

# **THE IMPACT OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ADOPTION ON VALUE RELEVANCE OF EARNINGS IN LISTED COMPANIES OF THE PLANTATION SECTOR IN SRI LANKA**

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## **Abstract**

This study investigates the impact of International Financial Reporting Standards (IFRS) adoption, on value relevance of earnings in listed companies of the plantation sector in Sri Lanka. The main objective of the study is to identify whether value of earnings has increased after the adoption IFRSs in listed companies of the plantation sector in Sri Lanka. In order to investigate the impact of IFRS adoption on value relevance of earnings in listed companies of the plantation sector in Sri Lanka, this study uses a panel data regression analysis using 144 firm/quarter observations of share prices and earnings per share (EPS) over period of 6 years before and after the adoption of IFRSs. In addition to the earnings, size of the firm and leverage of the firm also considered as moderating variables in explaining the share prices. Results indicate that value relevance of earnings has been decreased after the adoption of IFRSs

**Keywords:** Value relevance, IFRS adoption, Plantation sector

# **01. Introduction**

## **Background of the study**

Financial reporting means simply the process of providing information that disclose an organization's financial status to its stakeholders. This information represents a company's financial performance and financial health during a certain period. Commencing from 01 January 2012, Sri Lanka started adopting International Financial Reporting Standards (IFRS) in line with the global trend in order to facilitate a common language for financial reporting.

This study focuses on analyzing the impact of International Financial Reporting Standards (IFRS) adoption on value relevance of earnings in listed companies of the plantation sector in Sri Lanka. The term 'value relevance' has been defined by scholars according to the context it is being used. However, value relevance is being defined by Suadiye (2012) as the ability of information that is presented by financial statements to capture and summarize the firm value. Chebaane and Othman (2014) also defined value relevance as the statistical association between financial information and prices or returns. Value relevance can be measured by the statistical relations between information that financial statements present and stock market values or returns. In other words, Value relevance is the ability of financial information contained in the financial statements to explain the stock market measures, basically the share prices.

According to Bauman's Review of Fundamental Analysis Research in accounting (as cited in Henrik Nilsson 2003, p. 03) four approaches were identified to study the value relevance. First approach is the fundamental analysis view of value relevance. That means, determining the firm's intrinsic value without reference to the price at which firm's equity trades on stock market. Second approach is the prediction view of value relevance. Information is relevant if it can be used to predict future earnings, dividends or future cash flows. This is the statistical association between financial statement information and stock prices/returns. Third approach is information view of value relevance. Accounting information is value relevant if it is used by investors when setting prices. Accounting information is considered to be valuable if it causes stock price to change. Accounting information has value relevance if stock market reacts upon the disclosure of it. This deals with relationship between earnings and its components (Earnings and book value) and stock prices. Fourth approach is the measurement view, which is defined as the ability to capture or summarize the information regardless of the source that affects equity value. Here both price and returns are used as market metrics. In

this view, relationship between stock returns and accounting information over a large period is analyzed.

As a mean of achieving the objective of this research, relationship between EPS and the reaction of stock prices for the disclosed information (EPS) in the Financial Statements is being used. It is not an objective of this research to reach the extent of predicting future earnings based on current financial information or to calculate the intrinsic value of stock prices traded. Accordingly, for this study information view of value relevance has been used.

In According to Chandrapala (2010), earnings, book value and Return on Equity (ROE) has value relevance on market value of securities but for Sri Lankan context most relevant variable is earning per share (EPS). Therefore in this research, EPS is used as the measuring variables of the value.

Most importantly, as per CA Sri Lanka (2012), the companies in the plantation sector of Sri Lanka used to prepare financial statements based on Sri Lanka Accounting Standard (SLAS) 32 – Plantations before 01 January 2012. After the adoption of IFRS on 01 January 2012, International Accounting Standard (IAS) 41 – Plantations was introduced which was started to be used by plantation companies in Sri Lanka. The main difference between these two standards was the fair value principle. Instead of the historical cost method as per SLAS 32 which was used to record the value of biological assets, IAS 41 introduced fair value accounting. This was a significant change that affected the financial information of the companies in the plantation sector of Sri Lanka as per CA Sri Lanka (2012). Then again, a significant change like this may affect the value relevance of financial information. Even though researchers such as Chandrapala (2013), Weerathunga and Udayakumara (2015); have conducted researches on the impact of IFRS adoption on value relevance in listed companies of Sri Lanka; they have not specifically analyzed the impact to the plantation sector. Therefore, a research gap could be identified in relation to the Plantation Sector

