

International Accounting Standards: Implementation and Impact on Firm Accounts An Empirical Investigation of UK Firms

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Abstract

This paper examines the behaviour and accounting policy choice of managers. It focuses mainly on the presentation of financial statements under the International Accounting Standard (IAS) 1 and the accounting treatment of translation gains and losses under IAS 21. The paper also investigates accounting issues, such as dividend policy, management remuneration, the increase of equity capital and financial leasing. The sample consists of 262 UK industrial firms that are listed on the London Stock Exchange, while the period under analysis is 1 January to 31 December 2004, i.e. one accounting period before the official implementation of IASs. The study shows that the decision-making process of firms is significantly influenced by the political cost concept and the intention to improve key financial measures, such as leverage, profitability and growth. Firms would tend to adopt an accounting policy or regulation when they feel that adoption would favourably impact on their financial situation. For example, the study indicates that large firms adopted IASs 1 and 21 early to show that they act in accordance with the accounting regulation and avoid political attention. The results show that firms that adopt IASs early tend to exhibit more favourable financial results compared to normal adopters. Similar findings are obtained for firms that distribute dividends, display higher management remuneration, increase their equity capital and use financial leasing. The requirement for quality accounting disclosures following the implementation of IAS 1 enhances the quality of financial reporting and does not lead to adverse financial implications for firms' financial performance.

1 Introduction

Positive accounting theory makes a number of predictions regarding the behaviour of firms. For example, Healy (1985) suggests that the flexibility allowable in financial reporting may make firms behave opportunistically. This would imply that firms might tune the timing of adoption of an accounting policy or regulation in order to influence the reported earnings and the stock returns (Hand and Skantz, 1998; Fields et al, 2001). Firms appear to be more inclined to disclose positive rather than negative accounting information (Chung et al, 2002). Therefore, they tend to influence their accounting numbers in order to meet their financial obligations and debt covenants and avoid political and regulatory costs (Lambert, 2001).

The study focuses on the accounting choices of firms listed on the London Stock Exchange, and determines whether their decisions following their financial and corporate goals improve their financial performance. The focal point of the study is the implementation of IASs, which is compulsory for listed firms that belong to member-states of the European Union. Given that the effective date for the adoption of IASs is 1 January 2005, the study shows that along with the firms that adopted within the official adoption period (normal adopters), there are firms that chose to adopt before the official period (early adopters), i.e. within the period January to December 2004. A crucial question is why managers would choose to time the adoption of an accounting standard, and what would the related financial impact be on firms' accounting numbers. The findings of this study have important implications for the extent to which a decision to time the adoption of IASs might conflict with the objectives of accounting standard setters.

In particular, the paper studies the presentation of financial statements under IAS 1 and tests for systematic differences among UK firms given their decision to adopt IAS 1 early or normal. The requirements of IAS 1 for quality accounting disclosures would tend to reduce the scope for judgement, subjectivity and earnings manipulation. At the same time, IAS 1 would enhance the quality of financial reporting and the efficiency of the stock market. A central question of the study is how the presentation of quality accounting statements impacts on firms' accounting numbers and financial position. Such information would be useful for the accounting standard setting process, particularly with regard to whether stricter financial reporting should be imposed (see Levitt, 1998).

The study also examines the decision of firms to time the adoption of IAS 21. IAS 21 deals with the accounting treatment of translation gains and losses and requires firms to recognise such differences in the balance sheet, while any transaction differences should be recorded in the income statement. The recognition of translation differences in the balance sheet would tend to reduce earnings volatility as well as the need to hedge translation exposure (Khoury and Chan, 1988). The sign of translation differences, however, might influence the timing of adoption. For example, firms with translation gains might not be inclined to adopt before the official adoption period in order to recognise them in the income statement and enhance their profitability.

The study also assesses the incentives of managers and the related effects on firm financial performance with regard to major accounting issues including dividend policy, management remuneration, the increase of equity capital and financial leasing. The main research question of the study is how the accounting choices of firms affect their financial behaviour and decisions, and whether firms' intention and driving force is to influence their key financial measures. The motivation of the study relates to whether a particular accounting

method/rule has real economic consequences, such that managerial decisions would need to be altered to minimise the adverse effects of the accounting change. The economic consequences of an accounting change could be mitigated by smoothing the accounting numbers and consciously timing the accounting change to suit the financial decisions of the firm (see Bazaz and Senteney, 2001).

The remaining sections of the study are as follows. Section 2 presents the literature review of the study. Sections 3 and 4 describe the research hypotheses and the data sets respectively. Section 5 discusses the empirical findings, and Section 6 presents the conclusions and implications of the study.

2 Literature Review

2.1 Firms' Behaviour and Accounting Disclosure

The quantity and quality of accounting disclosure varies from firm to firm (see Ball et al, 2000). Firms are usually more eager to disclose good information, while they tend to delay the announcement of bad information (Aboody and Kaznik, 2000). The provision of informative accounting disclosures leads to lower information asymmetry between user-groups as well as to the efficient allocation of resources in the stock market (Holthausen and Leftwich, 1983; Watts and Zimmerman, 1986). The reflection of firms' true and fair financial picture on stock returns will assist investors in their investment decision-making and financial analysts in making correct and unbiased earnings forecasts (Reilly and Brown, 1997).

Accounting policy choice is associated with contractual arrangements, such as compensation schemes and debt covenants (Han and Wang, 1998; Fields et al, 2001). It is also related to asset pricing, information asymmetry as well as to the reduction of political and agency costs (Dye and Verrecchia, 1995; Francis, 2001; Lambert, 2001). The incentives and accounting policy choice of managers appear to significantly affect the quality of accounting disclosure and the information that is conveyed to stock market participants (Fields et al, 2001). This implies that the behaviour of managers may some times be opportunistic and in contradiction to stakeholders' interests (Weil et al, 2006). Firms may defer revenue recognition into future accounting periods to reduce the current period's tax charge (Scholes et al, 1992). Managers that are entitled to stock options or bonus schemes tend to use discretionary accounting policies in order to enhance the value of their compensation of current and future periods (Healy, 1985; Watts and Zimmerman, 1990). Managers may also influence their accounting numbers in order to successfully abide by the requirements of accounting regulation or debt covenants that are embedded in their loan agreements (Sweeney, 1994; Han and Wang, 1998; Lambert, 2001). In a similar vein, they may be inclined to use income-increasing policies in order to positively influence their dividend payout and market value and give positive signals to investors (Easton and Harris, 1991; Kasanen et al, 1996; Fairchild, 2003). The above considerations would tend to apply especially in the case of large firms, which are politically and financially visible and would intend to smooth their earnings and improve their financial picture.

