Print ISSN: 2288-4637 / Online ISSN 2288-4645
doi:10.13106/jafeb.2021.vol8.no12.0153

Convergence with International Financial Reporting Standard and Its Effect on Stock Return: Evidence from Malaysia*

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Received: July 15, 2021 Revised: September 28, 2021 Accepted: November 01, 2021

Abstract

Convergence is the process of gradual adoption of a certain accounting standard issued by different regulatory bodies. The aim is to achieve uniformity and standardization across borders to open opportunities for international investment and collaboration. The implementation of IFRS, in theory, encourages more transactions by presenting financial statements in a simple and understandable manner for all investors and other businesses interested in the company. Using event study methodology, this study investigates whether Malaysian companies' adoption of IFRS is recognized by the investment community. A total of 89 public listed companies in Bursa Malaysia are involved in this study. The results show that about 62.8 percent of the companies that adopted IFRS-based financial statements experienced an increase in their average abnormal return after the announcement. However, the paired sample test results show that only 5.6 percent out of 89 companies studied experience a significant difference in abnormal return before and after the announcement. The inexistence of the average abnormal return difference between before and after the announcement may indicate that IFRS-based financial statements do not have any new market informational content. This study found little evidence to show that convergence with IFRS affects the company's stock price in Malaysia.

Keywords: Convergence, Financial Reporting, Abnormal Returns, IFRS

JEL Classification Code: E44, L1, M41

1. Introduction

The financial statement provides important information that is crucial for investment decision-making. A set of high-quality financial statements enables investors to obtain appropriate information to increase their decision-making confidence (Hameedi, Al-Fatlawi, Ali and Almagtome, 2021). There has recently been a push for global accounting standards and practices to be embraced by regulators, certification agencies, the accounting profession, business, and academic groups all around the world.

The differences in financial reporting standards and requirements create inconsistencies in financial reporting. International Financial Reporting Standards (IFRS) are a set of accounting standards that were developed by the International Accounting Standards Board (IASB), which is becoming the global standard for the preparation of public company financial statements (AICPA, 2013). Adopting the International Financial Reporting Standard (IFRS) could reduce problems associated with information asymmetry in the capital market. IFRS provides many benefits such as enhancing comparability, increasing transparency and financial reporting efficiency, and, hence, financial reporting quality. Horton and Serafeim (2009) found that adoption

***Acknowledgements:**
The authors would like to thank anonymous referees for their constructive comments on the earlier version of this paper.

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of IFRS alters investors' beliefs on stock prices, indicating IFRS's based financial statement gives new information to the market. In contrast, Klimczak (2011) found that the annual report does not produce unexpected information before or after adopting IFRS.

In the case of Malaysia, starting from 1st January 2012, the Malaysia Accounting Standard Boards (MASB) had imposed a full convergence of IFRS. However, companies in agriculture and real estate (Transitioning Entities) were permitted to defer its adoption until annual periods beginning or after 1st January 2015 (IASPlus, 2013). According to MASB, Malaysian companies are all set to adopt the global accounting standards by 2018.

Empirical studies on the impact of adopting IFRS on market behavior are still considered new and limited. Most research focuses on its effect on financial statements and ratios (Stent et al., 2010) or accounting quality (Paglietti, 2009). Only a few studies focus on the impacts of IFRS on a company's performance, particularly on stock market behavior. Therefore, this study intends to investigate whether the adoption of IFRS influences companies' stock returns in Malaysia.

2. Literature Review

Convergence is the gradual adoption of a certain accounting standard issued by different regulatory bodies, such as adopting IFRS. Many scholars have studied this convergence and its relation to several factors, such as politics or technological change. Hassel and Beyer (2001) found that convergence can be explained by the increasing orientation of firms towards the international financial markets and the increasing importance of a market of corporate control.

Convergence aims to achieve uniformity and standardization across borders, opening opportunities for international investment and collaboration. At the same time, convergence is also made to improve the quality of accounting standards through consistency, comparability, and efficiency of financial statements (Topazio, 2008).

Differences in financial reporting standards create inconsistencies in financial reporting. Due to this, the International Accounting Standards Board (IASB) created the International Financial Reporting Standards (IFRS), which is becoming the global standard for preparing public company financial statements (AICPA, 2013).

