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Does IFRS and GRI adoption impact the understandability of corporate reports by Chinese listed companies?

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01 Introduction

Introduction



- Corporate reports are the primary sources of information for stakeholders to better understand the firm and its value system (Al-Ajmi, 2009; Jensen and Berg, 2012). However, current corporate reporting is widely perceived as overly complex (du Toit, 2017)
- With the adoption of both IFRS and GRI, the content included in corporate reports is now much broader, leading to heightened concerns of complexity and severe information overload (Lim et al., 2018)
- This study aims to examine the role of IFRS and GRI in promoting corporate reporting understandability



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02 Hypotheses, Methodology and Conclusion

Hypotheses

H1: There is an association between **IFRS** adoption and the level of **readability/ conciseness** of the corporate report.

H2: There is an association between **GRI** adoption and the level of **readability/conciseness** of the corporate report.

- (1) Some experts argue that the high complexity of IFRS results in corporate reports with **low levels of readability** (Jones and Higgins, 2006; Cheung and Lau, 2016). (2) The empirical results of prior studies are **inconclusive**. Such as Melloni et al. (2017), Cheung and Lau (2016).
- Corporate reports have become **lengthier** after the adoption of IFRS due to extensive disclosure requirements. Such as Morunga and Bradbury (2012).
- Harjoto et al. (2020) find that GRI adoption is positively correlated with the **higher readability** of CSR reports. However, some researchers assert that after adopting GRI, corporate reports have become **more complex** (du Toit et al., 2017)
- The adoption of GRI may cause **disclosure overload** (Maniora, 2015)

Methodology

- **Sample:** the top 100 Chinese A-share listed companies measured by market capitalisation at the end of the fiscal year 2014.
- **Sample period:** 2014 to 2018.

Measure readability:

Fog \geq 18 (unreadable); 14–18 (difficult); 12–14 (ideal); 10–12 (acceptable); and 8–10 (childish).

$Fog = (\text{words per sentence} + \text{percent of complex words}) \times 0.4$

$$Fog_{i,t} = \beta_0 + \beta_1 GRI_{i,t} + \beta_2 IFRS_{i,t} + \Sigma Control + Industry + Year + \varepsilon_{i,t} \quad (1)$$

dummy variable, =1 if a firm adopts GRI standards

dummy variable, =1 if a company is listed on the Hong Kong Stock Exchange and Chinese mainland Stock Exchange simultaneously

$$Page_{i,t} = \beta + \beta_1 GRI_{i,t} + \beta_2 IFRS_{i,t} + \Sigma Control + Industry + Year + \varepsilon_{i,t} \quad (2)$$

To measure conciseness: the length of the corporate report

Conclusion

- Both the levels of readability and conciseness of corporate reports by Chinese companies are not satisfactory and also exhibit a downward trend.
- IFRS adoption results in a longer but more readable report, whereas GRI adoption leads to a longer but less readable report.

IFRS → longer, readable

GRI → longer, less readable

- This study confirms that IFRS is suitable for Chinese firms. However, it is necessary to incorporate some explicit guidelines with regards to the conciseness and readability of corporate reports in the GRI framework.



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03 Strengths & Limitations

Strengths:

- The research topic of this article is in line with the current hot topic, which scholars pay great attention to.
- The topic of the paper is for both IFRS and GRI.
- No study has examined the association between compliance with IFRS and the GRI and corporate report understandability for Chinese companies.
- This article is readable.

Limitations:

- **Abstract:** This study examines the level of readability and conciseness of corporate reports and whether IFRS and GRI adoption impacts these aspects of understandability.
- Paper tests readability and conciseness separated. If readability and not conciseness, is it understandability?

Literature Review

- Two of the most widely embraced accounting standards in the world, namely the International Financial Reporting Standards (IFRS) and Statement of Financial Accounting Concepts (SFAC) No. 2 of the US GAAP, agree that the information presented in corporate reports is not useful if the report users cannot understand them (Jang and Rho, 2016)
- Cited from Jang and Rho(2016), one of the objectives of the IFRS Foundation is to develop a single set of high quality, understandable (our emphasis) and globally accepted accounting standards. Statement of Financial Accounting Concepts (SFAC) No.2 of the US GAAP also states that information is not useful if it is not understandable to its target users.
- It should say: Both IFRS and the US GAAP Or both IASB and FASB..