Managers may employ earnings management techniques in order to avoid or reduce political and agency costs, scrutiny, and primarily satisfy investors' expectations and financial analysts' forecasts (Levitt, 1998; Abarbanell and Lehavy, 2003). Firms may also manage the reported earnings and transfer income from "good" years to "poor" years in order to reinforce the stock returns (DeFond and Park, 1997; Maydew, 1997; Hand and Skantz, 1998). Earnings management can be achieved when the firm spreads certain types of revenues and expenses over different accounting periods, or classifies certain components of income between, for example, ordinary and extraordinary items. Earnings management also involves firm transactions appropriately structured in order to lead to a desirable result, as well as the timing of disclosing good and bad news and adopting accounting regulation and policies (early, normal and late) (Ronen and Sadan, 1981; Aboody and Kaznik, 2000). The determination of the timing of disclosure and adoption may relate to firms' financial goals and to the respective financial implications on firms' accounting numbers (Gaver and Gaver, 1998). It is noteworthy that the flexibility in financial reporting gives firms some leeway in the implementation of accounting standards, which may allow firms to select the most appropriate to their financial situation accounting policies or mitigate any adverse implementation effects. Hence, the flexibility in financial reporting may in certain cases enhance the scope for earnings management and subjectivity.

The factors that appear to affect the quality and detail of accounting disclosure are firm size, industry sector, stock ownership, stakeholder interests, international exposure, investors' expectations and other key financial variables, such as profitability, liquidity, financial leverage, growth, etc. (Lang and Lundholm, 1993; Healy and Palepu, 2001). Firms tend to provide voluntary disclosures when they plan to issue debt or equity or to acquire another company (Healy and Palepu, 1993, 1995). The reduction of information asymmetry following the provision of voluntary accounting disclosures would tend to reduce the related agency and political costs (Bushman and Smith, 2001) and lead to lower costs in issuing equity capital (Diamond and Verrecchia, 1991) and debt (Sengupta, 1998). Financial analysts' ratings appear to be positively associated with the amount of disclosure (Gigler and Hemmer, 2001). Firms that provide extensive disclosures tend to exhibit a significant appreciation in their stock returns (Blacconiere and Patton, 1994; Healy et al, 1999; Gelb and

Zarowin, 2002). Firms with bad news are generally more likely to provide voluntary disclosures and explanations to investors than firms with good news (Skinner, 1994). Firms are inclined not to disclose information that will damage their financial picture, even if this increases the cost of issuing new capital (Newman and Sansing, 1993; Gigler, 1994).

3 Research Hypotheses

3.1 Implementation of IAS 1

The effective date for the adoption of IASs for listed firms that belong to member states of the European Union is 1 January 2005. The analysis of the financial statements of the sample firms shows that a number of firms had adopted IAS 1 before the official adoption date (early adopters). In particular, 151 sample firms had adopted IAS 1 in the accounting period 01/01/2004 to 31/12/2004. The study focuses on the identification of the motives for early adoption and the related impact on firm financial figures. Hence, it assesses empirically the financial attributes of early adopters and normal adopters, i.e. those firms that adopted IAS 1 within the official adoption period. The study concentrates on the pre-official adoption period, i.e. 01/01/2004 to 31/12/2004. It is noteworthy that, under the period under investigation, normal adopters had not yet adopted IAS 1. Thus, the study essentially expresses to users of accounting information and firms that will subsequently adopt the IASs the likely effects of the implementation of IAS 1 on firm financial numbers.

The disclosure of high quality and transparent accounting information that reflects the true and fair firm financial picture is appreciated and rewarded by the stock market (Skinner, 1994). Hence, following the disclosure requirements of IAS 1 (as described in Section 2.2) and the related implications for firm accounts, the hypothesis that is tested is as follows:

H₁ Early adopters of IAS 1 are likely to exhibit more favourable financial measures than normal adopters.

The logistic regression that is employed uses a dummy variable as the dependent variable, which is dichotomous and takes two values, i.e. 1 for firms that adopt IAS 1 before the official adoption period and 0 for firms that adopt IAS 1 within the official adoption period. This categorisation is based on the examination of firms' financial statements and the identification of their timing of adoption of IAS 1.

3.2 Faithful Implementation of IAS 1

The paper studies how faithfully firms implement IAS 1 and meet requirements, such as the presentation of turnover and profits that come from continuing, discontinued and acquired operations, the disclosure of exceptional and extraordinary items above the line, the presentation of basic and diluted earnings per share, and the preparation of the statement of total recognised gains and losses and the reconciliation of movements in shareholders' funds. Here, the study examines the impact of IAS 1 on firms' financial performance and questions whether firms that faithfully implement IAS 1 exhibit better financial results than those that do not. The hypothesis is as follows:

H₂ Firms that faithfully implement IAS 1 are likely to exhibit better financial results compared to firms that do not fully comply with the requirements of IAS 1.

The dependent dummy variable in the logistic regression takes the following values: 1 for firms that faithfully implement IAS 1 and 0 for firms that do not fully comply with the requirements of IAS 1. This categorisation has been performed after close examination of the financial statements of the sample firms and is based on the extent to which firms satisfy the requirements of IAS 1, as described above, and prepare their financial statements accordingly, or either intentionally or not, choose to inadequately or partially follow and incorporate the provisions of IAS 1 into their accounting statements.