On the other hand, the contribution from Agriculture, Forestry and Fishing to GDP is 7.9% as per Annual Report issued by Central Bank of Sri Lanka (2015). Even though this shows a less involvement, 29% of the export income of Sri Lanka is derived from the plantation sector, including tea, rubber and rubber based products, coconut based products and spices. Moreover 18.6% employees out of total labour force are engaged in plantation sector implying the importance of the industry specially for a developing country like Sri Lanka. Thereby, plantation sector plays an important role in Sri Lankan economy and hence it is

important to study the impact of IFRS adoption on value relevance of earnings in the listed companies of the plantation sector in Sri Lanka.

### **Research Issue**

Following research questions have been formulated with the intention to identify whether the IFRS adoption has improved value relevance of earnings of plantation sector in Sri Lanka or not.

1. Does the adoption of IFRS improve value relevance of earnings?
2. Are the earnings of large size firms more value relevant than the earnings of small size firms?
3. Are the earnings of low levered firms more value relevant than the earnings of high levered firms?

### **Research Objectives**

Main objective of this study is to investigate whether the IFRS adoption has improved value relevance of earnings in listed companies of the plantation sector in Sri Lanka or not. This will be done by studying the relationship between EPS and share price.

### **Specific Aims**

1. To investigate whether the adoption of IFRS improved value relevance of earnings
2. To investigate whether the earnings of large size firms are more value relevant than the earnings of small size firms
3. To investigate whether the earnings of low levered firms are more value relevant than the earnings of high levered firms

### **Significance of the Study**

Significance of the study can be discussed referring two fundamental criteria namely theoretical significance and practical significance as these research findings will reinforce both theory and practice as well.

### ***Theoretical Implications***

This research is focused on finding out any association in between IFRS adoption and value relevance of earnings. Over the time, researchers such as Chandrapala (2013) had conducted studies to investigate the value relevance of the financial information prepared as per IFRS.

The findings of these studies found, either the accounting numbers of post adoption are more value relevant. But there are no any previous studies relating specifically to the Plantation Sector. But when it comes to the Sri Lankan context, this research area is still far more away from Sri Lankan researchers Therefore applicability of research findings in other countries is questionable as there is no evidence in Sri Lankan context. Furthermore, it has being noted that Sri Lanka is a country with an emerging economy, which has a low GDP growth rate. Moreover, Sri Lanka is still in the initial stage of realizing the importance in adoption of IFRS for financial reporting. In conclusion, it has provided evidence that there is a research gap on the studies of value relevance in adopting IFRS in Sri Lankan context.

### ***Practical Considerations***

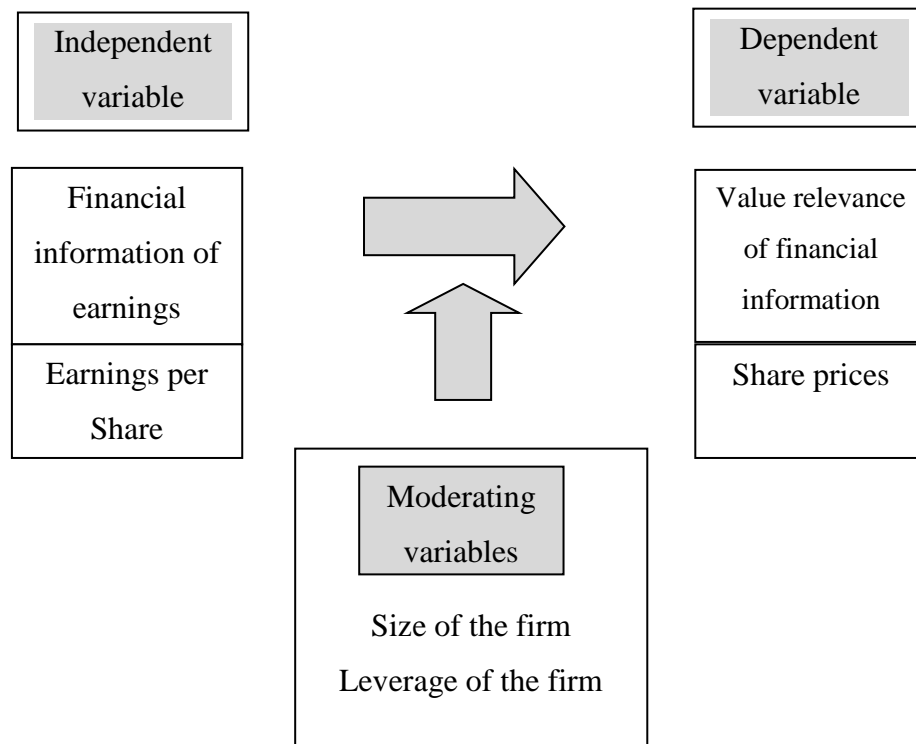
Commencing from 01 January 2012, Sri Lanka started adopting International Financial Reporting Standards (IFRS) in line with the global trend in order to facilitate a common language for financial reporting process. CA Sri Lanka has taken required steps to adopt International Financial Reporting Standards (IFRS) by issuing Sri Lanka Financial Reporting Standards (SLFRS) and Sri Lanka Accounting Standards (LKAS). Since this is a significant change in accounting field, it has been noted that, the study on the impact of international harmonization of financial reporting standards is vital for the enhancement of accounting undergraduates.

