


IFRS ADOPTION, COST OF EQUITY AND FIRM VALUE: EVIDENCE FROM IRAQ

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ARTICLE INFO	<u>ABSTRACT</u>
<p>Article history:</p> <p>Received 30 Dezember 2021</p> <p>Accepted 07 February 2022</p>	<p>Purpose: The aim of this study is to examine the effect of adoption of IFRS on the Iraqi environment by studying the relationship between the adoption of international financial reporting standards and the cost of equity and the effect of the cost of equity on the value of the company.</p>
<p>Keywords:</p> <p>IFRS; Cost of Equity; Firm Value.</p>	<p>Theoretical framework: The international financial reporting standards (IFRS) are becoming special driver for the convergence of management and financial accounting and as the leading principles for over 120 countries in the world including those that voluntarily adopted the standards.</p>
	<p>Design/methodology/approach: The population of the study comprises 17 commercial companies listed in the Iraqi Stock Exchange for the periods of 2011-2013 and 2016-2018 with the exception of Islamic companies due to the difference in the privacy of the applicable regulations</p>
	<p>Findings: The results from the data collected through questionnaire survey showed the distinctive effects of financial and management accounting standards before and after the adoption of IFRS. Therefore, there are inconsistencies in the results of the value of the companies between the samples for the periods before and after the application of international financial reporting standards.</p>
	<p>Research, Practical & Social implications: The study examined the differences in the outcomes of the years when IFRS was yet to be adopted when the standards are adopted by considering the control variables such as age of the companies, size of the companies and leverages.</p> <p>Originality/value: the value of the study's originality by measuring adopting IFRS for the first time in Iraqi Banking for the periods of 2011-2013 and 2016-2018 with the exception of Islamic companies due to the difference in the privacy of the applicable regulations.</p>
	<p>Keywords: IFRS, Cost of Equity, Firm Value. Doi: https://doi.org/10.26668/businessreview/2022.v7i3.0602</p>

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ADOÇÃO DO IFRS, CUSTO DO PATRIMÔNIO E VALOR DA EMPRESA: EVIDÊNCIA DO IRAQUE

RESUMO

Objetivo: O objetivo deste estudo é examinar o efeito da adoção das IFRS no ambiente iraquiano, estudando a relação entre a adoção das normas internacionais de informação financeira e o custo do patrimônio líquido e o efeito do custo do patrimônio líquido sobre o valor da empresa.

Estrutura teórica: As normas internacionais de informação financeira (IFRS) estão se tornando um motor especial para a convergência da administração e da contabilidade financeira e como os principais princípios para mais de 120 países no mundo, incluindo aqueles que adotaram voluntariamente as normas.

Design/metodologia/abordagem: A população do estudo compreende 17 empresas comerciais listadas na Bolsa de Valores do Iraque para os períodos de 2011-2013 e 2016-2018, com exceção das empresas islâmicas devido à diferença na privacidade dos regulamentos aplicáveis.

Conclusões: Os resultados dos dados coletados através da pesquisa por questionário mostraram os efeitos distintos das normas contábeis financeiras e de gestão antes e depois da adoção das IFRS. Portanto, existem inconsistências nos resultados do valor das empresas entre as amostras para os períodos antes e depois da aplicação das normas internacionais de relato financeiro.

Pesquisa, implicações práticas e sociais: O estudo examinou as diferenças nos resultados dos anos em que as IFRS ainda não foram adotadas quando as normas foram adotadas, considerando as variáveis de controle como idade das empresas, tamanho das empresas e alavancagens.

Originalidade/valor: o valor da originalidade do estudo medindo a adoção das IFRS pela primeira vez nos bancos iraquianos para os períodos de 2011-2013 e 2016-2018, com exceção das empresas islâmicas devido à diferença na privacidade dos regulamentos aplicáveis.

Palavras-chave: IFRS, Custo do Patrimônio, Valor da Empresa.

ADOPCIÓN DE LAS NIIF, COSTE DEL CAPITAL Y VALOR DE LA EMPRESA: DATOS DE IRAK

RESUMEN

Objetivo: El objetivo de este estudio es examinar el efecto de la adopción de las NIIF en el entorno iraquí, estudiando la relación entre la adopción de las normas internacionales de información financiera y el coste de los fondos propios y el efecto del coste de los fondos propios en el valor de la empresa.

Marco teórico: Las normas internacionales de información financiera (NIIF) se están convirtiendo en un motor especial para la convergencia de la contabilidad financiera y de gestión y en los principios rectores para más de 120 países del mundo, incluidos los que adoptaron voluntariamente las normas.