3.3 Disclosure of Profitability Layers

The number and type of profitability layers, e.g. profit before interest and tax, profit before exceptional items, operating profit, net profit, etc., that are disclosed in the income statement vary from firm to firm. This happens because some firms wish to provide investors with detailed disclosures of their accounting results and descriptions of revenues/expenses and gains/losses, while other firms provide brief accounting information to avoid regulatory inspection or hide unfavourable accounting figures. As described in Section 2, the stock market appreciates the disclosure of quality accounting information that describes the true and fair firm financial picture and help investors make correct decisions and predictions about firms' future financial prospects. Therefore, the stock market would be expected to value positively the presentation of multiple profitability layers in the profit and loss statement. Here, the study examines whether the disclosure of multiple profitability layers has a positive impact on firms' financial performance. The hypothesis is as follows:

H₃ Firms that disclose multiple profitability layers in the income statement are likely to exhibit better financial results compared to firms that present brief information on profitability figures.

The analysis of the sample shows that firms tend to display up to ten profitability layers in the income statement. The profitability layers that exhibit higher frequency are profit before tax, profit after tax, profit for

the financial year and retained profit. The dependent dummy variable in the logistic regression takes the following values: 1 for firms that disclose 6 to 10 profitability layers in the income statement and 0 for firms that disclose 0 to 5 profitability layers.

3.4 Dividend Policy

Based on their investment preferences and their risk and return profile, investors generally tend to expect a good potential capital gain on their investment and a good dividend as a reward for their trust in the firm. Hence, firms that distribute part of their profits as dividends to their shareholders give a positive signal to the stock market about their managerial ability and profitability. In a sense, firms would not pay dividends unless they could bear the cost. Firms would tend to adjust their dividend policy so as to satisfy investors' expectations and/or meet financial analysts' forecasts, in order to favourably affect their financial picture and attract more investors. It should be noted that firms that choose to retain and reinvest their profits do not necessarily give investors a negative signal, as long as they clearly clarify this in their financial statements and also describe the expected returns and impact of the reinvestment on their financial performance. The hypothesis is as follows:

H₄ Firms that distribute dividends to their shareholders are likely to exhibit better financial results compared to firms that do not distribute dividends.

The dependent dummy variable in the logistic regression takes the following values: 1 for firms that pay dividends and 0 for firms that do not pay dividends. Information on the dividend policy of firms has been collected from their financial statements.

3.5 Managers' Remuneration

Linking managers' remuneration to bonuses, stock options and other compensation schemes gives them a strong motive to increase their performance and productivity. It follows that managers would tend to be more careful in their decision-making and business administration in order to maintain their position and reinforce their compensation. On the other hand, in certain cases, managers may use earnings management techniques in order to positively influence their firm's accounting numbers and financial picture and finally their compensation arrangements. The hypothesis that is tested is as follows:

H₅ Firms with high managers' remuneration are likely to exhibit better financial results compared to firms with low managers' remuneration.

The dependent variable in the logistic regression is a dummy variable that takes the following values: 1 for firms with high managers' remuneration and 0 for firms with low managers' remuneration. The categorisation is based on the median of the observations obtained for the variable "management remuneration to total assets" (DREMTA).

3.6 Stock Returns

Based on how efficient the stock market is, the movements in stock returns tend to reflect the changes in firms' financial performance and position. The stock returns are affected by firm performance indicators as well as external market and economic factors. Firms that perform well would be expected to exhibit higher stock returns. Here, the study assesses the relation between firm financial numbers and stock returns. The hypothesis is as follows:

H₆ Firms with high stock returns are likely to exhibit better financial measures compared to firms with low stock returns.

The dependent dummy variable in the logistic regression takes the following values: 1 for firms with high stock returns and 0 for firms with low stock returns. The categorisation is based on the median of the variable "annual stock returns" (AR).

3.7 Changes in Equity Capital

An increase in the equity capital of a firm would be expected to reinforce its financial and business performance and improve its future potential and accounting measures. This of course would tend to lead to a higher required rate of return for investors, who would expect the increase in the equity capital of the firm to strengthen its cash flows and key financial figures and enable the firm to support its operating activities and fulfil its strategic plan. The use of the equity capital that is paid in, the related opportunity cost and the return on equity are strongly considered by the stock market and significantly affect investors' expectations and firms' stock returns. In contrast, firms with stable equity capital might not experience any significant change in their financial measures (to the extent that any such benefits have already been impounded into their accounting numbers), unless they find (or have found) alternative sources of financing their operations. The study, therefore, examines the impact of changes in equity capital on firms' financial performance. The hypothesis is as follows:

H₇ Firms that display an increase in their equity capital are likely to exhibit better financial results compared to firms with no change in their equity capital.

The dependent dummy variable in the logistic regression takes the following values: 1 for firms that exhibit an increase in their equity capital and 0 for firms with no change in their equity capital. Information on the changes of the equity capital of firms has been collected from their financial statements.

3.8 Financial Leasing

The financial lease transfers all the risks and rewards of ownership of an asset to the lessee. At the end of the lease contract, the lessee has the right to purchase the leased property for a price that is significantly lower than its expected fair value (bargain purchase option), or to continue to lease the asset after the end of the primary period for as long as they wish at a peppercorn rent. Financial leasing enhances the cash flow management, the conservation of capital, the flexibility of production capacity and continuity, in the sense that financial lease contracts cannot be terminated at anytime (see Blake et al, 1995). The use of financial leases leads to a smaller negative impact on the income statement compared to the purchase or simple rent option, and enhances off-balance-sheet-financing and particularly the use of economic resources that do not appear in the balance sheet. The main implications of financial leasing on firms' accounting numbers involve the capitalisation and recognition of the leased asset in the lessee's balance sheet and also the determination of higher return on asset and lower debt to equity and debt to asset ratios. The latter would in turn tend to significantly reinforce firms' creditability and enhance their financial performance and future prospects. Here, the study examines the impact of financial leasing on firms' financial measures. The hypothesis that is tested is as follows:

H₈ Firms that use financial leasing are likely to exhibit better financial results compared to firms that do not use financial leasing.

The dependent dummy variable in the logistic regression takes the following values: 1 for firms that use financial leasing and 0 for firms that do not use financial leasing. Information on the use of financial leasing has been collected from firms' financial statements.