The effect of new accounting standards must be considered against the desired results. Daske (2008) examined the economic consequences of mandatory IFRS worldwide and found that liquidity and equity market valuation increased during the introduction of mandatory IFRS. However, there is mixed evidence on its effects on the cost of capital. Klimczak (2011) found no evidence of abnormal returns before, during, or after adopting the IFRS, while Horton and Serafeim (2009) found that mandatory IFRS adoption alters investors' beliefs on stock prices.

The mechanistic and no-effect hypotheses anticipate the relationship between a change in accounting technique and stock prices (Kabir, 2010). According to the mechanistic hypothesis, market reaction is based on the impacts of change in accounting method on corporate earnings. If the change in accounting method leads to an increase in profits, it means that the market reacted positively.

On the other hand, according to the no-effect hypothesis, market reaction is based on the impact of accounting method changes on company cash flow (company value). If the change in accounting method leads to improved earnings but cash flow does not increase, it means that the market did not react. If the change in accounting method leads to improved earnings and cash flow increase, the market reacted positively.

There are several studies that investigated the relationship between financial information and trading volume (Ha and Kang, 2019). Bamber (1986) found that the most fundamental element related to stock valuation is new information provided. Meanwhile, Beaver (1973) noted that a volume is a useful tool for determining how much disagreement occurs by the arrival of new information. Chen and Sami (2008) examined how short-term trade volume reacted to International Accounting Standards (IAS) reconciliation (IAS). They found that U.S. investors incorporated information contained in earnings reconciliation from IAS to U.S. GAAP into their trading decisions, particularly in the short term.

3. Research Methodology

In this paper, the impact of IFRS on the company's stock return is tested using event study methodology. Through the event study methodology, abnormal movements in market prices around the time of accounting statement publication would be identified. Such price movements can be interpreted as evidence of market reaction to the new information provided by IFRS-based reporting.

This paper adopts the event study timeline as used by Hussain and Hasan (2010). In their study, Hussain and Hasan set 205 trading day periods prior to the event window as estimation period, with 11- day event window comprising 5 pre-event days and five post-event days. The event window is when the company announces its financial statement; hence, the publication date is the even date ($t = 0$).

The study was conducted on 913 public listed companies registered with Bursa Malaysia. Out of 913 companies, only 803 have published annual reports. Only 210 of the 803 annual reports produced comply with the International Financial Reporting Standards (IFRS). It is also important to eliminate the announcements of IFRS from being tainted by another event. Therefore, companies that practice a stock split, share buyback, dividend payment, organizational change, merger, and acquisition are excluded from the samples. Finally, only 89 companies were involved in this study.

The impact of IFRS reporting on market prices is evaluated through the company's stock abnormal return. The abnormal return (AR_{it}) is calculated as the difference between the actual return (R) and the expected return ($E(R_{it})$). The abnormal return during the event window is interpreted as a measure of the impact of the publication of IFRS-based financial statements on market behavior.

The expected return, $E(R_{it})$, is used as the benchmark return in a normal situation. Similar to The expected returns are estimated using the following model in this study.

$$(R_{it}) = \alpha + \beta_i R_{mt}$$

where, $E(R_{it})$ is the expected return of security i on period t, and R_{mt} is the market return of portfolio i on period t. Coefficients αi and βi are obtained by regressing actual and market returns using the ordinary least-square (OLS) method.

In the estimation process, daily stock price data and market daily stock data from January 2012 to November 2013 was used (205 days until five days before the announcement). The data was obtained from Bursa Malaysia Knowledge Centre. The actual return for each sample is calculated using the following formula.

$$R_{it} = \frac{t - P_{it} - 1}{P_{it} - 1}$$

R_{it} is the actual return of stock i in period t, P_{it} is the price of stock i in period t, and $P_{it}-1$ is the price of stock i in period $t-1$. Meanwhile, the daily market return (R_{mt}) is obtained by comparing the closing index in period t ($KLCI_t$) with the closing index in $t-1$ ($KLCI_t-1$). The market index used in this study is FBMKLCI; the calculation is as follows:

$$R_{mt} = \frac{KLCI_t - KLCI_{t-1}}{KLCI_{t-1}}$$

There are several statistical tests involved in this study. First, the normality test is conducted to determine whether the abnormal return of the company is normally distributed or not. The Shapiro-Wilk test will be used to detect any deviations from normality. Then, a paired sample test will be performed to check whether there is a significant difference in the company's abnormal return before and after the announcement of IFRS-based financial reporting. If the normality test on abnormal return shows that the data is normally distributed, a paired sample t-test will be used. If it is not normally distributed, a non-parametric Wilcoxon test will be used.