Diseño/metodología/enfoque: La población del estudio comprende 17 empresas comerciales que cotizan en la Bolsa de Valores de Irak para los períodos 2011-2013 y 2016-2018, con la excepción de las empresas islámicas debido a la diferencia en la privacidad de la normativa aplicable.

Resultados: Los resultados de los datos recogidos a través de la encuesta del cuestionario mostraron los efectos distintivos de las normas de contabilidad financiera y de gestión antes y después de la adopción de las NIIF. Por lo tanto, existen incoherencias en los resultados del valor de las empresas entre las muestras para los periodos anterior y posterior a la aplicación de las normas internacionales de información financiera.

Investigación, implicaciones prácticas y sociales: El estudio examinó las diferencias en los resultados de los años en los que aún no se habían adoptado las NIIF cuando se han adoptado las normas teniendo en cuenta las variables de control como la edad de las empresas, el tamaño de las empresas y los apalancamientos.

Originalidad/valor: el valor de la originalidad del estudio al medir la adopción de las NIIF por primera vez en la banca iraquí para los periodos de 2011-2013 y 2016-2018 con la excepción de las empresas islámicas debido a la diferencia en la privacidad de la normativa aplicable.

Palabras clave: NIIF, Coste de los Fondos Propios, Valor de la Empresa.

INTRODUCTION

The present situation of every sector worldwide regarding accounting internationalization has grown by integrating international accounting standards into the accounting standards of each country with the purpose to propagate and encourage adoption of IFRS (Hoshino, 2017). In contrast, the movement towards the adoption of IFRS in Iraq is still

slow. Thus, the blueprint for IFRS adoption by many sectors in Iraq is yet to be clarified although the international accounting standard board and accounting standard board of Iraq are still keeping upwards regular consultations. The truth of the story is that the report presentation of the securities by IFRS has not been accepted even though the adoption of the standard is progressing (Ali et al., 2019). Widely, the impact of the adoption of IFRS has reached the way annual reports are prepared and how financial measures are reviewed as a business process and evaluation base as a way to business management. The effect of this on the financial performance of many companies is huge due to the changes in the financial measures after the adoption of IFRS. Regarding the opportunity related to international accounting standards, it has been shown that the financial performance of Iraqi commercial banks is unstable (Ali et al., 2019). Therefore, the condition of importance and the change of the availability of the standards are examined by the internationalization of the accounting standard. Iraq has witnessed mandatory transformation of commercial banks listed in the Iraqi Stock Exchange since the beginning of 2016 after applying international financial reporting standards, while abandoning the application of the standardized accounting system which has been applied for many years in the Iraqi banking environment. Thus, the importance of this study is derived from the level at which the Iraqi commercial banks benefited from the advantages of applying for those standards.

This study aims to evaluate the difference between before and after adoption of the international financial reporting standards (IFRS) by commercial banks excluding the Iraqi shariah banks on financial and performance measurement. There is possibly significant impact of adoption of IFRS on the business management basis of Iraqi companies for example in the case of renewal of information system, retention of shareholdings, annual report preparation by profit disclosure using detailed incomes and improvement of business processes. This paper studied the effects of adoption of IFRS on the management accounting and the effect of the cost of equity on the value of the companies.

LITERATURE REVIEW

Corporate performance and IFRS in developing countries have become a major issue receiving crucial attention both in industry and academic research as a result of interest of shareholders' investments into such companies (Adeuja, 2015). The growth trajectory mechanism have been drawn to the public attention through strong impact on share prices, increase in marketplace globalization, expansion of firm and assurance in high payment of dividend. The major objective of IFRS as a special standard of mechanism is to give opportunity

for greater demands for performance in corporate sectors that are required by stakeholders and investors in their quests for quality in financial reporting (Patro & Gupta, 2014),(Al-Wattar, Almagtome, & ALShafeay, 2019; Khaghaany et al., 2019). According to Yeboah and Akacs (2019), previous studies relate the value of a company with adoption of international financial reporting standards which allowed all the firms listed in Iraq to have their annual financial statements prepared under IFRS. Both empirical and theoretical studies are in consonance with the relationship between adoption of IFRS and cost of equity and value in a company. As this study considers emerging economy in developing country such as Iraq, their relationships remain far well comprehended. It is reported from extant literature that quality financial information from IFRS has inherent higher performance to avoid or reduce information asymmetries among the participants of the corporate market. Value of a company can be determined by the discretionary behavior and strategic actions of the managers about accounting standards.