4 Datasets

The sample consists of 262 UK companies that are listed on the London Stock Exchange. Information on firms' accounting policies and disclosure has been collected from firms' annual financial statements. The financial statements have been obtained from the "Financial Times Annual Report Service". Financial accounting data and stock returns have been collected from DataStream. The empirical analysis concentrates on the accounting period 01/01/2004 to 31/12/2004. The effective date for the adoption of IASs for listed firms that belong to member states of the European Union is 1 January 2005. The number of companies that adopted IASs in the official adoption period amounts to 109 (normal adopters). Firms that implemented the IASs before the official adoption period are 153 (early adopters). The analysis excluded banks, insurance, pension and brokerage firms because their accounting measures are not always comparable with those of industrial firms. The sample firms used in the study are from a number of industries including textile, retail, chemical and electrical firms (see Appendix 1). The accounting measures that are employed in the analysis are presented in Appendix 2.

5 Empirical Findings

5.1 Implementation of IAS 1

Table 1 (Panel A) shows that early adopters of IAS 1 tend to display higher leverage measures (TLSFU, IGEAR and CGEAR) compared to normal adopters. The higher financial leverage would tend to lead to higher financial obligations and interest charges for early adopters, which would in turn negatively affect their liquidity. Indeed, Panel A shows that early adopters exhibit lower liquidity (CUR and CFM). Despite the higher financial leverage, early adopters appear to be more profitable (OPM) than normal adopters. This may signify that early adopters may be profitable anyway and that they use borrowings to finance their operations and business plans. In spite of their higher profitability, early adopters appear to distribute lower dividend (DIVCOV) to their shareholders. In the light of their higher financial leverage and lower liquidity, early adopters may choose to pay lower dividend in order to retain and/or reinvest their profits and adequately meet their financial obligations. Even though the dividend payout is lower, the dividend per share growth ratio (DIVSHG) appears to be higher, which signifies the higher future potential for early adopters following their higher profitability. This may also be due to the higher borrowed capital of early adopters, which would be expected to enhance their future financial performance, if efficiently used. The results show, therefore, that *H₁* holds. The results of the K-W test (Table 2, Panel A) are generally similar, and show that early adopters display higher size, profitability, leverage, dividend payout and dividend per share growth ratio, while they exhibit lower liquidity and management payout.

TABLES 1 & 2

5.2 Faithful Implementation of IAS 1

Firms that present the reported accounting information in consistency with the requirements of IAS 1 and disclose the required accounting statements, such as the statement of total recognised gains and losses and the

reconciliation of movements in shareholders' funds, would tend to please investors and stock market authorities, and strengthen their stock market picture. This would in turn favourably affect firms' financial performance and stock returns as well as managers' bonuses and contractual arrangements. Indeed, Table 1 (Panel B) shows that firms that faithfully implement IAS 1 tend to exhibit higher stock returns (AR) and management payout (DREMTA) compared to firms that inadequately or partially follow IAS 1. Large firms would be expected to faithfully comply with IAS 1, in order to satisfy investors' and financial analysts' expectations and avoid political attention and scrutiny. Panel B shows that firms that faithfully implement IAS 1 are indeed larger (SALESHA). The specific firms are also found to display higher growth prospects (EPSG), implying that in order to please investors and lenders and obtain equity finance and/or borrowings to realise their growth plans, they appear to faithfully follow the requirements of IAS 1. Panel B indicates that the firms above would be inclined to faithfully abide by IAS 1 because of their higher leverage (CLSFU), implying that they would seek to give assurance to lenders that they meet the standard's provisions and that their financial statements are prepared accordingly. This would tend to enhance firms' credibility and reduce the associated financial risk, which would in turn reinforce firms' creditability and lower the cost of capital. In conclusion, the study shows that the faithful compliance with IAS 1 does not adversely affect the financial results of firms. In fact, such firms tend to display better financial figures. The results show, therefore, that H_2 holds. The results of the K-W test (Table 2, Panel B) show that firms that faithfully implement IAS 1 display higher dividend payout and profitability.

5.3 Disclosure of Profitability Layers

The disclosure of multiple profitability layers in the income statement tends to enhance firms' financial picture and creditability and attract investors and lenders. Table 1 (Panel C) shows that firms that disclose multiple profitability layers tend to be larger (SALESHA). Especially for large firms, which are politically and financially visible, the disclosure of detailed accounting information would in fact give positive signals to investors and other market participants, and make them less sceptical about their real financial performance and future prospects. With regard to financial leverage, Panel C shows that firms that disclose multiple profitability layers appear to exhibit lower current liabilities (CLSFU) and higher total liabilities (TLSFU), implying that long-term liabilities tend to be higher. The higher financial leverage tends to have a negative impact on firms' liquidity (CFSH and CUR), which appears to be lower. Despite the higher long-term leverage and the subsequent lower liquidity, firms' profitability (EPS and NPM) is not adversely affected and tends to be higher compared to firms that present brief information on profitability figures. This may also signify that profitable firms tend to disclose detailed accounting information to impress the stock market. In contrast, less profitable firms would tend to provide less detailed disclosures to avoid attention and scrutiny. Panel C also shows that firms' higher profitability enables them to distribute higher dividends (DIVSH) to shareholders, which would in turn tend to attract investors and improve their financial profile. In conclusion, the results show that H_3 holds. The results of the K-W test (Table 2, Panel C) are similar, and show that firms that disclose multiple profitability layers display higher size, profitability, leverage, dividend payout and dividend per share growth ratio, while they exhibit lower liquidity and management payout.

