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Diversity in IFRS reporting: The Case of Japanese subsidiaries and Australian Peer Companies

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This study investigates financial reporting during 2000–2010 for unlisted, 75 Japanese subsidiary companies and 189 Australian peer companies. The results show that the adoption of International Financial Reporting Standards was not always effective in reducing financial reporting diversity.

Keywords: International Financial Reporting Standards (IFRS); Financial reporting diversity; Japan; Australia

JEL Codes: M40; M41

1. Introduction

The purpose of this study is to examine whether the adoption of International Financial Reporting Standards (IFRS) was effective in decreasing the financial reporting diversity for the firms with Japanese legal code or traditions and the firms with the common-law legal code or traditions in Australia.

Japan is classified as one of the code-law countries which tend to resolve social problems through government ownership and mandates (La Porta et al., 2008, p. 310). In 2005, the Committee of European Securities Regulator[1] (CESR) announced that Japanese generally accepted accounting principles (GAAP) were significantly different from IFRS in relation to 26 issues[2] (Financial Services Agency, 2005; CESR, 2005). A question arises as to whether the financial reporting for Japanese subsidiaries which operated businesses in Australia with the common-law based institutional setting is still different from the financial reporting of their Australian peer companies.

In this regard, Jones and Finley (2011) found that the diversity in financial reporting generally decreased after IFRS adopted in the European Union (EU) member states and Australia. Based on Jones and Finley's (2011) approach, we measured the coefficient of variation (CV) in the financial statements, as proxied by the variability of 15 financial ratios during the period 2000–2010. The results in this paper suggest that financial reporting diversity for the Japanese subsidiary companies in Australia and the Australian locally-owned companies did not decrease after the Australian IFRS adoption, rather the diversity increased. Nevertheless, the foreign-owned subsidiaries which were controlled by the other countries effectively reduced the variability in their IFRS financial reporting. This shows that IFRS adoption may not be always effective in standardising reporting practices in the Australian heterogeneous business community.

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This study is important, since previous IFRS studies mainly focused on publicly listed companies, but have rarely investigated the unlisted and foreign-owned companies (Cameran et al., 2014). The original contribution of this study is in examination of the IFRS reporting for Japanese-company related entities in Australia. Under the long-term economic relationship concluded in 1976 (Dee, 2006), approximately 400 Japanese-company related entities operated businesses in a variety of industries in Australia (*Toyo Keizai Data Bank Series*, 2007). IFRS studies related to Japan are in an infant area, because IFRS have not been publicly committed in Japan yet. Under the given environment, Australia provides a unique research opportunity to investigate the IFRS reporting for Japanese entities.

The rest of the paper is presented as follows. Section 2 discusses Japan's accounting environment, Australian IFRS harmonisation, financial reporting diversity and hypothesis developing. Section 3 provides methodology, including sample selection and research design, and is followed by Section 4 presenting the findings and discussions of the CV analysis. Finally, this study concludes by stating a summary of the findings and contributions of this research in Section 5.

2. Literature Review

2.1 Accounting Environment in Japan

The institutional settings in Japan are historically influenced by the German code-law legal systems, since Japan has had the diplomatic relation with Germany for more than 150 years (Ministry of Foreign Affairs, n.d.)[3]. In the code-law legal societies, the main users of financial reporting are tax authorities, banks and creditors, rather than external investors who are the dominant users in the common-law countries (Ball et al., 2000; Ball et al., 2003; Ding et al., 2007; La Porta et al., 2008). As such, the motivations to disclose accounting information available to the public are unlikely to be the same as those of companies in the common-law legal systems. Particularly, Mizuno (2004) stated that the Japanese accounting model deviated from the internationally accepted accounting standards of IFRS and the United States (US) GAAP. The technical advice provided by the CESR (2005) confirmed Mizuno's (2004) statement.

As of 22 March, 2016, 119 jurisdictions have committed for all or most domestic listed companies and financial institutions to apply IFRS in their capital markets (IFRS Foundation, 2016[4]). Despite the global trend towards harmonisation of IFRS with the national accounting standards, the US and Japan are yet to implement mandatory adoption of IFRS. However, the harmonisation of IFRS in Japan has progressed. Voluntary IFRS implementation was approved in Japan in 2010. Although Japanese version of IFRS for the consolidated financial statements will be accepted from the March-ending in 2016, the timing of the mandatory implementation of IFRS for publicly traded companies is still unclear. Accordingly, Japan has a dissimilar legal origin and accounting environment to Australia.

2.2 Australian IFRS Adoption

Based on the Legal Origin Theory (developed by La Porta et al., 2008), common-law in Australia originated from the law of England. These countries are regarded to be judicially independent with strong protection of private contracts. On 1 January, 2005, Australia became one of the first countries to adopt IFRS, along with the EU member states. Unlike the majority in the EU nations where IFRS apply only to public companies, reporting entities in Australia

are required to implement Australian equivalents to IFRS (hereafter, called A-IFRS) under the Corporations Act 2001.

The Australian accounting-setter of the Australian Accounting Standards Board (AASB) has been closely working with the other standard-setting bodies of Canada, France, Germany, Japan, New Zealand, the United Kingdom and the US for promoting global use of IFRS (AASB, 2002). In Policy Statement 4 *International Convergence and Harmonisation Policy*[5], the Australian government recognised a considerable divergence in national accounting standards across countries. According to this statement, the term 'international harmonisation' refers to "a process which leads to these standards being made compatible with the standards of international standard-setting bodies to the extent that this would result in high quality standards" (Background 2, Policy Statement 4, 2002, p. 6). Australian involvement on the accounting standards harmonisation program was started from 1995 (Deegan, 2014). This institutionalised IFRS adoption was considered to be a long-awaited enforcement by the Australian government which expected to lead a high quality financial reporting in the Australian society and to enhance standardisation of IFRS in the globe. Under the Section 292[6] in the Corporations Act 2001, a small proprietary company which was controlled by a foreign company was required to prepare and lodge their financial reports and auditors' report to the Australian Securities and Investments Commission (ASIC). This study verified that all sample companies in this study lodged their financial reports[7] to ASIC.