In general, each and every organization seeks to create value, for their stake holders in different perspectives. Value can be defined in many perspectives according to the stakeholder being concerned. Sometimes a company with a rocketing stock price might not be making much money, but the rising price means that investors are hoping that the company will be profitable in the future - of course, there are no guarantees that the company will fulfill investors' current expectations. Most stakeholders are concerned about the company's profitability and EPS is an appropriate variable to measure that. Therefore EPS is selected as the measuring variable for this research. Main objective of this study has been to identify whether there is a relationship between EPS changes and IFRS adoption. This means that this study has been designed to check whether, adopting IFRSs has helped companies in Plantation Sector to prepare their financial statements, to reflect information regarding to accurate financial performances and financial position.

### Conceptual model of the study

As long as earnings of the firm can explain the variances of share prices, such financial information is value relevant. That means earnings of the firm are informative to the investors in making decisions.

*Figure 1: Conceptual Model*



Source: Author constructed

According to Figure 1, financial information regarding earnings of a company can be identified as independent variable whereas the value relevance of such information is the dependent variable. EPS is a proxy variable of earnings while price of shares is a proxy variable of value relevance.

On the other hand, the earnings of a company are not the only factor that affects the value relevance of financial information. According to Chandrapala (2013), to strengthen the relationship between EPS and share price, some moderating variables such as book value of equity, earnings, ownership concentration, firm size and cash flows may affect. For this research, size and the leverage of the firm has been used as moderating variables as shown in figure 1 above based on the work of Chebaane and Othman (2014).

### Statement of the hypotheses

Based on the objectives of this study, the hypotheses have been formulated as follows:

Objective 01: To investigate whether the adoption of IFRS improved value relevance of earnings

H<sub>0</sub>: Adoption of IFRS have not improved the value relevance of earnings of Sri Lankan listed companies of the plantation sector

H<sub>1</sub>: Adoption of IFRS have improved the value relevance of earnings of Sri Lankan listed companies of the plantation sector

Objective 02: To investigate whether the earnings of large size firms are more value relevant than the earnings of small size firms

H<sub>0</sub>: Earnings in big firms are not more value relevant than earnings in small firms in the plantation sector

H<sub>1</sub>: Earnings in big firms are more value relevant than earnings in small firms in the plantation sector

Objective 03: To investigate whether the earnings of low levered firms are more value relevant than the earnings of high levered firms

H<sub>0</sub>: Earnings in low levered firms are not more value relevant than earnings in high levered firms in the plantation sector

H<sub>1</sub>: Earnings in low levered firms are more value relevant than earnings in high levered firms in the plantation sector

### **Limitations of the Study**

#### **1. Limitation of Sample & Sample size**

The sample consists of only listed companies in the Colombo Stock Exchange (CSE). However in Sri Lanka, most of the plantation companies come under the small and medium (SME) enterprise category and are not listed. Moreover, out of the population only 6 companies were selected as the sample due to non-availability of information.

#### **2. Measure used to collect the data**

This study is limited only for the explanatory power of EPS on share price. But to have a better understanding of value relevance, the explanatory power of Book Value per Share (BVPS), Dividend per Share (DPS), etc. should also be examined.