4. Results

In brief, changes in average abnormal return before and after can be categorized into seven categories: (1) from negative to negative but increase; (2) from negative to negative and decrease; (3) from positive to positive and increase, (4) positive to positive but decrease; (5) negative to positive, (6) positive to negative, and (7) unchanged.

From a total of 89 companies studied, 17.9 percent experienced a change in their average abnormal return before and after the announcement, from negative to negative but increased, 7.8 percent from negative to negative and a decrease, 14.6 percent from positive to positive, and an increase, and 6.7 percent from positive to positive but decrease.

After the announcement, the majority of companies (30.3 percent) show an increase in their average abnormal return from negative to positive. In comparison, 20.2 percent of companies experienced a decrease in average abnormal returns, from positive to negative. Only 2.2 percent did not find any change. In summary, about 62.8 percent of the companies that adopted IFRS-based financial statements experienced an increase in their average abnormal return after the announcement.

In the next step, the normality test was conducted to determine whether the distribution was normally distributed or not. The test result found that 32 companies' abnormal returns are not normally distributed. Subsequently, a non-parametric approach Wilcoxon test was performed. Meanwhile, for the normally distributed data (57 companies), a paired sample t-test is used. The purpose is to test whether there is a significant difference in the company's abnormal return before and after the announcement of the IFRS-based financial statement. The results from the paired sample t-test and Wilcoxon test are presented in Table 1 and Table 2.

The results from paired sample t-test in Table 1 show only in the case of two companies, the abnormal returns

Table 1: Paired Sample Tests on Abnormal Return

Company	*t*-value	Sig.	Company	*t*-value	Sig.
AFFIN HOLDINGS	−1.558	0.194	DKSH HOLDINGS (*M*)	−1.740	0.157
AL-`AQAR	1.417	0.230	EASTLAND EQUITY	−0.029	0.978
AMANAH HARTA	−1.508	0.206	EXCEL FORCE MSC	−3.297	0.030*
AMANAHRAYA REIT	0.541	0.617	FORMOSA PROSONIC	−0.695	0.525
AMWAY (*M*)	−0.038	0.971	FEDERAL FURNITURE	1.087	0.338
APFT BERHAD	−0.692	0.527	FOCUS LUMBER	0.791	0.473
ASIA MEDIA GROUP	1.082	0.340	HARVEST COURT	−1.039	0.357
AXIS REIT	0.196	0.854	HB GLOBAL LIMITED	−0.023	0.983
BP PLASTICS HOLDING	−0.037	0.972	HEKTAR REIT	−1.181	0.303
CAPITAMALLS	−0.746	0.497	HWA TAI IND	0.454	0.673
CHUAN HUAT	2.914	0.043*	IGB REIT	−1.376	0.241
COCOALAND	−0.818	0.460	IHH HEALTHCARE	1.181	0.303
CSC STEEL HOLDINGS	0.624	0.566	JADI IMAGING	0.057	0.957
CYCLE & CARRIAGE	−0.332	0.757	JT INTERNATIONAL	0.005	0.996
KIA LIM BERHAD	−0.315	0.769	PETRA ENERGY	0.160	0.881
KPS CONSORTIUM	0.415	0.700	PMB TECHNOLOGY	1.519	0.203
KSK GROUP	0.492	0.649	PREMIER NALFIN	−0.085	0.936
LANDMARKS BERHAD	−1.050	0.353	RHB CAP	−1.778	0.150
LEBTECH BERHAD	0.089	0.933	SARAWAK CABLE	0.243	0.820
LPI CAPITAL BHD	−1.670	0.170	SEALINK INT	0.735	0.503
LUSTER INDUSTRIES	0.818	0.459	TA WIN HOLDINGS	0.052	0.961
MALAYAN BANKING	−1.233	0.285	TANJUNG OFFSHORE	−1.425	0.227
MBM RESOURCES	−0.131	0.902	TEXCHEM	1.564	0.193
METRONIC GLOBAL	−0.338	0.752	TH HEAVY ENG	−0.501	0.643
MIECO CHIPBOARD	0.796	0.470	TOMYPAK HOLDING	1.769	0.152
NCB HOLDINGS	1.445	0.222	TRADEWINDS	−0.351	0.743
PAN MALAYSIA	−0.255	0.811	TRIUMPHAL	−0.024	0.982
PAVILION REIT	−0.169	0.874	WAWASAN TKH	−0.445	0.679