5.4 Dividend Policy

Table 1 (Panel D) shows that firms that distribute dividends to their shareholders tend to display higher leverage measures (DSFU and CLSFU) compared to firms that pay no dividends. The payment of dividends would tend to attract investors and equity capital and allow firms to make use of alternative and/or additional sources of finance given that they already use borrowings. Panel D shows that the specific firms tend to exhibit higher profitability (EPS) and liquidity (CFSH and QUI) measures, which do not appear to be adversely affected by the higher leverage. The higher profitability and liquidity measures would evidently tend to reinforce the ability of firms to pay dividends and also to adequately meet their financial obligations, including interest payments and debt covenants. Firms may borrow in order to reinforce their future financial potential, which in association with the higher profitability and the dividend distribution would tend to make their stock more attractive. Size would be expected to affect firms' dividend policy and be positively associated with dividend payout (Ndubizu and Tsetsekos, 1992). Following that they are more visible in the stock market, large firms would in fact tend to pay dividends in order to satisfy investors' expectations, positively influence investors' perceptions about their managerial ability and future prospects, and improve their stock market picture. Indeed, Panel D shows that firms that distribute dividends appear to be larger (RESTAS). In conclusion, the results show that H_4 holds. The results of the K-W test (Table 2, Panel D) are similar, and show that firms that distribute dividends are larger and exhibit higher profitability, liquidity, leverage and growth. Also, they display higher dividend payout and stock returns.

5.5 Managers' Remuneration

Table 1 (Panel E) shows that firms with high managers' remuneration tend to be larger (RESTAS) compared to firms with low managers' remuneration. Large firms are possibly better organised and structured and are able to facilitate the provision of bonuses, stock options and other incentive-based schemes. Given that managers tend to pursue the maximisation of their compensation (May, 1995), the provision of such schemes would tend to reinforce firms' productivity and quality, and subsequently improve the relationship between managers (agents) and shareholders (owners). Panel E also shows that the specific firms tend to display higher profitability (ROSC) and liquidity (CASH) and lower current liabilities (CLSFU), which enable them to pay higher compensation to managers. It is noteworthy that firms with high managers' remuneration also tend to exhibit higher stock returns (AR). It appears that the stock market appreciates the provision of bonus incentives to managers, the expected favourable impact on firm financial numbers and shareholders' wealth, the higher profitability and liquidity and the subsequent future prospects, and "rewards" them accordingly. The results presented above show therefore that H_5 holds. The results of the K-W test (Table 2, Panel E) are similar, and show that firms with high managers' remuneration exhibit higher profitability and liquidity, while they display lower leverage and dividend payout.

5.6 Stock Returns

Table 1 (Panel F) shows that firms with high stock returns tend to exhibit larger size (SALETAS). Due to their size and the attention that they might attract, large firms would tend to structure their decision-making or influence their financial numbers so as to meet investors' expectations and financial analysts' forecasts, and thus, positively affect their stock returns (Levitt, 1998). Firms with high stock returns also appear to display higher profitability (EPS). This would be expected following that the disclosure of higher profits in corporate financial reports tends to have a positive impact on stock returns (Burgstahler and Dichev, 1997). The specific firms also exhibit higher financial leverage (IGEAR), which appears not to adversely affect their profitability. The higher leverage may express firms' need for additional capital in order to facilitate their financial and investment arrangements or enhance their future prospects. On the other hand, investors' required rate of return would tend to increase because of the higher financial leverage, implying that the borrowing capital inflows and their utilisation would raise investors' expectations about firms' future financial performance and growth potential. The higher leverage appears to negatively affect managers' remuneration (DREMTA). This shows that in their effort to adequately meet their financial obligations and enhance their creditability and credibility, firms may choose to reduce managers' remuneration in order to reinforce their income statement and financial position. In conclusion, the results show that H_6 holds. The results of the K-W test (Table 2, Panel F) are generally similar, and show that firms with high stock returns exhibit higher profitability.

5.7 Changes in Equity Capital

Firms may choose to increase their equity capital in order to facilitate the expansion of their business operations or to smooth the progress of their investing and financing activities. Table 1 (Panel G) shows that firms that display an increase in their equity capital tend to display higher profitability (ROSC) and growth (EPSG) compared to firms with no change in their equity capital. This implies that they make good use of the additional equity capital, which appears to enhance their profitability and growth prospects. Despite the increase in their equity capital, the specific firms appear to need additional financing and to make use of borrowings. In particular, Panel G indicates that firms' need for financing tends to be short-term rather than long-term, as shown by the positive coefficient of current liabilities (CLSFU) and the negative coefficient of long-term liabilities (DSFU) respectively. Following their higher profitability, firms that display an increase in their equity capital also tend to exhibit higher liquidity (WCR) despite their higher current liabilities. In conclusion, the results show that H_7 holds. The results of the K-W test (Table 2, Panel G) are generally similar, and show that firms that display an increase in their equity capital are larger and exhibit higher profitability, liquidity, growth, stock returns, and dividend and management payout.

5.8 Financial Leasing

Firms that use financial leasing capitalise the leased assets and recognise them in their balance sheet, leading thus to higher total assets and market value compared to firms that do not use financial leasing. The higher total assets would tend to serve as a safety margin for lenders, especially when firms display higher financial leverage. In fact, Table 1 (Panel H) shows that firms that use financial leasing exhibit higher long-term liabilities (DSFU), while their current liabilities (CLSFU) appear to be lower. The higher long-term leverage may be linked to the use of financial leasing, since both are sources of finance, and therefore, signify firms' need to finance their operations. Also, the specific firms tend to be larger (SALETAS) and visible in the marketplace, and therefore, they may utilise financial instruments, such as financial leases, to improve their financial position and stock market picture. In comparison with the purchase or simple rent option, the use of

financial leasing leads to a smaller burden for firms' income statement and higher flexibility in their operating and financing activities. Indeed, Panel H provides evidence that firms that use financial leasing tend to display higher profitability (ROCE) as well as liquidity (CFSH) measures. The higher profitability and liquidity would allow the specific firms to pay higher dividends (DIVYI), and thus, draw the attention of investors. Hence, following the favourable impact on firms' financial statements, the use of financial leasing, as a means of financing, would tend to please the stock market and enable firms to attract equity finance when needed. The results presented above show therefore that H_8 holds. The results of the K-W test (Table 2, Panel H) are generally similar, and show that firms that use financial leasing exhibit higher size, growth, profitability, liquidity and leverage.

