1 Introduction

1.1 Motivation and scope

Over the last decade, international financial reporting underwent several profound changes in reporting harmonization – the most important being the rise of International Financial Reporting Standards (IFRS) as the globally predominant accounting regime.

Indeed, as of April 2011, 118 countries either require or permit the use of IFRS for listed companies in their domestic markets (IAS Plus, 2011). By the end of 2011, it is projected that the majority of Global Fortune 500 companies will employ IFRS (Deloitte, 2010). All major economies that have not yet introduced IFRS have established time lines to converge with or adopt IFRSs in the near future, which is further supported by the Group of 20 Leaders (G20) (IFRS Foundation, 2011a). Of particular importance is the convergence project between the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB). By June 2011, also the last remaining three major convergence projects are targeted to be completed (FASB and IASB, 2009).¹ Later in 2011, the U.S. Securities and Exchange Commission (SEC) will make their decision on the use of IFRS by U.S. domestic companies (Securities and Exchange Commission (SEC), 2010), after having accepted financial statements in accordance with IFRS without reconciliation to U.S. GAAP from foreign private issuers since 2008 already.

In general, the objective of the IASB is to provide a “single set of high quality, understandable, enforceable and globally accepted” standards (IFRS Foundation, 2011b). Participants supporting and promoting the worldwide implementation of such standards expect benefits for companies and investors in several critical

¹From the 10 major projects that were originally identified as the joint programme in the 2006 Memorandum of Understanding, the IASB and the FASB have only three major projects remaining to be completed – revenue recognition, leasing, and financial instruments.
ways. For instance, when introducing the IAS regulation, the European Commission (2002) articulated the expectation that it would ‘help eliminate barriers to cross-border trading by ensuring that company accounts are more reliable, transparent, and comparable’. In turn, these accounting reforms, it was thought, would increase market efficiency and reduce the cost of raising capital for companies. Only recently, IASB Chairman, David Tweedie, articulated that “global accounting standards will enhance the drive towards the free trade of capital internationally” and that “all companies – large and small – are able to attract capital from a larger pool of investors, driving down the cost of capital and facilitating cross-border mergers and acquisitions activity and strategic investments” (Tweedie, IASB Chairman on March 10, 2011).

With IFRS emerging as the globally dominant standard, however, also more implementation-oriented questions are raised in the context of international financial reporting.

One prominent question is which role enforcement plays in realizing the expected economic benefits from introducing IFRS. Typically, national regulations regarding the monitoring of compliance with the applicable reporting standards and providing appropriate measures in case of infringements differ quite substantially. In turn, the variation in enforcement of international financial reporting is associated with distinct economic consequences regarding, e.g., earnings management or market valuation of affected companies. Therefore in Europe, the “IAS Regulation” (EC, 2002: No. 1606/2002) not only prescribes the application of IFRS for publicly traded companies, but also requires all EU Member States to install effective mechanisms for the enforcement of IFRS.

Another widely discussed topic in international financial reporting over the last decade has been the level of mandatory disclosure that firms should follow when reporting under IFRS. Effective in 2007, the European Commission adopted a Directive to increase the transparency of financial reporting in Europe. Unlike other directives, the “Transparency Directive” (2004/109/EC) is not a “maximum harmonization” directive. Member states can set requirements above the minimum level envisaged in the directive, e.g., with respect to the frequency of interim reporting. This can be seen as a compromise after several countries (e.g., UK, Denmark, and the Netherlands) had objected to further harmonized regulation regarding minimum publication requirements for companies publicly-traded in the EU. As a result, for
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instance, the Transparency Directive requires firms only to disclose “Interim Management Statements” (IMS) – instead of full quarterly reports like in the U.S.

From an academic point of view, however, it remains an open question whether the purported benefits touted by supporters of harmonizing international financial reporting have actually materialized – be it in terms of IFRS adoption effects, whether the reforms in enforcement mechanisms have paid off, or how, in turn, leaving certain choices in the implementation of disclosure regulation could actually level the playing field at all.

The purpose of this dissertation is to analyze the economic implications of major regulation changes in international financial reporting by examining three critical aspects: first, the introduction of IFRS as the internationally common accounting standard; second, the role of consistent enforcement mechanisms in realizing the benefits of IFRS; and third, the implications of leaving national discretion regarding interim reporting frequency. These three topics are analyzed based on 5 separate papers that each individually contribute to the discussion and debate regarding the benefits and costs of international financial reporting harmonization.