*Significance level 5% percent levels.

before and after the announcement are statistically significant. Meanwhile, the results from the Wilcoxon test in Table 2 show that only three companies are significant. In total, only five companies experienced a significant difference in abnormal returns before and after the announcement. This is about 5.6 percent of a total of 89 companies studied.

5. Discussion and Conclusion

This paper investigates the effect of convergence with international financial reporting standards on the company's stock return using event window methodology. A total of 89 public listed companies on Bursa Malaysia are involved in this study. The analysis results show that the majority of companies experienced an increase in their abnormal return after the announcement of IFRS-based financial statements. Further analysis, however, found that only five are statistically significant. The findings from this study are consistent with Klimczak (2011), who found that annual report publication does not produce unexpected information either before, during, or after the adoption of IFRS.

The inexistence of the average abnormal return difference between before and after the announcement may

Table 2: Wilcoxon Signed Rank Test on Abnormal Return

Company	Sig.	Decision	Company	Sig.	Decision
AL HADHARAH	0.225	Not Significant	HOCK HENG	0.893	Not Significant
APEX HEALTHCARE	0.500	Not Significant	INDUSTRONICS	0.686	Not Significant
ATRIUM	0.500	Not Significant	LCTH CORP	0.686	Not Significant
ATURMAJU	0.500	Not Significant	LEN CHEONG	0.225	Not Significant
BTM RESOURCES	0.500	Not Significant	MAJOR TEAM	0.893	Not Significant
CAM RESOURCES	0.686	Not Significant	MALAYSIA PACKAGING	0.500	Not Significant
CCM DUOPHARMA	0.893	Not Significant	MALAYSIA SMELTING	0.043	Significant*
CHINA OUHUA	0.043	Significant*	MISC BERHAD	0.138	Not Significant
CLASSIC SCIENIC	0.686	Not Significant	MULTISPORTS HOLDING	0.500	Not Significant
DUFU TECHNOLOGY	0.893	Not Significant	PENTAMASTER	0.500	Not Significant
DUTCH LADY	0.893	Not Significant	PUBLIC BANK	0.080	Not Significant
EKOWOOD	0.345	Not Significant	RGB	0.500	Not Significant
EMAS KIARA INDUSTRIES	0.138	Not Significant	SIG GASES	0.345	Not Significant
FSBM HOLDING	0.043	Significant*	SINOTOP	0.686	Not Significant
GLOBAL CARRIERS	0.500	Not Significant	SUMATEC	0.500	Not Significant
GOLDEN PHAROS	0.138	Not Significant	SYARIKAT TAKAFUL	0.686	Not Significant

*Significance level 5% percent levels.

indicate that IFRS-based financial statements do not have any new market informational content. This result also could be a sign that investors already anticipate the event of the announcement. It is also a sign that investors perceive IFRS as a non-important parameter to their decision. This result is aligned with Azmi (2011) who stated that Malaysia's story of convergence has been a 'slow and steady' approach. Additionally, Malaysia announced convergence into IFRS in 2012 and issued a new accounting framework, the Malaysian Financial Reporting Standard (MFRS). This resulted in confusion between investors, as reported in the Malaysia edition of Accounting and Business Magazine in May 2012.

In conclusion, although previous research such as Armstrong et al. (2008) and Lee, Lee, Choi and Kim (2020) found that investors perceived net benefits associated with IFRS adoption, this study shows that IFRS had no impact on investors' demand for Malaysian companies' equity.

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