The benefits from adopting a common set of accounting standards are documented in the IFRS literature, such as an enhancement in international comparability of financial statements and a reduction in cost of capital (e.g., Daske et al., 2008). This globalised movement of accounting standardisation is viewed as an institutionalised formal structure (Nurunnabi, 2015). The outcomes of IFRS reporting for publicly listed companies have been widely studied. However, not many studies have investigated the IFRS reporting outcomes for unlisted companies. The economic environment for unlisted companies, which do not have access to the capital markets, are systematically different from publicly listed companies. Ball and Shivakumar (2005) were of the opinion that market demand is a major determinant of the quality of accounting, rather than accounting standards. If market demand is unlikely to be involved in the financial reporting process, the benefits and higher quality of IFRS financial reporting for unlisted entities and small- and medium-sized entities (SMEs) may be limited. Our current study focuses on the outcomes from IFRS adoption for the unlisted, Japanese subsidiaries operating in Australia. Under our understanding, such a study has not been undertaken before.

2.3 Financial Reporting Diversity

One of the IFRS studies by Jones and Finley (2011) compared the financial reporting diversity between the pre-IFRS period (1994–2004) and post-IFRS period (2006) for publicly listed companies in the EU nations and Australia. The authors describe financial reporting diversity as "the differences in corporate reporting practices which can arise between a country's own local GAAP and those reporting practices and requirements based on IFRS" (p. 27). Jones and Finley (2011) state that a reduction in financial reporting diversity was a key driver for the Australian regulators to introduce the common global accounting language of IFRS into the Australian diversified business environment (p. 23). The researchers considered that if the variability in IFRS financial reporting would decrease from that in accordance with the local GAAP, IFRS will be regarded as effective in standardising reporting practices in the country. Jones and Finley (2011) found mixed results; however, the overall results indicate that the

mandatory introduction of IFRS had effectively reduced variability in financial reporting at the intra-country or intra-industry level, controlled by firm size differences.

2.4 Hypothesis Development

Drawing on Jones and Finley's (2011) proposition and results including the Australian observations, we predict that Australian IFRS regime has been effective in harmonising financial reporting practices. The variability in the financial statements would decrease after the adoption of A-IFRS among the Australian unlisted, locally- and foreign-owned entities. The first hypothesis is therefore set as follows:

> **H_1:** An adoption of IFRS is associated with a decrease in financial reporting diversity for the sample groups.

The second hypothesis is related to the impacts arising from the legal origin of the sample companies on their financial reporting practices. Managers in the code-law countries generally rely on insider or private communication network to resolve information asymmetry, so have less incentives for public information disclosure (Ball et al., 2003). In contrast, information asymmetry and private dispute are resolved judicially in the common-law countries (La Porta et al., 2008). Due to the systematic differences of legal origin, Navarro-Garćia and Bastida (2010), Cameran et al. (2014) and Lyu et al. (2014) are sceptical regarding the application and quality of IFRS application to the code-law countries and to all types of reporting entities. Following these perspectives, the outcomes of IFRS implementation are predicted to be dissimilar for the dichotomous legal origin groups. The second hypothesis is as follows:

> **H_2:** IFRS financial reporting diversity is less likely to decrease for the code-law groups, compared with that of the common-law groups.

Finally, Ball et al. (2000) found that Japan has the lowest quality in accounting among the seven sampled countries. Herrmann et al. (2003) argue that Japanese companies were likely to report earnings figures which are close to the amounts of management forecast; thus, managers may manipulate earnings figures in order to reduce management forecast errors. Based on these arguments, it can be predicted that financial reporting for Japanese companies will tend to be different from their peer companies in Australia. Thus, the third hypothesis is as follows:

> **H_3:** The change in financial reporting diversity for Japanese subsidiaries was not similar to their peer companies.

The next section describes the sample selection and research design to investigate the diversity in IFRS financial reporting among the sample firms.

3. Methodology

3.1 Sample Selection

The information for the Japanese subsidiary companies which operated businesses in Australia (hereafter, called JSCs) were firstly drawn from *Toyo Keizai Data Bank Series* (2007 year version). This annual periodical supplies the latest information about Japanese subsidiaries which were incorporated overseas. From this periodical, the number of Australian

local subsidiaries[8] was 403 entities. Next, all of these subsidiaries were searched in the Mint Global database in the period 2000–2010. Australia adopted IFRS on 1 January, 2005, so this period is expected to be relevant for comparing the reporting practices under Australian GAAP (AGAAP) and under Australian IFRS (A-IFRS). Among the 98 companies which were listed in Mint Global as having 'Japan' as the 'Global Ultimate Ownership Country'[9], 75 firms disclosed relevant corporate and financial information for conducting statistical tests. These 75 entities were selected as JSCs which were considered to possess the Japanese legal traditions.