6 Conclusions

This study is concerned with the various dimensions of firms' behaviour and decision-making process in the light of their accounting policy choices and corporate priorities. The findings show that financial measures, such as leverage, profitability, liquidity and growth, affect the decision to adopt or defer the adoption of an accounting policy or regulation. It appears that firms tend to time the adoption of accounting regulation in order to influence their financial performance and suit their corporate plans. For example, early adopters of IAS 1 appear to display higher leverage measures compared to firms that adopted in the official adoption period, i.e. normal adopters. Following that IAS 1 enhances earnings stability and gives assurance to lenders about the validity of the reported accounting information, firms with higher leverage would be inclined to adopt early to favourably affect their financial situation. Similar considerations apply in the case of IAS 21, where normal adopters exhibit higher profitability, liquidity and lower leverage, implying that earlier adoption might not have been profitable or advantageous enough.

The results suggest that the implementation of IAS 1 has not led to adverse financial implications for firms' financial performance. In fact, early adopters tend to exhibit higher profitability and growth compared to normal adopters. Similar findings are obtained for firms that faithfully implement IAS 1. With regard to IAS 21, the recognition of translation differences in the balance sheet would tend to reduce earnings volatility, and thus, allow firms, such as early adopters, that display higher leverage to efficiently schedule the payments to their creditors and pay higher dividends. With regard to the early or normal adoption of IAS 21, the sign of translation differences may have influenced firms' accounting choices. For example, following their translation gains in the pre-official adoption period, normal adopters might have been inclined to adopt in the official adoption period and not earlier to record the translation gains in the income statement and strengthen their profits.

The study shows that the accounting policy choices and decision-making process of firms are significantly influenced by the political cost concept, and the intention to improve their stock market profile and financial numbers. This appears to hold especially for large firms, which are more visible in the stock market and seek to positively influence investors' perceptions about their managerial ability and future prospects. For example, the study indicates that large firms adopted IASs 1 and 21 early to show that they act in accordance with the accounting regulation and avoid political attention. Firms that disclose multiple profitability layers in the income statement, distribute dividends to their shareholders, provide bonus incentives to managers, increase their equity capital and use financial leasing generally appear to be larger and tend to exhibit positive financial results, in terms of profitability, liquidity, growth and dividend payout. In their effort to adequately meet their financial obligations and enhance their creditability, firms with high leverage may in certain cases choose to reduce managers' remuneration in order to reinforce their income statement and financial position. The findings show that besides borrowings, firms also consider the use of alternative sources of financing that may have less adverse financial implications, such as the increase of equity capital and financial leasing. The study shows that firms with positive financial results and growth prospects are positively valued by the stock market and are found to display high stock returns.

Notes

¹ The super exceptional items refer to restructuring costs, business termination costs and disposal of fixed assets.

² Future research should concentrate on the comparison between the international accounting system and the UK Generally Accepted Accounting Practice (GAAP) in general, or between specific IASs and UK Statements of Standard Accounting Practice (SSAPs) and Financial Reporting Standards (FRSs).

³ Although they appear to influence the timing of adoption and firms' financial performance, the study does not suggest that the decision to adopt early or normal is entirely based on the sign and size of translation differences. To do so would require that: (a) firms have an economic model that correctly predicts future exchange rates, and therefore the sign of translation differences; and (b) firms have the right mix of assets and liabilities denominated in the appropriate currencies.

⁴ The results that are obtained from the K-W test are not statistically significant, and therefore, they are not presented here.

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TABLE 1 Logistic regression analysis

Panel A: Implementation of IAS 1		Panel B: Faithful implementation of IAS 1		Panel C: Profitability layers		Panel D: Dividend policy		Panel E: Management remuneration	
Variables	Coefficients	Variables	Coefficients	Variables	Coefficients	Variables	Coefficients	Variables	Coefficients
EPSG	-2.8126 (2.241)	PEG	1.7175 (1.3635)	EPS	6.4366 * (4.0519)	NPM	4.4500 (4.3477)	RESTAS	5.3667 ** (2.3218)
DIVCOV	-1.7545 *** (0.6862)	CUR	0.9598 (0.6572)	ROSC	-5.6214 * (2.4606)	EPS	19.0000 *** (7.3159)	EPSG	0.6512 (0.5878)
DIVSH	-10.3060 (11.0037)	AR	831.1757 ** (435.0154)	CFSH	-8.6378 *** (2.4614)	ROSC	-3.0746 (1.9713)	NPM	-7.1231 (4.8347)
DIVSHG	7.0004 *** (2.8287)	SALESHA	2.0018 ** (1.1019)	CUR	-1.2571 ** (0.5607)	CFSH	2.3775 *** (0.9205)	ROSC	3.6083 * (1.9973)
OPM	111.7591 *** (37.2812)	EPSG	18.1489 * (12.4038)	WCR	0.0142 * (0.0066)	DSFU	3.5438 ** (1.7528)	CASH	2.3432 * (1.2208)
CFSH	1.9685 (2.0512)	SALETAS	-3.3131 (2.1352)	CLSFU	-1.3800 ** (0.6599)	TLSFU	-2.6634 ** (1.2747)	CLSFU	-0.4375 * (0.2677)
CUR	-3.0073 *** (1.0755)	DSFU	-0.9056 (0.6092)	TLSFU	1.5355 *** (0.6114)	QUI	3.2987 ** (1.4216)	AR	228.9559 * (137.441)
CFM	-39.7928 ** (17.0472)	CGEAR	-0.5932 (0.5558)	SALESHA	0.2494 ** (0.1243)	CASH	-8.1581 *** (2.2959)	Constant	-0.2051 (1.3422)
TLSFU	0.0965 ** (0.0548)	DREMTA	85.9723 * (59.475)	RESTAS	-4.6280 (2.3009)	RESTAS	6.0946 * (3.4238)		
IGEAR	1.1343 ** (0.6553)	DIVYI	122.0834 (82.7828)	EPSG	-1.4560 (0.7846)	DIVSHG	1.8868 (1.426)		
CGEAR	0.8074 *** (0.2795)	CLSFU	1.0683 * (0.7594)	PEG	-0.2976 (0.2113)	CLSFU	4.1272 ** (1.8245)		
Constant	6.1034 (2.4135)	Constant	-9.4976 (6.4729)	DIVSH	15.8879 * (7.8728)	CGEAR	-0.4522 (0.3267)		
				NPM	12.1494 ** (5.4234)	WCR	0.0112 (0.0088)		
				Constant	4.5778 (1.8031)	Constant	-3.1429 (2.0044)		
Model χ^2	50.2186 ***		15.9456 *		43.5772 ***		68.1766 ***		43.8795 ***
% correctly classified	90.6976 ***		95.5882 ***		81.9148 ***		95.2702 ***		78.7234 ***
Sample size	N ₀ =109, N ₁ =153		N ₀ =15, N ₁ =138		N ₀ =150, N ₁ =112		N ₀ =86, N ₁ =177		N ₀ =132, N ₁ =121

