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Accounting Standards Complexity, Audit Fees and Financial Analyst Forecasts in Australia

A thesis submitted in fulfilment of the requirements for the degree of
Doctor of Philosophy
in
Accounting

At Massey University, Albany,
New Zealand

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2017

Dedicated to
My Wife and My Parents

ABSTRACT

While the beneficial effects of International Financial Reporting Standards (IFRS) on financial reporting quality, cost of capital, cross-country investment, corporate decision making and governance are well studied in the literature, there is relatively little research on the cost side of IFRS adoption and its impact on users. This thesis contributes by investigating the impact of IFRS complexity on two important groups of users of financial reports namely auditors and financial analysts. The hypotheses are built on the premise that principles-based standards are more complex than rules-based standards. This study examines the relationships between IFRS complexity, audit fees, and analyst forecast properties. IFRS is likely to require more of auditors in terms of professional expertise, time and effort, hence resulting in higher audit fees. Financial analysts may be similarly affected by the complexity of IFRS resulting in less accurate forecasts on key financial components.

This thesis measures IFRS complexity based on individual IFRS standards specifically identified as having higher levels of complexity. Scores are then calculated to indicate the difference between these IFRS standards and their equivalent previous domestic accounting standards. The degree of complexity is also measured at aggregate level to indicate an overall complexity impact based on the combined score for all identified ‘complex’ IFRS standards.

Findings indicate that aggregate IFRS complexity is positively and significantly associated with audit fees but that specific IFRS standards are identifiable as being particularly complex, hence explaining much of the positive relationship with audit fees. The results also reveal that the incremental effect of IFRS complexity on audit fees is more pronounced when firms are audited by city-level industry specialists as opposed to those audited by non-industry specialists. Furthermore, IFRS complexity is found to have a positive and significant association with analyst forecast properties (forecast errors, forecast dispersion, and forecast revision). Surprisingly some of the standards identified as being more complex for auditors (i.e., driving higher audit fees) do not appear similarly complex in relation to financial analyst forecast properties. Finally, this thesis investigates the moderating role of high quality audits (proxied by industry specialist auditors) on complexity and analyst forecast properties and finds that forecast errors decrease for firms which are exposed to higher levels of IFRS complexity if they are audited by city-level industry specialists.

This study provides important insights for regulator regarding the complexity of specific IFRS standards. Findings may also be of benefit to countries which are in the process of adopting IFRS or planning to do so.

ACKNOWLEDGEMENTS

I am thankful to The Almighty Allah for His grace throughout the whole PhD process over the last three years. I am grateful to my supervisors, Associate Professor Dr Haiyan Jiang, Dr Warwick Stent, and Professor Asheq Rahman. Dr Haiyan has supervised me, both consciously and unconsciously during the last three years. I wish that I could be as lively, enthusiastic, and energetic as Haiyan. Her excellent critics, comments and analytical skills were really useful. Haiyan knew the tricks to revive my confidence when I lost it. I will remain indebted to her for her understanding and support during the times when I was really down due to personal and family issues. Dr Warwick Stent guided me in how to improve my academic skills and provided insightful suggestions from time to time. He has been motivating and encouraging through the whole process. His in-depth auditing experience and technical expertise really helped me to improve my research design. I am really thankful to Warwick. Professor Asheq Rahman has helped me from the day I arrived at Massey University. It was easy for me to survive in a new environment with the help of Professor Asheq. I am also indebted to Professor Ahsan Habib and Dr Borhan Bhuiyan for their valuable advice time to time.

I am indebted to numerous faculty members of the School of Accountancy, especially Professor Jill Hooks, Professor Mike Bradbury for their insightful guidance at the early stages of my PhD. I am also grateful to a few other professional staff namely Andrew Brown (Digital Media) and Fiona Diesch (Library). I am very happy with the continuous administrative help I received from Natalie Snyders, Administrative Secretary at the School of Accountancy. I am grateful to Massey University for awarding me a ‘Massey Doctoral Scholarship’, a prestigious and competitive scholarship which made my PhD journey easy and smooth. I want to thank in particular some of my colleagues at the University of Dhaka: Professor Abu Hena Reza Hasan, Professor S. M. Mahfuzur Rahman, Prof. Mizanur Rahman (Accounting), Prof. Nazim Uddin Bhuiyan, Assoc.Prof. Al-Amin, Dr. Chowdhury Saima Ferdous, Rakib Uddin Bhuiyan, and Aditi Shams. A special thanks in this regard goes to Professor Dr. Kamal Uddin, who has been a great help on many occasions: thank-you for being so generous. I have been fortunate to have in my life a few good friends and family, especially Dr Humayun Kabir, Dr M. A. Rashid, Fawad Ahmed, Oyouna, Shafiullah (Stalin), and Enamul Hoque (Emon).

Finally, I would like to thank an important person in my life – my wife Sadia Chowdhury. She has been a continuous source of inspiration and strength. Her sacrifice, caring, and motivation has been far beyond my expectations. I am grateful to my parents and my younger brothers and sister. I am also thankful to my father-in-law and mother-in-law for their support. Finally, I am grateful to Almighty Allah, who has given me a blessing in the middle of my PhD, my son, Safwan Bin Muhammad who has been an additional source of inspiration.

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LIST OF ABBREVIATIONS

| | | |
|-------|---|---|
| AAA | - | American Accounting Association |
| AARF | - | Australian Accounting Research Foundations |
| AASB | - | Australian Accounting Standards Board |
| AcSB | - | Accounting Standard Board |
| AFE | - | Analyst Forecast Errors |
| AGAAP | - | Australian Generally Accepted Accounting Principles |
| ASIC | - | Australian Securities and Investments Commission |
| ASX | - | Australian Securities Exchange |
| ASRB | - | Australian Standards Review Board |
| AUASB | - | Australian Auditing Standards Board |
| CAANZ | - | Chartered Accountants Australian and New Zealand |
| CLERP | - | Corporate Law Economic Reform Program |
| CPA | - | Certified Practicing Accountants |
| DISP | - | Forecast Dispersion |
| ED | - | Exposure Draft |
| EU | - | European Union |
| FASB | - | Financial Accounting Standards Board |
| FRC | - | Financial Reporting Council |
| GAAP | - | Generally Accepted Accounting Principles |
| GAO | - | Governmental Accounting Office |
| IAS | - | International Accounting Standards |
| IASB | - | International Accounting Standards Board |

| | | |
|----------|---|---|
| IASC | - | International Accounting Standards Committee |
| ICAA | - | The Institute of Chartered Accountants in Australia |
| ICAEW | - | Institute of Chartered Accountants in England and Wales |
| IFAC | - | International Federation of Accountants |
| IFRS | - | International Financial Reporting Standards |
| IFRSB | - | International Financial Reporting Standards Board |
| ISA | - | International standards on Auditing |
| ISP | - | Industry Specialist Auditors |
| PSASB | - | Public Sector Accounting Standards Board |
| REVISION | - | Analyst Forecast Revision |
| SEC | - | Securities and Exchange Commission |
| UK | - | United Kingdom |
| US | - | United States |