## **02. Literature Review**

### **Background**

As a result of the global requirement of harmonizing accounting standards, more than 145 countries including Sri Lanka have adopted IFRS as at 31 December 2015 according to PWC (2015). Researchers throughout the world have conducted studies on value relevance of financial information and the impact of adopting IFRS on value relevance.

Value relevance is defined by Suadiye (2012), as the ability of information disclosed by financial statements to capture and summarize firm value. Chebaane and Othman (2014) also defined value relevance as the statistical association between financial information and prices or returns.

Based on above definitions value relevance could be defined as the ability of financial information to explain the stock market measures, basically the share prices.

### **Value relevance and adoption of IFRS**

The value relevance of accounting information had been studied in many perspectives. One such perspective had been the impact of adopting IFRS on value relevance. Studies done by Oliver and Warsame (2016), Oliver, Anderson and Warsame (2015), Espinosa (2015), Umoren and Enang (2015) and Rozainun and Ibrahim (2009) had identified a positive impact of IFRS adoption on value relevance whereas studies done by Negakis (2013), Padmini and Narasimhan (2012) and Ahmed and Goodwin (2006) had identified a negative impact of IFRS adoption on value relevance.

When compared, the number of studies, which say that there is a negative or neutral impact of IFRS on value relevance is lesser than the number of studies which say there is a positive impact. Moreover, the study by Negakis (2013) indicated that the fair value principle introduced by IFRS has a significant effect on the value relevance of financial information.

These studies were carried out in different parts of the world. Therefore, an inconsistency in the findings could be identified. According to a study by Negakis (2013) there could be several reasons for such inconsistency. The background and context of the country in which the studies have been conducted could influence the findings. The economic system, political system, the way rules and regulation are enforced on the system and the socio cultural factors of the people may also lead to different findings.



Additionally, European countries like Italy and American regions have noticed the financial information more value relevant. Whereas, the research studies in emerging economies such as China, Africa and India have noticed the financial information less value relevant.

Countries like Nigeria, Australia and Canada had been preparing their financial statements as per local accounting standards and adopted IFRS whereas countries such as Italy were converged with IFRS already at the time of introducing latest IFRS.

### **Positive impact of IFRS adoption on value relevance**

Among the studies which found that IFRS adoption is more value relevant, a study by Rozainun and Ibrahim (2009) is important. According to their study on European, American and African context, it was found that book values and earnings under IFRS are value relevant. Further, studies done by Espinosa (2015) and Oliver (2015) have also highlighted that IFRS has impacted to increase the value relevance of financial information.

Similarly, the results of the study done by Umoren and Enang (2015) which was a study on Nigerian economy indicated that the equity value and earnings of banks were relatively value relevant to share prices under IFRS than under the previous Nigerian SAS. That means, earnings reported by Nigerian Commercial banks have become more informative to investors in determining the value of banks following IFRS adoption.

Financial information prepared under IFRS in Canada exhibited incremental value relevance relative to Canadian and US GAAP reports, at least in the short-run as per a study carried out by Oliver, Anderson and Warsame (2015). Moreover this has been further emphasized by Oliver and Warsame (2016), providing the empirical evidence, based on unique Canadian environment, that accounting information prepared and disclosed under IFRS exhibits higher price and returns value relevance than accounting information prepared previously under local GAAP.

According to a study by Espinosa (2015), it had been also proved that there was a significant impact on the financial ratios when adopting IFRS. The study had found a significant increase in financial ratios based on accounting information after adopting IFRS. That means, in addition to improving the financial accounting information, the companies benefitted from adopting IFRS because they showed improvement in their financial indices.

Further, a study carried out by Chebaane and Othman (2014) had identified that role of EPS in explaining share prices became observable in the post-adoption period. That means, EPS recorded as per IFRS became more value relevant than EPS recorded as per previous used GAAP.

### **Negative impact of IFRS adoption on value relevance**

The findings in a study carried out by Negakis (2013), showed that IFRS had negative effects on the value relevance of earnings. In particular, the available information content of both earnings and earning changes decreased after the introduction of the IFRS. The reduction in the information content of earnings for stock prices could be attributed to the IFRS and, in particular, to the introduction of the fair value principle.