IFRS was developed by the international accounting standards board (IASB) in order to quality improvement in financial reporting that heightens corporate performance and value of a firm (IASB, 2004). In contrast, there are opposite views on the effects of IFRS on firm performance those shows that IFRS provides no high-quality accounting information because it does not give account to need why institutional and political environment in which the firms operated need to be recognized (Steinhoff, 2016). The adoption of IFRS adapts to two theories which are the bonding theory and signaling theory. The theory of bonding as related to IFRS adoption explains the increase in trend of individual firm's interest in growth from corporate performance and reputation associated with financial market. The signaling theory indicates that commitment of a firm to quality financial report or disclosure form the foundation on which adoption of IFRS is signaled (Amahalu & Beatrice, 2016). For developing accounting activities, the IFRS was developed by the IASB to be acceptable in the world. The rules of accounting harmonization is improved and promoted from this. Also, there is a comprehensive association between adoption of IFRS on financial accounting information of listed commercial banks and quality firm performance in relation to the value of the company through return of equity (ROE), earning per share and return on assets (ROA). Results from IFRS adoption showed that there is an affirmative change in profitability ratio from the increase in the statement of income (Cohen & Karatzimas, 2013). This indicates the quality IFRS has effect on the financial report and subsequently improve the performance of the companies as IFRS is more of capital market oriented than the local standards. In addition, IFRS is perceived to be the best world collections of accounting practices (Iatridis & Rouvolis, 2010). Therefore, it reduces the challenges of

moral hazard which leads to improvement in effectiveness of investment in future economic performance of companies and corporate social responsibility (CSR) (Chebaane & Othman, 2014).

Therefore, there is clash of view whether the adoption of IFRS and corporate performance are substitutive or complementary. Empirical studies in Iraq are still scanty in relation to quality cost of equity under the adoption of IFRS. This study empirically focused on the level at which commercial banks in Iraq is in term with adoption of IFRS. Also, the aim of this study is to know the reflection of the application of international financial reporting standards in the Iraqi environment by studying the relationship and the impact of the application of international financial reporting standards on the cost of property rights and the value of Iraqi commercial banks listed in the Iraqi Stock Exchange.

DATA AND METHODOLOGY

The population of the study comprises 17 commercial companies listed in the Iraqi Stock Exchange for the periods of 2011-2013 and 2016-2018 with the exception of Islamic companies due to the difference in the privacy of the applicable regulations. All the banks whose financial statements are available for these two periods were selected. Banks were obliged to apply for the international financial reporting standards under Iraqi legislation in the beginning of 2016. The study time limits included three years before the application of financial reporting standards and the most stable years were selected in terms of local conditions in the Iraqi environment from 2011 to 2013 and three years after implementation of IFRS from 2016 to 2018.

Independent variables

International financial reporting standards

It is measured through a placebo variable that takes the number 1 in the years of applying the standards and the number zero for the years before the standards are applied (Jeanjean & Stolowy, 2008; Uwalomwa et al., 2016).

The cost of equity

These are measured by using the CAPM pricing model (Sumaryati & Tristiarini, 2018; Zhao, 2010; Li, 2010; Aharony, J., Barniv & Falk, 2010; Mazzi, André, Dionysiou & Tsalavoutas, 2017; Hussein, 2022):

$$k_e = r_f + b(r_m - r_f) \dots\dots\dots(1)$$

Where:

k_e = Cost of Equity

r_f = Risk free interest rate

b = Beta coefficient of shares

r_m = Return on Market Portfolio

Dependent Variables

According to the following formula, the value of the company was measured based on the Tobin's Q model created by James Tobin in 1969 and was later developed by Chung and Pruitt in 1994 (Turki, Wali, & Boujelbene, 2017 ; Mashhadani, & Talab, 2013 ; Talab, Manaf, & Malak, 2018).

$$\text{Approximate Q} = (\text{MVE} + \text{PS} + \text{DBET}) / \text{TA} \dots\dots(2)$$

Where:

MVE = The total market value of the company's shares.

PS = Cash value of preferred shares

DBET = Liabilities (short-term + long-term) minus short-term assets

TA = Total assets

The value of the company increases when there is greater value of Q than the correct one, but when it decreases, it indicates that the company's assets are valued above its market value.