TABLE 1 Logistic regression analysis (cntd.)

Panel F: Stock returns		Panel G: Changes in equity capital		Panel H: Financial leasing	
Variables	Coefficients	Variables	Coefficients	Variables	Coefficients
SALESHA	-0.1873 (0.1033)	SALETAS	-0.67 (0.4434)	SALETAS	1.2615 * (0.7901)
SALETAS	1.5748 *** (0.6668)	EPSG	5.2725 *** (2.1334)	RESTAS	3.8035 (2.7422)
EPS	4.1906 * (2.3813)	ROSC	1.4811 * (0.8892)	NAVSH	-0.2511 (0.2309)
CFSH	-1.5032 (0.9873)	WCR	0.0465 ** (0.023)	DIVYI	195.5693 *** (71.8855)
CFM	1.7963 (2.0541)	CLSFU	1.0321 ** (0.4878)	DIVSH	-10.8373 (9.0101)
IGEAR	3.1704 * (1.7146)	DSFU	-0.798 * (0.4293)	ROCE	2.2524 ** (1.0435)
CGEAR	-0.1427 (0.1086)	Constant	0.8284 (0.6037)	ROSC	-2.5395 (3.2141)
DREMTA	-51.815 ** (26.6905)			CFSH	4.787 * (2.6736)
Constant	-0.5272 (1.0529)			CLSFU	-8.3376 * (4.6476)
				DSFU	8.4705 * (4.7624)
				CGEAR	-0.146 (0.1813)
				AR	-609.4277 (213.5719)
				Constant	-5.0087 (2.5552)
Model χ^2	22.6524 ***		28.077 ***		44.918 ***
% correctly classified	73.2558 ***		77.647 ***		91.8604 ***
Sample size	N ₀ =96, N ₁ =94		N ₀ =71, N ₁ =167		N ₀ =96, N ₁ =166

***, ** and * indicate statistical significance at the 1%, 5% and 10% level (two-tailed) respectively. All the explanatory variables were entered/removed from the logistic regression using a step-wise procedure with a p-value of 0.05 to enter and a p-value of 0.10 to remove. The Wald statistic was used to test the null hypothesis that each coefficient is zero.

TABLE 2 Kruskal - Wallis statistic

	Panel A: Implementation of IAS 1	Panel B: Faithful implementation of IAS 1	Panel C: Profitability layers	Panel D: Dividend policy
Variables	K-W statistic	K-W statistic	K-W statistic	K-W statistic
SALESHA	141.8207 ^a ***	73.8086 ^a	149.9550 ^a ***	149.4277 ^a ***
SALETAS	124.0276 ^a	72.5469 ^a	138.9550 ^a ***	132.4220 ^a ***
RESTAS	126.6569 ^b	75.8913 ^b	117.7928 ^b **	127.4318 ^a
NAVSH	153.6046 ^a ***	77.0326 ^a	149.9685 ^a ***	160.6250 ^a ***
EPSG	89.2600 ^b	55.3316 ^a	91.6910 ^a	88.8899 ^b
PEG	70.4895 ^a	40.5789 ^b	68.9044 ^a	71.0620 ^a **
DIVSHG	150.2059 ^a ***	78.1594 ^a	145.4054 ^a ***	158.1080 ^a ***
ROCE	110.3306 ^a	59.9907 ^b	105.9804 ^a	116.8288 ^a ***
OPM	141.2813 ^a ***	71.8031 ^a	131.0225 ^a	144.5552 ^a ***
NPM	139.2621 ^a ***	73.1094 ^a	129.3514 ^a	145.3873 ^a ***
EPS	159.0229 ^a ***	79.4746 ^a **	152.5856 ^a ***	165.4830 ^a ***
ROSC	151.3642 ^a ***	76.3259 ^a	152.5225 ^a ***	158.8218 ^a ***
CFSH	154.4605 ^a ***	77.2574 ^a	154.4864 ^a ***	160.2244 ^a ***
CUR	118.4106 ^b ***	74.0000 ^b	116.3000 ^b **	116.8140 ^b ***
QUI	115.2980 ^b ***	73.7761 ^b	112.7636 ^b ***	111.6802 ^b ***
CASH	115.6424 ^b ***	73.9291 ^b	113.0000 ^b ***	110.3779 ^b
CFM	137.0138 ^a ***	71.8425 ^a	126.5818 ^a	139.1503 ^a ***
WCR	116.9653 ^b	70.7440 ^a	127.7455 ^a	128.3000 ^a **
DSFU	108.1417 ^a ***	58.3832 ^b	104.5931 ^a	104.2752 ^a **
CLSFU	136.6954 ^a *	75.8060 ^a	145.9364 ^a ***	148.1802 ^a ***
TLSFU	143.9085 ^a ***	78.1522 ^a	151.2613 ^a ***	152.0284 ^a ***
IGEAR	113.1923 ^b ***	71.5000 ^a	103.0180 ^b ***	113.6273 ^b
CGEAR	147.0392 ^a ***	78.6087 ^a	144.0090 ^a **	142.0739 ^a
DREMTA	103.4567 ^b ***	75.5000 ^a	101.5660 ^b ***	103.6118 ^b
DIVYI	153.3170 ^a ***	79.3478 ^a **	152.5090 ^a ***	171.5028 ^a ***
DIVCOV	85.4385 ^b	53.3878 ^b	87.9894 ^a	88.4405 ^a **
DIVSH	98.3182 ^a ***	54.0361 ^a	87.0316 ^a	86.1786 ^a ***
AR	98.7302 ^a	57.8284 ^a	91.6452 ^b	98.9259 ^a **

TABLE 2 Kruskal - Wallis statistic (cntd.)