In the first part of this thesis, Papers I–III assess the general economic consequences of IFRS adoption, comparing the cost of equity capital differences of IFRS firms with firms that apply domestic or U.S. GAAP standards. The key paper on this topic is The German Accounting Triad – “Accounting Premium” for IAS/IFRS and U.S. GAAP vis-à-vis German GAAP? (Paper I), which compares the cost of equity capital differences between IFRS, U.S. GAAP and German GAAP firms. The paper makes use of the unique setting in Germany before 2005, where all three different types of accounting regimes could be analyzed in the same homogeneous institutional setting. Papers II and III represent more detailed analyses (or robustness tests”) on specific choices of how to assess the economic consequences of IFRS adoption in Paper I. The paper The Value and Accounting Premium for South African-listed Shares (Paper II) tests whether the “accounting premium” for IFRS also exists outside Germany, looking at South Africa as another case of early IFRS adoption and documenting cost of equity capital differences compared to domestic GAAP firms. The paper Das Fama-French-Modell: Eine bewährte Alternative zum CAPM – auch in Deutschland (The Fama-French model: A proven alternative to the CAPM – in Germany as well) (Paper III) provides more background on how to measure cost of equity capital differences in general and specifically tests the different performance of the CAPM
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and Fama-French model for a “naive” industry classification unwinding the “sorting portfolio” assumption, all in the institutional setting at hand, i.e. Germany.

The second part of this dissertation deals with the specific question of how enforcement regulation influences the economic consequences of IFRS (Economic Consequences of Accounting Enforcement Reforms: The Case of Germany, Paper IV), looking at recent enforcement reforms in Germany. The objective of these reforms was to promote a consistent and faithful application of accounting standards, which is associated with reducing earnings management as well as improving stock liquidity and market valuation.

The third part discusses how the frequency (quarterly vs. semi-annually) and type (voluntary vs. mandatory) of disclosure leads to different “business effects” within international financial reporting (The Real Business Effects of Quarterly Reporting, Paper V), i.e., myopia-induced deviations from normal operational practices through real activities manipulation. The focus lies on the resulting economic differences of leaving discretion on the introduction of mandatory quarterly reporting to the individual EU member states.

The remainder of this dissertation proceeds as follows. Section 1.2 gives a short summary on the individual papers as well as publication details, before chapters 2 to 6 present the five research papers in all detail.

1.2 Summary and publication details

This dissertation is a cumulative work that consists of five separate papers in the context of “International Financial Reporting – Economic Consequences of IFRS Adoption, Enforcement Reforms, and Interim Reporting Frequency”. In this section, each of the individual papers is briefly summarized. Moreover, publication details – including presentations on international conferences – are given.

Paper I: The German Accounting Triad – “Accounting Premium” for IAS/IFRS and U.S. GAAP vis-à-vis German GAAP?
Co-author: Jürgen Ernstberger
Abstract: This paper critically examines the impact of voluntary adoption of Internationally Accepted Accounting Principles (IAAP, i.e. IAS/IFRS and U.S. GAAP) on the cost of equity capital in Germany. We find that (1) overall cost of equity capital
estimates in the Capital Asset Pricing Model (CAPM) for companies applying IAAP are significantly lower compared to those applying German GAAP, (2) an enhanced multifactor model which incorporates the accounting regime differences (called “GM model”) absorbs the cost of equity capital differences, and (3) changes of the institutional background in Germany and of the accounting standards lead to different cost of equity capital effects for sub-periods of the 1998–2004 voluntary adoption period, while particularly controlling for effects like self-selection, cross-listing, and New Market (Neuer Markt) listing. The central thesis advanced in this paper is that changes in the accounting standards and the institutional infrastructure can influence the impact of applying IAAP. Therefore, we suggest to incorporating an accounting factor into the cost of equity capital analysis.

**Keywords:** Accounting regime adoption, cost of equity capital, multifactor model, IFRS, U.S. GAAP, Germany.

**Publication details:** Published in *The International Journal of Accounting*, 43 (December 2008), 339–386. A previous version of this paper was presented at the Illinois International Accounting Symposium held at the University of Hawai’i at Manoa, U.S. (June 2007), as well as at the 31st Annual Congress of the European Accounting Association in Rotterdam, NL (April 2008). The paper was granted the ERIM Best Paper Award in “International Financial Accounting”.

**Paper II: The Value and Accounting Premium for South African-listed Shares**

**Co-authors:** Jürgen Ernstberger, Christian Heinze

**Abstract:** In the last decade, empirical research has found strong evidence that value stocks provide higher returns than growth stocks (value premium). Firms with a high ratio of the book value of equity to the market value of equity are regarded as value stocks; a low ratio identifies growth stocks. Most research is tailored to the market in the United States of America. Only a few studies consider country-specific distinctions. This research analyses the value premium for the South African market and compares its magnitude to the findings for the U.S. market. Moreover, the effects of the introduction of IFRS for companies listed at the JSE Limited are examined. The adoption of IFRS is used to demonstrate that investors award an accounting premium for voluntary compliance with this new accounting standard.

