schmalenbach Business Review*, January.

Davis-Friday, P. and Rueschhoff, N. (1998), "International accounting standards versus US GAAP: how do they compare?", working paper, University of Notre Deme, Notre Deme, IN.

Eggert, R. (1998), "German corporate law and accounting legislation", *International Tax Review*, July/August.

Elliot, J. and Philbrick, D. (1990), "Accounting changes and earnings predictability", *The Accounting Review*, January.

Francis, J. and Schipper, K. (1999), "Have financial statements lost their relevance?", *Journal of Accounting Research*, Vol. 37.

Gigler, F. and Hemmer, T. (1998), "On the frequency, quality, and informational role of mandatory financial reports", *Journal of Accounting Research*, Vol. 36 (Supplement).

IFRS Foundation (2004), International Financial Reporting Standards, IFRS Foundation, London, available at: www.ifrs.org

IFRS Foundation (2006), International Financial Reporting Standards, IFRS Foundation, London, available at: www.ifrs.org

International Accounting Standards Board (2008), International Financial Reporting Standards, IFRS Foundation, London, available at: www.ifrs.org

International Accounting Standards Committee (1998), International Accounting Standards, IFRS Foundation, London, available at: www.ifrs.org

Joos, P. and Lang, M. (1994), "The effects of accounting diversity: evidence from the European community", *Journal of Accounting Research*, Vol. 32, pp. 141-68 (Supplement).

Leuz, C. and Verrecchia, R. (2000), "The economic consequences of increased disclosure", *Journal of Accounting Research*, Vol. 38.

Neumann, F. (1968), "The auditing standard of consistency", *Journal of Accounting Research*, Vol. 6.

Purdy, C., Smith, J. and Gray, J. (1969), "The visibility of the auditor's disclosure of deviance from APB opinion: an empirical test", *Journal of Accounting Research*, Vol. 7.

Street, D., Gray, S. and Bryant, S. (1999), "Acceptance and observance of international accounting standards: an empirical study of companies claiming to comply with IASs", *The International Journal of Accounting*, Vol. 34 No. 1, pp. 11-48.

Corresponding author
Eleni Vrentzou can be contacted at: vrentzou@mnec.gr

To purchase reprints of this article please e-mail: **reprints@emeraldinsight.com**
Or visit our web site for further details: **www.emeraldinsight.com/reprints**

Managerial Finance 2011.37:334-346.

This article has been cited by:

1. Zinatul Iffah Binti Abdullah, Mahmoud Khalid Almsafir, Ayman Abdal-Majeed Al-Smadi. 2015. Transparency and Reliability in Financial Statement: Do They Exist? Evidence from Malaysia. *Open Journal of Accounting* **04**, 29-43. [CrossRef]

Managerial Finance 2011.37:334-346.