Table 1: Breakdown of sample companies

Panel A: Observations by group					
		JSCs	**APCs**	**COMMON**	**CODE**
Number of companies		75	58	67	64
Panel B: Industry classifications					
		JSCs	**APCs**	**COMMON**	**CODE**
Manufacturing	Resources	5	4	5	5
	Motor vehicles	5	2	4	3
Wholesaling	Resources	11	11	8	8
	Motor vehicles	11	11	8	9
	Electric goods	11	8	11	11
	Machinery	15	8	15	15
Service	Finance	2	2	2	2
Other	Other	15	12	14	11
Total		**75**	**58**	**67**	**64**

Source: Mint Global; annual reports from the sample companies; data gathered in this study.
'JSCs' denotes Japanese subsidiary companies which operated businesses in Australia between 2000 and 2010. 'APCs' denotes Australian peer companies which were independent companies without any dominant shareholders or were owned by their Australian parent entities. 'COMMON' denotes firms owned by parent entities registered in one of the common-law countries, excluding Australia. 'CODE' denotes firms which were owned by parent entities incorporated in one of the code-law countries, excluding Japan.

Based on these 75 firms, we secondly selected the matched Australian peer companies[10] (APCs) in Mint Global. APCs were chosen based on either (1) their ultimate parent entities which were incorporated in Australia, specified in the 'Controlling Shareholders' section on Mint Global, or (2) Australian independent entities without any dominant controlling shareholders. As a result, 58 matched sample APCs satisfied these conditions, but the other 17 entities to match with the 75 JSCs could not be found. To distinguish a quality and effectiveness on financial reporting between the dichotomous classifications of common-law and code-law countries, we also collected data of the other groups called 'COMMON' and 'CODE' in this study, using similar sample selection criteria as above. In relation to classifying an entity's legal origin (La Porta et al., 1999; 2006; 2008), foreign-owned peer subsidiaries whose parent entities were headquartered in one of common-law countries, excluding Australia, were chosen as the common-law peer companies (COMMON), while the foreign-owned peer subsidiaries whose parent entities were registered in one of code-law countries, excluding Japan, were classified as the code-law peer companies (CODE). This study collected the samples of 75 companies for JSCs, 58 companies for APCs, 67 companies for COMMON and 64 companies for CODE, and 264 reporting entities in total. Table 1 describes the demographic information of the sample groups.

3.2 Research Design

Jones and Finley (2011) measured the coefficient of variation (CV), as proxied by the variability of financial ratios, and compared the CV measures between the pre- and post-IFRS periods. The researchers report that this CV measure is appropriate to capture the variability in financial reporting and is widely used in various fields in the social science literature to calculate the variability in the dataset. This method is "a simple scale neutral measure" (Jones and Finley, 2011, p. 27), so it is also suitable for this study because the population of unlisted companies in Australia is diversified. The formula of the coefficient of variation is as follows (Norušis, 2008, p. 91);

$$\text{Coefficient of variation} = \frac{standard\ deviation\ (\sigma)}{|mean\ (\mu)|} \text{ x } 100 \qquad (1)$$

The formulae of financial ratios employed in this method are described in Table 2.

Table 2: Formulae of financial ratios used in this study

Financial ratio	Definition/Formula
Panel A: *Profitability ratios*	
Return on assets	Net income after tax divided by total assets.
Return on equity	Net income after tax divided by total equity.
Net assets turnover	Operating revenue divided by non-current liabilities and total equity.
EBITTA	Earnings before interest and taxation divided by total assets.
EBITDA	Earnings before interest, taxation, depreciation and amortisation divided by total assets.
Profit margin	Net income before tax divided by operating revenue
Asset turnover	Sales divided by total assets.
Growth	Annual percentage change in sales revenue.
Panel B: *Liquidity ratios*	
Current ratio	Current assets divided by current liabilities.
Interest cover	Net income after tax divided by interest paid.
Panel C: *Capital structure ratios*	
SIZE	Natural logarithm of book value of total assets.
Debt to equity	Total liabilities divided by total equity.
Debt to asset	Total liabilities divided by total assets.
Equity to asset	Total equity divided by total assets.
Shareholder liquidity	Total equity divided by non-current liabilities.

Sources: Mint Global; Jones and Finley (2011); Birt et al. (2012)

This method compares the coefficient of variation for the 15 financial ratios between the pre-adoption period (2000–2005) and post-adoption period (2006–2010) among the four legal origin groups. In the analyses, we assessed the Levene's test for the equality of variances and the changes in mean values between the two different accounting periods, applying parametric test of independent samples *t*-test and non-parametric test of Mann Whitney U test. The tables display the mean results measured by the Mann Whitney U tests only, rather than *t*-test. This is because the distribution of the observations was not normal, and non-parametric test is not sensitive to the assumption of normality of distribution. The change in the mean value, the denominator of the CV formula, influences the result of the coefficient of variation. If the mean value increases and other things being equal, the CV measure would decrease. Thus, we take

into account which factor, either the change in standard deviation or that in mean value, is more likely to influence the change in the CV measure. This analysis helps to understand the financial reporting behaviours and book values reported under the two different accounting regimes.

4. Results and Discussions

4.1 Individual Group Results

To observe the IFRS impacts on the four sample groups, Tables 3, 4 and 5 present the results for JSCs, APCs and the COMMON and CODE groups, respectively. Each table contains the comparative figures of the coefficient of variation (CV), the percentage change in the CV measures, the significance of the mean changes between the pre- and post-adoption periods. Table 3 and Table 4 also include the changes in the standard deviation and mean values for the financial ratios.

Overall, the group that shows the largest reduction in the CV measures from the AGAAP period to A-IFRS period is the code-law group (13 financial ratios), followed by the common-law group (10ratios) and JSCs (8 ratios). In contrast, the majority of the CV measures (10 ratios) for APCs further increased the variability within the group post A-IFRS. A decline in the majority of the CV measures for the code-law and common-law groups suggests that the financial reporting diversity in these groups effectively reduced, and their reporting practices tended to move toward each other under A-IFRS. Furthermore, the standard deviations for the JSC, COMMON and CODE groups reduced by 7, 9 and 13 ratios, respectively. With regard to the APC group, an increase in the standard deviations for the 10 ratios was associated with an improvement in the CV measures. The results for the APC group might suggest that the introduction of A-IFRS had an adverse effect on this group in standardising their reporting practices.