Padmini and Narasimhan (2012) had found out by their research carried out in India that the annual parent-only financial statements are value relevant. However, wherever quarterly financial statements are available parent-only financial statements are not value relevant as per their study.

Ahmed and Goodwin (2006) studied value relevance of book value and earnings in Australia. They compared the value relevance of book value and earnings using both Australian Generally Accepted Accounting Principles (AGAAP) and Australian International Financial Reporting Standards (AIFRS). They found that AGAAP book value and earnings are more value relevant than AIFRS book value and earnings.

### **Factors affecting value relevance**

According to Suadiye (2012), value relevance can be measured through the statistical relations between information presented by financial statements and stock market values or returns. In other words, financial information is value relevant only if such information shows a statistical relationship with share prices.

Further Chebaane and Othman (2014) identified that the value relevance is based, on one hand, on the explanatory power of the regression of stock price on net income and book value of equity and on the explanatory power of the regression of annual return of the net income, on the other hand. That means financial information is value relevant if an entity's earnings or book value of equity explains any variance occurred in share prices.

On the other hand, findings in a study carried out by Negakis (2013) showed that IFRS had several effects on the value relevance of earnings.

Furthermore, Chandrapala (2013) identified giving a true and fair view of the company's operations and financial position as the main purpose of financial statements. If there is no relationship between firm value and numbers in the financial statements, such statements have no value relevance. Here, firm value had been understood to be depicted by share prices. And also, findings in a research study by Beisland and Knivsfla (2015) suggested that the effects of IFRS adoption on value relevance may be highly sensitive to firm characteristics

such as the size of the firm. Whereas this study relied on observations from Africa only, the findings suggested that the effect of IFRS adoption may differ in that country and the rest of the IFRS universe, depending on the quality of the domestic GAAP that are used prior to IFRS adoption. Results identified the benefits and costs of IFRS adoption in general and of intangible asset recognition and fair value accounting in particular.

Book value of equity, earnings, ownership concentration, firm size and cash flows can be listed as factors affecting the value relevance of financial information as identified by Chandrapala (2013). These factors can explain the variance in share prices which is directly related to the value relevance.

### **Sector wise impact of IFRS adoption on value relevance**

Chandrapala (2013) examined the effect of ownership concentration and firm size on value relevance of earnings and book value, for firms listed in Colombo Stock Exchange in Sri Lanka from 2005 to 2009. The sample of that study consisted of firms which belong to every sector of the economy and the sector wise impact of IFRS adoption on value relevance had not been discussed.

Srinivasan and Narasimhan (2012) examined the value relevance of cash flows in India using a sample of 4,954 listed companies in the Bombay Stock Exchange (BSE). In this study also, the entire economy was analysed. The researchers had not discussed the sector wise impact of IFRS adoption on value relevance.

Chebaane and Othman (2014) examined the effect of mandatory adoption of International Financial Reporting Standards on the value relevance of earnings and the book value of equity using a sample of 10,838 firm- year observations of listed companies from African and Asian emerging economies. This sample consisted of firms, which belong to six economic sectors namely, 1: Industrial, 2: utility, 3: transportation, 4: Bank saving loans, 5: Insurance and 6: other financial. These sectors denoted the highest percentage from GDP of each country. But, the researchers had not discussed the sector wise impact of IFRS adoption on value relevance.

### **Impact of IFRS adoption on value relevance of plantation sector in Sri Lanka**

Earlier companies in Plantation sector have used SLAS 32, but with the adoption of IFRS, IAS 41 was required to be applied. Main difference of this standard is application of fair value for the measurement. Even though there were prior researches studies done over the impact of IFRS adoption on value relevance in Sri Lankan companies by researchers such as

Chandrapala (2013), Weerathunga and Udayakumara (2015), there were no research studies carried out analysing the impact to plantation sector.

### **03. Methodology**

#### **Sampling design**

All the listed companies of the plantation sector in Sri Lanka as at 15 July 2016 are included in the population of the study. Out of the population 6 companies has been selected on the basis of availability of information and financial information would be analyzed over 03 consecutive years before adoption of IFRS and over 03 consecutive years after adoption of IFRS. As a result, the sample consists of 144 firm/quarter observations.

This sample has been selected based on the availability of financial Statements for the financial years from 2009/2010 to 2014/2015. Thus, the sample does not include the companies closed down after adoption of IFRS, companies in which the financial year ends as at 31 December, companies in which the financial year end was changed from 31 December to 31 March within the period of observation and the companies which were incorporated after adoption of IFRS.