Control variables

The control variables are life of the company, leverage and the size of the company and they are defined as follow:

- a) The life of the company shall be measured by the age of the company in months from the date of incorporation until the end of the measurement year (Talab, Abdul Manaf, & Abdul Malak, 2017 ; Thijeel, Flayyih, & Talab, 2018 ; Jabbar, 2018 ; Haniffa & Hudaib, 2006).
- b) Leverage is measured by the total liabilities divided by the total assets (Haniffa & Hudaib, 2006; Hussein, 2018; Mandacı & Gumus, 2010).
- c) The size of the company is measured by the natural logarithm of the assets (Isik & Soykan, 2013; Boone, Colombage & Gunasekarage, 2011; Hussein, 2018).

RESULTS AND DISCUSSION

It can be noted from Table 1 that. The sample size for all variables is 66 views. This shows that there are no abnormal or extreme values in the data of all variables. The highest value of the variable value of the company is reported.

Table 1. Descriptive statistics of variables

Descriptive Statistics	N	Minimum	Maximum	Mean	Std. Deviation
Standard	66	0	1	.50	.504
COE (capm)	66	-.999	.537	-.01838	.236843
Firm Value (T 'Q)	66	-.78000	.73859	-.1592480	.26219453
Age	66	76	311	189.55	65.302
Size	66	10.6427	12.2467	11.547802	.3455459
Lev	66	.241	.841	.52705	.158901
Valid N (listwise)	66				

The question arises is that to what extent is there is a relationship between the adoption of international financial reporting standards and the cost of ownership Iraqi companies. The hypothesis goes thus: There is a significant relationship between the adoption of international financial reporting standards and the cost of equity.

Table (2) the relationship between the adoption of IFRS and the cost of equity

Correlations			
		Standard	COE
Standard	Pearson Correlation	1	-.284*
	Sig. (2-tailed)		.021
	N	66	66
COE	Pearson Correlation	-.284*	1
	Sig. (2-tailed)	.021	
	N	66	66

*. Correlation is significant at the 0.05 level (2-tailed).

From the result in the Table (2), it is noted that there is a weak and inverse relationship by 28.4%, but it is significant at the level of 0.05. Therefore, the hypothesis of the study is accepted. The second problem brought out the question: what the impact of both the adoption of international financial reporting standards and the cost of equity on the value of the company is. The second hypothesis goes thus: “there is a statistically significant impact of both the adoption of financial reporting standards and the cost of equity on the value of the company”. For the purpose of testing this hypothesis, the following multiple linear regression model was formulated:

$$FV_{it} = a_0 + a_1 STAN_{it} + a_2 COE_{it} + a_3 AGE_{it} + a_4 SIZE_{it} + a_5 LEV_{it} + \varepsilon_{it} \dots\dots(3)$$

Where:

FV_{it} = Company Value

$STAN_{it}$ = International Financial Reporting Standards

AGE_{it} = Age of company

$SIZE_{it}$ = Company Size

LEV_{it} = Leverage

The Table (3) below shows the self-correlation matrix between the variables in the regression equation used to test the hypothesis. The result shows there is weak correlation between the variables used which indicate high level of accuracy.

Table (3) self-correlation matrix between the variables

	standard	COE	value firm	age	size	lev
standard	1					
COE	-.284-	1				
value firm	-.141-	.222	1			
Age	.419	-.274-	.096	1		
Size	-.304-	.008	.144	-.294-	1	
Lev	-.324-	.028	.505	.028	.317	1

This study made sure that there no problem of linear interference between the independent and control variables used in the study before testing the hypothesis through the test of linear interference i.e. Multicollinearity which is known as the Diagnostic Collinearity Scale.

Table (4) Diagnostic Collinearity Scale

Model	Collinearity Statistics	
	Tolerance	VIF
standard	.666	1.501
COE (capm)	.825	1.212
Age	.742	1.348
Size	.730	1.370
Lev	.786	1.272

From the above Table (4), all values of VIF are less than 10, and that all the values of Tolerance are greater than 0.1. Regression analysis was carried out using SPSS after confirming that the condition passed the non-linear interference and ensuring the weakness of the self-binary correlation. The results are presented in the following table (5):

Table (5) the Regression analysis

Model Summary				
Model	R	R Square	Adjusted R2	Std. Error
1	.521a	.272	.211	.23285829

The correlation value (R) between the variables was 0.521 as presented in the summary Table of the selected banks which is a median value. The coefficient of determination, R Square is 0.272, which represents the explanatory power of the model used. Also, the standard deviation of the estimate error is reported to be 0.2328582. As the value is low, it shows that this type of error is statistically better.