The profitability ratios in Panel A in Table 3 to Table 5 exhibit an increase in variability for the JSC and APC groups and a substantial reduction in variability for the common-law and code-law groups. Regarding the reporting behaviours, JSCs tended to have a reduction in the mean values (the denominator of the CV formula) but an increase in the standard deviation values (the numerator of the formula), resulting in an increase in the CV measures for 5 ratios. The majority of the mean values increased for the APC and COMMON groups. However, the mean increase for APCs did not assist in offsetting an increase in the standard deviation, resulting in an increase in the CV measures for 5 out of 8 ratios. The mean values for CODE did not always increase (for example, the average value of the return on equity ratio decreased from 0.25 to 0.16), but a greater decrease in the scores of standard deviation (from 0.67 to 0.21 for the return on equity ratio) led the CV measures to be substantially reduced (by 52.1% in this example).

Table 3: The changes in the CV measures for the Japanese subsidiary group

Japanese subsidiary group								
							MNU	
Key financial ratios		**No.**	**St. Dev.**	**Mean**	**CV**	**Change CV (%)**	***Z***	***p***
Panel A: *Profitability ratios*								
Return on asset	Pre	249	0.070	0.061	115.27	32.23	–0.23	
	Post	306	0.084	0.055	152.42			
Return on equity	Pre	249	0.276	0.155	177.30	458.76	–1.70	
	Post	306	0.504	0.051	990.70			
Net assets turnover	Pre	247	6.032	6.482	93.06	–2.38	–2.19	**
	Post	297	4.818	5.303	90.84			
EBITTA	Pre	241	0.096	0.089	107.86	35.88	–1.97	**
	Post	296	0.104	0.071	146.56			
EBITDA	Pre	225	0.094	0.117	80.90	51.42	–3.35	***
	Post	101	0.094	0.076	122.50			
Profit margin	Pre	249	0.091	0.061	149.49	8.62	–0.71	
	Post	301	0.100	0.062	162.37			
Asset turnover	Pre	250	1.236	2.178	56.74	–1.83	–2.27	**
	Post	307	1.102	1.979	55.70			
Growth	Pre	175	0.194	0.030	652.02	–42.64	–0.42	
	Post	300	0.189	0.051	373.97			
Panel B: *Liquidity ratios*								
Current ratio	Pre	247	1.452	1.870	77.61	–7.59	–0.71	
	Post	298	1.393	1.943	71.72			
Interest cover	Pre	228	968.223	211.008	458.86	–8.72	–0.40	
	Post	271	655.626	156.536	418.83			
Panel C: *Capital structure ratios*								
SIZE	Pre	250	1.089	11.791	9.23	2.28	–4.10	***
	Post	307	1.149	12.165	9.44			
Debt to equity	Pre	250	2.967	2.355	125.97	32.96	–2.06	**
	Post	306	3.382	2.019	167.49			
Debt to asset	Pre	250	0.228	0.588	38.74	8.11	–2.09	**
	Post	306	0.229	0.547	41.88			
Equity to asset	Pre	250	0.229	0.410	55.90	–9.73	–2.11	**
	Post	306	0.227	0.451	50.46			
Shareholder liquidity	Pre	243	224.364	98.734	227.24	–9.81	–1.92	*
	Post	293	244.609	119.346	204.96			

Sources: Mint Global; Jones and Finley (2011); Birt et al. (2012); data gathered in the research.

Note: *, **, and *** denotes the significance levels at 10%, 5% and 1% significance levels, respectively. 'No.' denotes the number of observations. 'CV' denotes the coefficient of variation of the ratio. 'St. Dev.' denotes the standard deviation. 'Change CV (%)' denotes the percentage change in the CV measure from the pre- to post-IFRS periods. 'MWU' denotes the Mann Whitney U test. 'z' denotes the z-value of the result of Mann Whitney U test. 'EBITTA' is the rate for earnings before interest and taxation to total assets. 'EBITDA' is the rate for earnings before interest and taxation to total assets. 'SIZE' is calculated by natural logarithm of book value of total assets.

Table 4: The changes in the CV measures for the Australian peer company group

Australian peer company group								
							MNU	
Key financial ratios		**No.**	**St. Dev.**	**Mean**	**CV**	**Change CV (%)**	***z***	***p***
Panel A: *Profitability ratios*								
Return on asset	Pre	196	0.068	0.044	155.48	–6.15	–0.88	
	Post	205	0.068	0.047	145.92			
Return on equity	Pre	195	0.305	0.117	259.60	–7.81	–2.01	**
	Post	204	0.581	0.243	239.33			
Net assets turnover	Pre	189	18.388	14.109	130.32	0.12	–0.57	
	Post	196	17.597	13.487	130.48			
EBITTA	Pre	175	0.095	0.079	120.87	2.36	–0.90	
	Post	182	0.106	0.085	123.72			
EBITDA	Pre	166	0.107	0.110	97.81	39.75	–0.60	
	Post	55	0.145	0.106	136.69			
Profit margin	Pre	195	0.062	0.029	209.85	47.96	–0.78	
	Post	195	0.101	0.033	310.50			
Asset turnover	Pre	196	2.376	3.361	70.68	12.12	–1.02	
	Post	210	2.637	3.327	79.25			
Growth	Pre	144	0.623	0.121	516.31	–10.84	–0.96	
	Post	233	0.196	0.043	460.32			
Panel B: *Liquidity ratios*								
Current ratio	Pre	195	2.376	3.361	70.68	435.55	–0.60	
	Post	195	10.050	2.655	378.54			
Interest cover	Pre	189	9.873	4.430	222.88	38.87	–0.23	
	Post	186	17.136	5.537	309.50			
Panel C: *Capital structure ratios*								
SIZE	Pre	196	0.902	10.964	8.23	3.64	–2.57	***
	Post	210	0.954	11.187	8.53			
Debt to equity	Pre	195	6.651	4.372	152.12	18.71	–0.30	
	Post	209	7.929	4.391	180.57			
Debt to asset	Pre	196	0.201	0.689	29.17	3.87	–0.49	
	Post	209	0.205	0.677	30.30			
Equity to asset	Pre	195	0.201	0.312	64.34	–2.78	–0.16	
	Post	209	0.197	0.314	62.55			
Shareholder liquidity	Pre	191	22.704	10.286	220.72	–9.77	–1.34	
	Post	196	21.810	10.951	199.16			