#### **Selection of the plantation sector as the study area**

Instead of the historical cost method as per SLAS 32 which was used to record the value of biological assets, IAS 41 introduced fair value accounting. This was a significant change that affected the financial information of the companies in the plantation sector of Sri Lanka as per CA Sri Lanka (2012). Then again, a significant change like this may affect the value relevance of financial information. Even though research studies on the impact of IFRS adoption on value relevance in Sri Lanka companies had been carried out by researchers such as Chandrapala (2013), Weerathunga and Udayakumara (2015), they have not analyzed the impact to the plantation sector. Therefore, a research gap could be identified.

#### **Collection of Data**

This study uses secondary sources of data regarding earnings, size (total assets) and financial leverage, which were obtained from CSE website ([www.cse.lk](http://www.cse.lk)). The price data were obtained from the CSE data library 2015.

## Methods of Data Analysis

The value relevance is based on the explanatory power of the regression of stock price on factors such as EPS, book value per equity (BVPS), size of the firm, leverage and cash flows. These associations have been introduced by Ohlson (1995) and it is known as Ohlson's Price Model. In other terms, if there is a link between share prices and accounting variables, such information is said to be value relevant.

This study uses Ohlson's Price Model, which was widely used in prior value relevance research studies by Chebaane and Othman (2014) and Chandrapala (2013) to explain the relationship between EPS or BVPS with share prices. Since main intention of this study is to examine the impact of IFRS adoption on value relevance of earnings. Therefore, above equation is modified as follows.

$$P_{it} = \alpha_0 + \alpha E_{it} + \alpha S_{it} + \alpha L_{it} + e_{it}$$

Where,

P = Market Price of Common Stock

E = Earnings per Share

S = Size of the firm

L = Leverage of the firm

i = company

t = time (year)

This study uses the coefficient of determination ( $R^2$ ) as the unit to measure the value relevance of earnings. This regression model is used for the total sample and sub samples of leverage and firm size. Information available as at 31 March 2012 is used as the criterion for classifying the sample into size based two sub samples and leverage based two sub samples. The reason for the creation of such sub-samples is the impact of size and leverage to the earnings of a firm.

Firms with a total asset value, which is less than median total asset value in the sector of all the listed firms in the plantation sector, are designated as small size firms and those with a total asset value greater than the median are designated as large size firms. Whereas the firms with a leverage ratio less than median in the sector are considered as low leverage firms while

the firms with a leverage ratio higher than median are considered high leverage firms for the purpose of this study.

## 04. Findings and Discussion

### Value Relevance of Earnings: All Firms

Table 01 represents the results of panel data regression of price on earnings, total assets and leverage of the sample. The sample consists of 144 firm/quarter observations of listed companies in the plantation sector of Sri Lanka in both pre- adoption period and post-adoption period.

*Table 1: Regression Analysis of all firms*

	Regression Coefficients			Coefficient of Determination ( $R^2$ )
	EPS	Total Assets	Leverage	
Pre-adoption	6.4488 (0.000)	51.9246 (0.000)	-49.8220 (0.008)	0.5510
Post-adoption	1.8009 (0.001)	27.7701 ( 0.005)	-21.3115 (0.012)	0.4411

\*\* p-values are reported in parenthesis

Source: Author's analysis based on CSE secondary data

The explanatory power ( $R^2$ ) of earnings in the Pre-adoption period is 0.5510 and 0.4411 in the Post-adoption period. These results show a decrease of explanatory power ( $R^2$ ) in the Post-adoption period indicating that the value relevance of earnings in the plantation sector has been decreased after the adoption of IFRSs. These findings are further confirmed by the research findings of Negakis (2013), Padmini and Narasimhan (2012) and Ahmed and Goodwin (2006), which show the value relevance of earnings has been decreased after the adoption of IFRSs. However, the findings are contradictory with the findings of Rozainun and Ibrahim (2009), Espinosa and Oliver (2015, Umoren and Enang (2015), which find that the value relevance of earnings has been increased after the adoption of IFRSs.

Even though the value relevance of earnings is decreased after the adoption of IFRSs, EPS is a significant variable in explaining the share price in both periods ( $p < 0.05$ ). In addition to the EPS, total assets and leverage is also significant in explaining the share prices in both periods.