Table (6) ANOVA

ANOVAa						
Model	Sum of Squares	Df	Mean Square		F	Sig.
1	Regression	1.215	5	.243	4.482	.002 ^b
	Residual	3.253	60	.054		
	Total	4.468	65			

The Table (6) comparing the results shows that the calculated F value was 482.4, which is higher than the tabular value calculated according to the degrees of freedom df (60,5) of 2.37 at a significant level of 5%. The accepted error in the social sciences is predetermined by 0.05, which indicates the suitability of the statistical model used for the test.

Table (7) Unstandardized Coefficients and Standardized Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.387	1.149		-.337	.737
	standard	.006	.070	.011	.083	.934
	COE (capm)	-.414	.463	-.109	-.895	.374
	Age	0.0003	.001	.085	.668	.507
	Size	-.019	.098	-.026	-.198	.843
	Lev	.829	.205	.503	4.044	.000

The Table (7) of coefficient shows that IFRS has a direct impact on the value of the company. This indicates that the implementation of those standards leads to increase in the value of the company. Also, the cost of equity negatively affects the value of the company i.e. the greater the value of the company, the lower the cost of equity but the effect between the relationships is statistically insignificant.

On the control variables, the size of the company has negative effect on the value of the company and no statistical significance. Also, the leverage was a positive and statistically

significant in relationship with the value of the company. The effect of age on the value of the company is positive, but it was not statistically significant.

Notably, the study opines that due to the fact that the Iraqi banks are newly entrusted with the application of international standards that has led to the reason for the lack of significance of the impact of standards and the cost of property rights on the value of the company. Banks are the only sector currently applying the standards optionally in 2015 and mandatorily in 2016 currently in Iraq. Similarly, the value of the company is closely linked to the stock prices which start to decline for many reasons including the security and economic instability in the country and with the recent knowledge of the Iraqi investor on the investor international standards currently applied. The Table (8) below shows the average price of the selected banks for the years under study.

Table (8) average price of the selected companies for the years (2011 – 2018)

Year	Average share price
2011	1.646364
2012	1.357273
2013	1.317273
2016	0.695455
2017	0.604545
2018	0.472727

The value of the company was divided into two samples for the purpose of subjecting the low value of the companies to further research: after the application of international financial reporting standards in 2018 and a t-test for the purpose of knowing the difference in the value of the company between the two samples. The results are as follows in Table (9):

Table (9) t-test for firm value

Group Statistics										
	code	N	Mean	Std. Deviation	Std. Error Mean					
Firm value	1	33	.211416	.2835123	.0493532					
	2	33	-.195972	.1608332	.0279975					
Independent Samples Test										
		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
									Lower	Upper
Firm value	Equal variances assumed	15.29	.000	7.18	64	.000	.4073876	.0567415	.2940	.5207

	Equal variance s not assumed			7.18 0	50.66 3	.000	.4073876	.0567415	.293456 0	.521319 2
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From the two tables above, it can be noted that there is a discrepancy in the results of the value of the company between the samples for the periods before and after the application of international financial reporting standards. The average value of companies is -0.195972 for the period after the application of the standards. This value is lower than the average value of companies before the application of the standards which account to 211,160. For a continuous decline in the value of stock prices to occur for the period after the application of the standards and before the application, the reasons behind this have been discussed earlier in this research.

CONCLUSION

This study examined the effect of adoption of IFRS and economic factors on the value performance of commercial banks listed in Iraqi stock exchange which including other control variables such as the age of the company, leverage and size of the company. In the current competition globally among the banks, it is easily concluded that quality accounting information has significant effect on the return of equity while the relationship between IFRS and the value of the company is not significant. Furthermore, the correlation between IFRS and the control variables are positive in the case of age of the company and size but negative in the case of size of the company. Additionally, the relationship between cost of equity (COE) and IFRS is found to be negative. Thus, the interaction or adoption of IFRS does not increase the values of the companies. Also, it can be concluded that IFRS has no impact on the return on equity. This study therefore concludes the impact of IFRS on the value of the selected companies i.e. the commercial banks depends on how the performances are measured. Due to the inconsistencies and discrepancies in the outcome of the results of this study, a cross-country study should be considered for future research. The selection of sample for this study was limited to only commercial banks with consistent published data from financial statements. The results of this study account for 17 commercial banks listed in the Iraqi Stock Exchange for the periods of 2011-2013 and 2016-2018 with the exception of Islamic Banks due to the difference in the privacy of the applicable regulations. Future studies can explore the research into another sector with individual firm's interest on IFRS adoption; also, the years for consideration can be extended to 5 or 10 year interval for more generalization of results. Lastly, findings can be

different if different variables are introduced and used and there are possibilities that more control variables can change the decision of the selected companies on the adoption of IFRS.

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