Sources: Mint Global; Jones and Finley (2011); Birt et al. (2012); data gathered in the research.

Note: *, **, and *** denotes the significance levels at 10%, 5% and 1% significance levels, respectively. 'No.' denotes the number of observations. 'CV' denotes the coefficient of variation of the ratio. 'St. Dev.' denotes the standard deviation. 'Change CV (%)' denotes the percentage change in the CV measure from the pre- to post-IFRS periods. 'MWU' denotes the Mann Whitney U test. 'z' denotes the z-value of the result of Mann Whitney U test. 'EBITTA' is the rate for earnings before interest and taxation to total assets. 'EBITDA' is the rate for earnings before interest and taxation to total assets. 'SIZE' is calculated by natural logarithm of book value of total assets.

Table 5: The changes in the CV measures for the common-law and the code-law groups

		Common-law peer group				Code-law peer group			
Key financial ratios		**No.**	**CV**	**Change CV (%)**	***p***	**N**	**CV**	**Change CV (%)**	***p***
Panel A: *Profitability ratios*									
Return on asset	Pre	253	177.89	–16.37		234	163.64	–24.97	
	Post	239	148.78			232	122.78		
Return on equity	Pre	253	465.38	–28.45		234	262.28	–52.09	
	Post	238	332.96			233	125.65		
Net assets turnover	Pre	251	460.50	–59.30		229	169.97	–35.00	
	Post	233	187.42			225	110.48		
EBITTA	Pre	246	137.86	–5.37		231	113.59	–16.73	
	Post	231	130.45			230	94.59		
EBITDA	Pre	183	213.09	6.19		202	90.44	–5.99	
	Post	55	226.28			67	85.02		
Profit margin	Pre	252	140.31	3.47		234	177.00	–32.34**	
	Post	237	145.18			232	119.75		
Asset turnover	Pre	249	53.22	–11.62		234	54.00	0.65	
	Post	239	47.04			233	54.36		
Growth	Pre	189	302.72	11.13		176	293.84	13.77*	
	Post	238	336.40			235	334.30		
Panel B: *Liquidity ratios*									
Current ratio	Pre	251	60.61	–20.18		229	47.77	–2.35	
	Post	233	48.38			224	46.64		
Interest cover	Pre	234	371.30	2.98		223	530.08	–38.95	
	Post	203	382.38			219	323.64		
Panel C: *Capital structure ratios*									
SIZE	Pre	253	10.04	3.47***		235	9.59	–2.47***	
	Post	239	10.39			233	9.35		
Debt to equity	Pre	254	625.58	–56.83		234	499.93	–76.17	
	Post	238	270.09			234	119.12		
Debt to asset	Pre	253	49.88	–21.87		234	36.40	5.33**	
	Post	237	38.97			233	38.34		
Equity to asset	Pre	253	102.68	–38.05		234	79.32	–14.31*	
	Post	238	63.60			233	67.96		
Shareholder liquidity	Pre	249	155.01	7.31**		223	237.04	–2.79**	
	Post	234	166.34			219	230.41		

Sources: Mint Global; Jones and Finley (2011); Birt et al. (2012); data gathered in the research.
Note: *, **, and *** denotes the significance levels at 10%, 5% and 1% significance levels, respectively. 'No.' denotes the number of observations. 'CV' denotes the coefficient of variation of the ratio. 'St. Dev.' denotes the standard deviation. 'Change CV (%)' denotes the percentage change in the CV measure from the pre- to post-IFRS periods. 'MWU' denotes the Mann Whitney U test. 'z' denotes the z-value of the result of Mann Whitney U test. 'EBITTA' is the rate for earnings before interest and taxation to total assets. 'EBITDA' is the rate for earnings before interest and taxation to total assets. 'SIZE' is calculated by natural logarithm of book value of total assets.

A decline in the average profitability ratios was generally caused by a reduction in the sales revenue in the post-IFRS period. The growth ratio expressed as the change in sales revenues between the two consecutive financial years. Except for JSCs, the other three groups showed a substantial reduction in the level of the average sales revenue from ordinary business

activities. Even though the standard deviation for the growth ratio decreased for all groups, the CV measures for COMMON and CODE groups increased. It is because the significant reduction in the average sales amounts ($p < 0.05$ measured by *t*-test) exceeded a decline in the standard deviations, resulting in an improvement in the CV measures.

The rate of return on equity for JSCs extremely soared the CV measures from the pre- to post-IFRS periods. This ratio significantly reduced its mean value from 0.16 to 0.05 and grew its standard deviation from 0.28 to 0.50, resulting in a substantial increase in the CV measure by 458.76%. An outstanding increase in this CV measure for the return on equity was related with the capital structure for JSCs. The formula of the return on equity ratio is net income divided by total equity. While the percentage change in the CV measure for the JSCs' return on asset ratio (net income divided by total assets) increased by 32%. Both ratios employ the same numerator of net income, but the CV measure of the return on equity increased more than 10 times than that of the return on assets. It is assumed that this drastic escalation in the variability in the return on equity ratio was caused by a significant increase in the standard deviation and/or a decrease in the mean value within the 'equity' component for JSCs, relative to their asset and liability components.