	Panel E: Management remuneration	Panel F: Stock returns	Panel G: Changes in equity capital	Panel H: Financial leasing
Variables	K-W statistic	K-W statistic	K-W statistic	K-W statistic
SALESHA	81.6757 ^b	96.0659 ^a	106.0769 ^b **	135.3201 ^a ***
SALETAS	120.8018 ^a	95.0549 ^a	107.4744 ^a *	136.0854 ^a ***
RESTAS	134.2810 ^a	93.9362 ^b	125.0898 ^a **	121.7078 ^b ***
NAVSH	81.9132 ^b	97.5213 ^a	115.0030 ^b	135.5693 ^a
EPSG	95.0082 ^a	92.3670 ^a	92.1330 ^a ***	87.7686 ^b
PEG	61.4565 ^b	68.7770 ^a	55.2471 ^b	72.4945 ^a **
DIVSHG	102.2934 ^b	101.8511 ^a	119.7455 ^a	134.2952 ^a
ROCE	91.4149 ^b	84.3784 ^a **	98.6957 ^a	113.9592 ^a ***
OPM	94.2613 ^b	92.2527 ^b	111.8526 ^b	118.5061 ^b
NPM	101.0901 ^b	96.8132 ^a	112.6667 ^a	118.9390 ^b
EPS	83.8967 ^b	103.9415 ^a **	114.5000 ^a *	139.2560 ^a **
ROSC	98.3182 ^a ***	99.6667 ^a	116.5000 ^b	138.6515 ^a
CFSH	81.6218 ^b ***	100.4309 ^a	114.2651 ^b	139.2030 ^a **
CUR	141.6446 ^a ***	90.8901 ^b	123.1386 ^a *	124.2683 ^b
QUI	147.9504 ^a ***	90.7473 ^b	123.6446 ^a **	124.2866 ^b
CASH	141.5785 ^a ***	93.5495 ^a	124.6747 ^a **	118.5244 ^b ***
CFM	93.8091 ^b ***	94.2418 ^a	111.6603 ^b	120.3804 ^b
WCR	121.9099 ^a	85.2472 ^b	115.5806 ^a	127.6420 ^a *
DSFU	75.8289 ^b ***	76.7532 ^b	89.3852 ^b	94.7153 ^b *
CLSFU	109.6777 ^b ***	97.0000 ^a	115.5783 ^b	143.2378 ^a ***
TLSFU	98.4628 ^b ***	96.9787 ^a	115.8323 ^b	141.7289 ^a ***
IGEAR	143.6750 ^a ***	89.7614 ^a	115.6149 ^a	127.8025 ^a
CGEAR	106.5124 ^b ***	96.2234 ^a	117.8443 ^b	142.5904 ^a ***
DREMTA	193.0000 ^a	89.4286 ^b	123.6104 ^a **	124.5031 ^b
DIVYI	95.0413 ^b ***	97.3351 ^a	111.0958 ^b	136.2319 ^a
DIVCOV	88.4364 ^a	84.9277 ^a	83.5196 ^a **	89.4526 ^a
DIVSH	50.4245 ^b ***	83.4286 ^a	73.9455 ^b	87.5905 ^a
AR	86.3485 ^b	143.4894 ^a	92.3186 ^a **	94.3770 ^b

***, ** and * indicate statistical significance at the 1%, 5% and 10% level respectively. ^a indicates that the mean rank of the Kruskal-Wallis (K-W) statistic is larger for firms that: Panel A: implement IAS 1; Panel B: faithfully implement IAS 1; Panel C: disclose multiple profitability layers; Panel D: distribute dividends; Panel E: exhibit high management remuneration; Panel F: exhibit high stock returns; Panel G: exhibit an increase in their equity capital; and Panel H: use financial leasing.

Appendix 1 Sample industrial sectors

<i>Industry</i>	<i>No of Firms</i>
Aerospace and defence	7
Automobiles	2
Beverages	4
Chemicals	15
Construction and building materials	17
Electricity	2
Engineering and machinery	11
Food and drug retailers	6
Food producers and processors	4
General retailers	9
Health	7
Household goods and textiles	7
Information technology hardware	8
Leisure entertainment and hotels	7
Media and entertainment	20
Mining	11
Oil and gas	18
Personal care and household products	2
Pharmaceuticals and biotechnology	14
Real estate	15
Software and computer services	27
Support services	31
Telecommunications services	4
Transport	9
Utilities	5
<i>Total</i>	<i>262</i>

Appendix 2 Accounting measures used as explanatory variables

<i>Size</i>	
SALESHA	Sales per share
SALETAS	Sales to total assets
RESTAS	Reserves to total assets
NAVSH	Net asset value per share
<i>Growth</i>	
EPSG	Earnings per share growth
PEG	Price to earnings growth
DIVSHG	Dividend per share growth
<i>Profitability</i>	
ROCE	Return on capital employed
OPM	Operating profit margin
NPM	Net profit margin
EPS	Earnings per share
ROSC	Return on shareholders' capital
<i>Liquidity</i>	
CFSH	Cash flow per share
CUR	Current ratio
QUI	Quick ratio
CASH	Cash ratio
CFM	Cash flow margin
WCR	Working capital ratio
<i>Leverage</i>	
DSFU	Long-term liabilities to shareholders' funds
CLSFU	Current liabilities to shareholders' funds
TLSFU	Total liabilities to shareholders' funds
IGEAR	Income gearing
CGEAR	Capital gearing
<i>Other variables</i>	
DREMTA	Management remuneration to total assets
DIVYI	Dividend yield
DIVCOV	Dividend cover
DIVSH	Dividend per share
AR	Annual stock returns