Measures

- Measures of Fog and Page
- Bushee et al. (Journal of Accounting Research, Linguistic Complexity in Firm Disclosures: Obfuscation or Information, 2018) : linguistic complexity commingles two latent components—obfuscation and information.
- Complex language can also reflect the provision of complex information; for example, informative technical disclosure.
- I think you should mention Bushees et al. paper. Your current results support it even considering Bushee et al.(2018) since AH corporations usually are larger and business more complicated.

Fog index

- In the formula, the words per sentence and the percentage of complex words are measured **using the Chinese Readability Index Explorer**.
- But that website is for general files, not for financial area.
- Can you try to find better source if there is?

Page

- Page: regulation different? Industries? Corporations' business?
- Special case, such as China National Petroleum Corporation issued financial statements based on both IFRS and CAS in its financial report.
- In introduction, the author mentioned that the main factors affecting understandability are disclosure overload, an unnecessarily long report and excessive length. Can the number of pages in corporate reports be well proxy “excessive” length? Would it be more appropriate to use “the number of pages in a corporate report in excess of industry average”?
- But since data is only for 100 corporations and so it would be very difficult. I think the paper should mention it as well.

How about market reaction?

- Paper finds that IFRS adoption results in a longer and more readable report, whereas GRI adoption leads to a longer but less readable report.
- But it does not test whether Fog and Page affect information users. Usually other papers test the reaction of market after annual reports issued. If lower understandability, then CAR is lower.

Not sure about data

- Paper mentions: the final data set consists of 500 firm observations over the period from 2014 to 2018. All other data are obtained from the China Securities Market and Accounting Research (CSMAR) database.
- CSMAR only have data based on CAS for AH shares.

Where has those data based on IFRS?

- Paper (page 10) mentions: *China's A-share listed companies need to comply with the domestic CAS, but dual-list A- and H-share companies need to prepare their financial statements in compliance with IFRS (Invesco, 2020; Zhang and Ye, 2020).*
- **(Zhang & Ye, 2020)** *Based on disclosure requirements from the CSRC (2007), AH-share companies disclosing GAAP differences should provide investors in the mainland Chinese market with a reconciliation between CAS- and IFRS-based net income or net asset numbers, and list the major factors causing these differences.*
- **(Zhang & Ye, 2020 in Abstract)** : *After 2011, less than one third of AH companies disclosed GAAP differences. Secondly, an increasing number of AH companies (35%) have published CAS-based financial statements in Hong Kong from 2014. ----Reason: seeking equivalence status between CAS and IFRS adopted by other jurisdictions, such as Hong Kong (CASC and HKICPA, 2007) and the European Union (2012).*
- *Authors need to examine the relationship between readability/ conciseness and IFRS/GRI based on reports under IFRS or HKFRS for AH shares.*

- <http://www.hkex.com.hk/>
- https://sc.hkex.com.hk/TuniS/www.hkex.com.hk/?sc_lang=zh-cn

Limitations: data

- The convergence of CAS and IFRS makes it difficult to compare. (Zhang & Ye, 2020)
- **If** reports disclosed in Hong Kong Stock Exchange are used for dual-listed A- and H-share companies while reports disclosed in Chinese mainland Stock Exchange are used for pure A-share companies, then people will argue that the difference in Fog\Page is caused by **regulations rather than IFRS and GRI adoption.**
- If use all data from mainland China, then I suggest: influenced by IFRS more or less instead of IFRS adoption or not.

Descriptive statistics :

- I recommend to add respective descriptive statistics of companies whose IFRS/GRI equals to 1 and companies whose IFRS/GRI equals to 0 , so that the comparison is more clear.

Inaccuracies in the details

- For example, the New Accounting Standard for Business Enterprises was issued on 15 February 2006, rather than 1 January 2007 but effective from 1 January 2007.

Suggestion

- Need check again to make sure right data and then think about other issues.



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Thanks!