Mixed results can be seen in Panel B in Tables 3, 4 and 5 for the liquidity ratios. The standard deviations and the CV measures for JSCs and the code-law group became smaller post A-IFRS. The current ratio for the common-law group substantially reduced the variability, yet the interest cover ratio slightly improved its variability. While the CV measures in liquidity ratios for APCs became greater, in particular there was an improvement in the CV measure for the current ratio by 436%. Similar to the rate of return on equity for JSCs, this unexpected escalation of the CV measure was due to a reduction in the mean value and a substantial improvement in the standard deviation. The current ratio measures the ratio of short-term assets divided by short-term debts, so this change was also related to the capital structure for APCs.

To figure out corporate sources of funds, Panel C displays the capital structure ratios. The average value of *SIZE* (which is computed by natural logarithm of total assets) shows that the economic resources in the Australian unlisted sample companies significantly improved in the post-IFRS period at the 1% significance level, along with a rise in the standard deviation (except for the code-law group showing a reduction in its standard deviation and CV measure). Thus, the overall internal resources became greater in the post-adoption period, compared with the pre-adoption period. With regard to the 'equity' component in the balance sheet, the average equity values relative to assets increased for all groups. As a consequence, the levels of corporate debts relative to assets decreased, specifically for the JSC and CODE groups at the 5% significance level. The change in the capital structure is also confirmed by the debt to equity and shareholder liquidity ratios for the code-law groups (JSCs and CODE) because of a reduction in the mean values. However, the average debt amount relative to the equity amount slightly increased for the common-law groups (APCs and COMMON) after the A-IFRS adoption. From these movements, all groups, specifically the code-law groups, were likely to expand their corporate assets financing by more equity issuance in the A-IFRS period and cutting down debt issuance. Some inconsistent results were found for the common-law groups. Overall, this study found that in the post-IFRS period, the sample groups were assumed to rely more on the source of funds from shareholders, rather than from creditors.

The results suggest that only JSCs displayed a strong sales growth, but the other groups decreased their sales revenue after the adoption of A-IFRS. Nevertheless, an improvement in income inflows for JSCs was unlikely to be associated with their accounting profits post A-

IFRS. Furthermore, the results from the capital structure ratios may imply that the controllers of the sample companies actively invested more funds in their Australian subsidiaries. If this inference is true, the influence from the equity shareholders on the Australian subsidiaries might become stronger in the post-IFRS period, compared with in the pre-IFRS period. However, such changes in the equity and liability components were assumed to be diversified within the JSC and APC groups, since the variability in their financial ratios, which relate to the equity or liability components, further improved.

4.2 Additional Analysis

This section presents the results of an additional test that excludes the observations reported in the year-ending 2005 financial statements from the original datasets discussed in the previous section. This approach is based on the Jones and Finley's (2011) study which removed the data for the financial year-ending 2005 from their analyses. IFRS were mandated on or after 1 January, 2005, and the fiscal year-endings of the sample companies of Jones and Finley's study were diversified. In Australia, fiscal year-ending is at the end of June, but in the EU, it is at the end of December, and in Japan it is at the end of March. Therefore, the data in the financial year-ending 2005 might be influenced by the two separate accounting standards of AGAAP and A-IFRS. Jones and Finley (2011) stated that the noise effect from mixed accounting standards may distort the financial ratios and the results. In order to avoid the risk arising from the noise effect and improve the analysis in this study, an additional test was performed to compare the results of this additional test with the results using the full-study period 2000–2010. Only the results for the pooling observations of the four groups were tabulated in Table 6.

The results of the additional test generally exhibit a development in standard deviation, because of a loss of observations. The mean values for the financial ratios changed in various ways. The overall results suggest an enlargement in the percentage changes in the CV measures. For example, the CV measure of the rate of return on equity for the pooling observations was originally recorded as –6.88% (untabulated), while the result in this additional test exhibits as –18.66%, because an increase in the mean value is greater than an increase in the standard deviation. These changes may indicate that the data in financial year-ending 2005 contain a strong factor to make the data stable.

Table 6: Pooling observations using the data excluding financial year-ending 2005

		Pooling observations						
							MNU	
Key financial ratios		**No.**	**St. Dev.**	**Mean**	**CV**	**Change CV (%)**	***Z***	***p***
Panel A: *Profitability ratios*								
Return on asset	Pre	674	0.081	0.051	157.76	–11.63	–1.24	
	Post	980	0.077	0.055	139.42			
Return on equity	Pre	674	0.515	0.183	281.94	–18.66	–0.44	
	Post	979	0.357	0.156	229.32			
Net assets turnover	Pre	662	12.359	7.600	162.63	–13.68	–2.49	**
	Post	951	9.201	6.555	140.38			
EBITTA	Pre	646	0.096	0.081	118.75	1.70	–0.34	
	Post	937	0.099	0.082	120.77			
EBITDA	Pre	614	0.240	0.149	160.69	50.95	–1.94	*
	Post	279	0.395	0.163	242.56			
Profit margin	Pre	674	0.077	0.048	161.33	–3.54	–2.04	**
	Post	963	0.087	0.056	155.61			
Asset turnover	Pre	673	1.430	2.206	64.81	3.06	–3.04	***
	Post	987	1.371	2.053	66.79			
Growth	Pre	423	0.344	0.093	370.58	3.43	–1.48	
	Post	752	0.201	0.052	383.27			
Panel B: *Liquidity ratios*								
Current ratio	Pre	666	0.959	1.613	59.43	17.34	–0.57	
	Post	950	1.167	1.674	69.73			
Interest cover	Pre	633	358.089	72.084	496.77	–9.75	–1.32	
	Post	877	388.246	86.594	448.35			
Panel C: *Capital structure ratios*								
SIZE	Pre	678	1.183	11.750	10.07	1.47	–5.63	***
	Post	986	1.237	12.109	10.22			
Debt to equity	Pre	678	6.801	2.553	266.40	–40.16	–6.65	***
	Post	985	4.028	2.527	159.40			
Debt to asset	Pre	676	0.245	0.657	37.33	–1.65	–3.39	***
	Post	983	0.225	0.613	36.71			
Equity to asset	Pre	677	0.245	0.342	71.53	–18.77	–3.14	***
	Post	984	0.223	0.384	58.10			
Shareholder liquidity	Pre	655	96.501	39.364	245.15	–4.52	–3.88	***
	Post	942	132.781	56.728	234.07			