**Keywords:** Value premium, accounting premium, South Africa, asset pricing, Fama-French model, multi-factor model.
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Publication details: Published in the *Journal of Economic and Financial Sciences*, 2 (October 2008), 187–202. A previous version of this paper was presented at the Value 2008 conference held at Sun City, SA (May 2008).

Paper III: Das Fama-French-Modell: Eine bewährte Alternative zum CAPM – auch in Deutschland (The Fama-French model: A proven alternative to the CAPM – in Germany as well)


Keywords: Bewertung, Fama-French-Modell, CAPM, Eigenkapitalkosten.

Publication details: Published in the *FinanzBetrieb*, 11 (Juli/August 2009), 382–388.

Paper IV: Economic Consequences of Accounting Enforcement Reforms: The Case of Germany

Co-authors: Jürgen Ernstberger, Michael Stich

Abstract: This study investigates recent reforms of financial reporting enforcement in Germany. The objective of these reforms was to promote a consistent and faithful application of accounting standards. Conducting multivariate analyses, we find a significant decrease in earnings management, a significant increase in stock liquidity, as well as limited evidence for an increase in market valuation for the companies that fall under the new enforcement regime. We document that companies that are characterized by an overall low level of enforcement through other internal and external mechanisms are particularly affected by these reforms. In our analyses, we carefully control for effects of the mandatory IFRS adoption in Europe as well as for various other effects arising from the application of different accounting principles. Our results hold for different research designs, including a difference-in-differences approach and a matched sample approach. We conclude that the enforcement reforms..
in Germany have leveled the playing field in the enforcement of financial reporting and have enhanced the trust in financial reports of the affected companies.

**Keywords:** Enforcement, regulation, IFRS, earnings management, stock liquidity, market valuation.

**Publication details:** Revise and resubmit (4th and final round) in the *European Accounting Review*. Previous versions of this paper were presented at the American Accounting Association (AAA) Annual Meeting in Anaheim, U.S. (August 2008), at the AAA Annual Meeting in New York, U.S. (August 2009), at the 32nd Annual Congress of the European Accounting Association (EAA) in Tampere, FI (May 2009), as well as at the 33rd Annual Congress of the EAA in Istanbul, TR (May 2010).

**Paper V: The Real Business Effects of Quarterly Reporting**

**Co-authors:** Jürgen Ernstberger, Benedikt Link

**Abstract:** We examine the real business effects associated with different interim reporting frequency regimes. Specifically, we investigate the impact of voluntary and mandatory quarterly reporting on real earnings management (REM), i.e., the deviation from normal operational practices through real activities manipulation. We hypothesize that mandatory (voluntary) quarterly reporting is associated with higher (lower) REM compared to semi-annual reporting. Using a sample comprising 15 countries from the European Union (EU) that provide a unique regulatory setting of both mandatory and voluntary quarterly reporting regimes, we find that mandatory quarterly reporters exhibit significantly higher REM compared to semi-annual reporters. This effect is particularly strong when company performance is below industry average, accounting earnings management is high, analyst coverage is low, and in countries with low minority shareholder protection (“suspect firm-years”). In contrast, voluntary quarterly reporting is associated with lower REM compared to semi-annual reporters in “non-suspect firm-years”, suggesting that primarily “good” firms voluntarily increase their disclosure frequency. In suspect firm-years, however, voluntary quarterly reporters exhibit disproportionally higher and thus comparable REM levels to semi-annual reporters. This indicates that “good” firms need to significantly increase REM levels under adverse conditions suggesting that the higher disclosure level becomes a burden. In line with expectations, mandatory quarterly reporters consistently exhibit higher REM compared to voluntary quarterly...
and semi-annual reporters across all settings underlining the evidence for reporting frequency-induced REM in mandatory regimes.

**Keywords:** Interim reporting, quarterly reporting, real business effects, real earnings management, international accounting, management myopia.

**Publication details:** Working Paper. This paper was presented at the AAA Mid-Year Meeting of the International Accounting and Financial Accounting and Reporting Sections in Tampa, U.S. (February 2011) and was afterwards discussed with 21 Accounting Professors at 10 U.S. Business Schools (among others, Chicago Booth School of Business, Harvard Business School, Kellogg School of Management, MIT Sloan School of Management, The Wharton School). The paper was granted the AAA Best Paper Award in International Accounting.