Sources: Mint Global; Jones and Finley (2011); Birt et al. (2012); data gathered in the research.
Note: *, **, and *** denotes the significance levels at 10%, 5% and 1% significance levels, respectively. 'No.' denotes the number of observations. 'CV' denotes the coefficient of variation of the ratio. 'St. Dev.' denotes the standard deviation. 'Change CV (%)' denotes the percentage change in the CV measure from the pre- to post-IFRS periods. 'MWU' denotes the Mann Whitney U test. 'z' denotes the z-value of the result of Mann Whitney U test. 'EBITTA' is the rate for earnings before interest and taxation to total assets. 'EBITDA' is the rate for earnings before interest and taxation to total assets. 'SIZE' is calculated by natural logarithm of book value of total assets.

With respect to the individual group results, the average sales growth for JSCs (0.03) and CODE (0.13) under the original test (which includes the observations for the financial year-ending 2005) decreased to 0.01 for JSCs and 0.12 for CODE in the additional test (which excludes the observations for the financial year-ending 2005). For the APC and COMMON groups, the average growth rates of the sales revenue increased in the additional test. Thus, we infer that the code-law groups might experience an enlargement in the sales revenue for the financial year-ending 2005.

Moreover, only JSCs present an improvement in the mean sales growth from the pre-IFRS to post-IFRS periods, but the other three groups decreased the ratio after the A-IFRS adoption (both the original test and additional test). One possible scenario can be inferred that the change in the JSCs' accounting policy in terms of 'revenue recognition' under AASB 118 *Revenue* might have substantially impacted on the sales revenue. For example, JSCs were likely to recognise more accounting items as revenue and disclosed more information to comply with A-IFRS. For this reason, the sales revenue for JSCs may have improved after the A-IFRS adoption.

To summarise, the group which exhibits the largest number of reductions in the CV measures was the code-law group, followed by the common-law group. The results for these two groups present the evidence that the Australian IFRS adoption is effective in promoting the harmonisation with the financial reporting, as evidenced by a substantial decrease in the financial reporting diversity. Variability in the financial ratios for JSCs and APCs rarely declined, rather increased during the A-IFRS reporting period. Thus, there is no adequate support for the first hypothesis H_1 that the variability in financial reporting decreased after the A-IFRS implementation.

Furthermore, the change in the financial reporting behaviour for JSCs was not similar to their benchmark CODE group. Likewise, the reporting behaviour for the APC group, which shows the least number of decreases in the CV measures, was not similar to its benchmark COMMON group. The results for the code-law groups were somewhat better than the common-law groups. This finding is different from the prior studies which compared the quality in financial information between the dichotomous legal origin countries (e.g., Ball et al., 2000; Ball et al., 2003; Bushman and Piotroski, 2006). Accordingly, the second hypothesis H_2 that compared the financial reporting diversity for the code-law groups with that for the common-law groups is rejected. The third hypothesis H_3 that only JSCs show dissimilar financial reporting practices to their peer groups is contradicted, since the APC group also shows an exceptional reporting behaviour. The financial reporting for JSCs and APCs were unlikely to be similar across companies and groups. Thus, inconsistent with the findings of Jones and Finley (2011), the variability in IFRS reporting practices for unlisted companies did not always decrease.

5. Conclusions

Under the Australian common-law institutional setting, this study measured the variability in financial statements among unlisted, locally-owned companies and foreign-owned subsidiary groups of (1) Japanese subsidiaries, (2) the firms controlled by the ultimate parent companies headquartered in the common-law countries, excluding Australia, and (3) the firms held by the ultimate parent companies incorporated in the code-law countries, excluding Japan. This study aimed to investigate whether the variability in financial ratios under the Australian domestic accounting standards was reduced by the adoption of Australian IFRS, specifically for

Japanese subsidiaries whose country of origin was regarded to have significantly different national GAAP from IFRS (CESR, 2005). To examine the effectiveness of the IFRS harmonisation, the coefficient of variation (CV) measures were compared between the pre-IFRS (2000–2005) and post-IFRS (2006–2010) periods. In spite of the IFRS harmonisation approach conducted by the Australian IFRS promoters (such as the Financial Reporting Council, which has a responsibility for overseeing the Australian financial reporting framework), the results in this paper did not provide definite evidence that the coercively enforced IFRS financial reporting achieved isomorphic stability (Greenwood et al., 2002) among these separate legal origin groups in Australia.

From the prior international accounting studies (e.g., Ball et al., 2000; Ball et al., 2003; Bushman and Piotroski, 2006), we expected that the common-law groups would have more adaptability of IFRS to harmonise their accounting policies with the principles-based IFRS than the code-law groups. Nonetheless, the CODE group showed the best outcomes to reduce variability in financial reporting, and the firms in the APC group exhibited a diversified reporting behaviour under the A-IFRS standards. Potential reasons could be, the code-law countries originally have strong political influence on accounting regulations and practices (Ball et al., 2000). Such firms might traditionally have greater adaptability to comply with institutional mandate. Nevertheless, some uncommon results were shown by the JSCs (such as the return on equity ratio and positive growth rate) and the APCs (for example, an outstanding CV measure for the current ratio). APCs were the only sample group which was locally-owned. Compared with the foreign-owned subsidiary groups which were controlled by multinational corporations, APCs had smaller firm sizes (computed by the *SIZE* ratio), and these firms might have been restricted by the preparation of the A-IFRS implementation. Jones and Higgins (2006) document the existence of the gap between larger firms and smaller firms in terms of the IFRS knowledge, resources and adaptability. This argument is consistent with the Jones and Finley's (2011, p. 33) statement that financial information for smaller firms was more likely to be diversified, compared with larger firms with greater accessibility of resources and more commitment on IFRS implementation. The results of JSCs and APCs might be consistent with these statements.

The findings in this study indicate that a dichotomous classification of common-law and code-law countries is less likely to be applicable to unlisted, small- and medium-sized companies. We found that the adaptability in regard to the IFRS institutionalised changes was likely to depend on the attribute of each legal origin group, and some unlisted companies might face difficulties to comply with the IFRS regulations. The strict IFRS regulations might have a negative impact on the accounting policies for JSCs and APCs (for example, IFRS require a wide range of recognition such as financial instruments and intangible assets in the balance sheet). Another reason could be caused by just fluctuations in operating activities over the business cycle or the subprime shocks in 2008–2009. Otherwise, these reporting behaviours could imply opportunistic management behaviour. Overall, the reporting practices were more likely to be heterogeneous in the Australian society during the observed period.

This study contributes to current IFRS studies by bringing to light the financial reporting practices for unlisted companies and the differences between locally-owned entities and foreign-owned subsidiaries. Under our understanding as per literature review, this research is the first study to research these types of entities in Australia. We acknowledge the limitation of this method that the sample companies were unlisted entities which did not trade their equity shares in public and were unlikely to be accountable to disclose their information. Corporate and financial information for unlisted companies is limited in the major database in terms of the amount, details and accessibility. This study collected data for four different types of legal

origin groups to overcome the problem of data and to generalise the results regarding Australian unlisted entities. The results expressed each group's specific features in the Australian intra-country setting. The findings in this study would be useful for accounting regulators and professions to be aware of the heterogeneous reporting practices for foreign-owned subsidiaries which have diversified legal traditions. Last, but not least, Japan-related IFRS findings could become valuable data for regulators, listed companies and academics in Japan and also in other countries for better preparation of the mandatory implementation of IFRS sometimes in the future.

Endnotes

[1] The CESR was formed under the European Commission on 6 June, 2001 and replaced by the European Securities and Markets Authority (ESMA) on 1 January, 2011.

[2] The areas that the CESR addressed as significantly different from IFRS were stock options (IFRS 2), business combinations other than pooling of interest method (IFRS 3), catastrophic reserves of insurance contracts (IFRS 4), construction contracts (IAS 11), disclosure of deferred tax assets (IAS 12), costs for assets retirement obligation (IAS 16), employee benefits (IAS 19), effects of changes in foreign exchange rates (IAS 21), impairment of assets (IAS 36), and agriculture (IAS 41) (Financial Services Agency, 2005).

[3] More information is available at Ministry of Foreign Affairs, *Geschichte* (in Japanese), viewed 26 April 2016, <http://www.mofa.go.jp/mofaj/press/pr/pub/pamph/pdfs/j_germany03.pdf#search='%E6%98%8E%E6%B2%BB%E6%99%82%E4%BB%A3+%E3%83%89%E3%82%A4%E3%83%84'>.

[4] The IFRS Foundation supplies the detailed information in terms of the profile for the IFRS jurisdictions. Available at <http://www.ifrs.org/Use-around-the-world/Pages/Analysis-of-the-IFRS-jurisdictional-profiles.aspx>.

[5] This policy was based on the Exposure Draft (ED) 102 *International Convergence and Harmonisation policy* issued in July 2001, which was merged Policy Statement 4 *Australia – New Zealand Harmonisation Policy* in July 1994 and Policy Statement 6 *International Harmonisation Policy* issued in April 1996 by the AASB and the Public Sector Accounting Standards Board. More information is available at <http://www.aasb.gov.au/admin/file/content102/c3/ACCPS4_4-02.pdf>.

[6] More detailed information for the section 292 is available in the Commonwealth Consolidated Acts websites at <http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s292.html>.

[7] In Note 1 *Summary of significant accounting policies*, the section on A-IFRS reports generally specified the fact that the reports were in compliance with A-IFRS.

[8] *Toyo Keizai Data Bank Series* defined a locally-incorporated subsidiary as one in which Japanese enterprises directly or indirectly invested more than 10% of the portion of the entity's ownership.

[9] In this study, a parent company or controlling shareholder is defined as an individual or entity with a shareholding of at least 50.01% for the sample entities. This information was mainly retrieved from the 'Controlling Shareholders' section in Mint Global or annual reports which generally specified the name of their own immediate/ultimate entity. The ultimate parent entity includes both cases of an immediate (direct) parent company and an ultimately controlling (grandparent) company. This study assumes that the ultimate parent company's philosophy, culture and traditions under the given legal origin have the most influence on the business practices in the group as a whole.

[10] The term 'peer' is used for a firm which had not listed their ordinary shares in the stock market, had operated in a similar industry (based on one of the industry codes of US SIC, NAICS 2007 and ANZ SIC) and was close in size to its relative JSC measured as the natural logarithm of the total assets at around the IFRS transitional period.

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