### Value Relevance of Earnings: Large Size Firms vs. Small Size Firms

Table 02 represents the results of panel data regression of price on earnings, total assets and leverage. The sample consists of 144 firm/quarter observations in both pre-adoption period and post-adoption period. Out of these 144 firm/quarter observations, 72 are classified as large size firms while other 72 as small size firms.

*Table 2: Regression Analysis of large and small size firms*

		Regression Coefficients			Coefficient of Determination ( $R^2$ )
		EPS	Total Assets	Leverage	
Large Size Firms	Pre-adoption	2.7741 (0.103)	178.8386 (0.000)	-10.5453 (0.846)	0.4082
	Post-adoption	1.5289 (0.008)	-8.6549 ( 0.594)	-5.0203 (0.613)	0.3903
Small Size Firms	Pre-adoption	4.7530 (0.018)	51.7910 (0.021)	-68.9904 (0.005)	0.3716
	Post-adoption	-.2850 (0.747)	42.7244 (0.001)	-18.6100 (0.121)	0.3389

\*\* p-values are reported in parenthesis

Source: Author's analysis based on CSE secondary data

The explanatory power ( $R^2$ ) of earnings in the pre-adoption period is 0.4082 and 0.3903 in the post-adoption period. These results show a decrease of explanatory power ( $R^2$ ) in the post-adoption period indicating that the value relevance of earnings of the large size firms in the plantation sector has been decreased after the adoption of IFRSs. Only the total assets is significant in explaining share prices of large size firms in pre-adoption period whereas EPS becomes significant in explaining share prices in the post-adoption period.

Small firms also show the same results indicating that the value relevance of earnings in the plantation sector has been decreased after the adoption of IFRSs. The explanatory power ( $R^2$ ) of the earnings is 0.3716 in the pre-adoption period and 0.3389 in the post-adoption period. EPS, total assets and leverage are significant in explaining share prices in the pre-adoption period while only the total assets is significant in explaining share prices in the Post-adoption period.

When the explanatory power( $R^2$ ) of small sized firms as well as large sized firms in pre-adoption period is compared, it is apparent that large sized firms depicts a higher explanatory power by having an  $R^2$  value of 0.4082 while small sized firms showing an  $R^2$  equal to 0.3716. Also, in post-adoption period, explanatory power ( $R^2$ ) of small sized firms is 0.3389

and large sized firms have a 0.3903 explanatory power ( $R^2$ ). By considering this information, it can be concluded that, in both pre-adoption period as well as post-adoption period, large sized firms contains higher value relevance in earnings information of Plantation sector of Sri Lanka compared to small sized firms.

### **Value Relevance of Earnings: High Levered Firms vs. Low Levered Firms**

Table 03 represents the results of panel data regression of price on earnings, total assets and leverage. The sample consists of 144 firm/quarter observations in both pre-adoption period and Post-adoption period. Out of these 144 firm/quarter observations, 72 are classified as high levered firms while other 72 as low levered firms.

*Table 3: Regression Analysis of high levered and low levered firms*

		Regression Coefficients			Coefficient of Determination ( $R^2$ )
		EPS	Total Assets	Leverage	
High Levered Firms	Pre-adoption	.9484 (0.074)	64.3341 (0.006)	-.1041 (0.992)	0.3091
	Post-adoption	.2626 (0.192)	8.5028 (0.042)	-5.4521 (0.083)	0.2703
Low Levered Firms	Pre-adoption	5.3760 (0.022)	71.2623 (0.004)	-132.2749 (0.014)	0.5010
	Post-adoption	4.8318 (0.000)	-2.5115 (0.863)	-5.5620 (0.830)	0.3994

\*\* p-values are reported in parenthesis

Source: Author's analysis based on CSE secondary data

In high levered firms, the explanatory power ( $R^2$ ) of earnings in the pre-adoption period is 0.3091 and 0.2703 in the post-adoption period showing a decrease of explanatory power ( $R^2$ ) in the post-adoption period indicating that the value relevance of earnings in the plantation sector has been decreased after the adoption of IFRSs. Only the total assets are significant on explaining share prices in both periods.

In low levered firms, the explanatory power ( $R^2$ ) of earnings in the pre-adoption period is 0.5010 and 0.3994 in the post-adoption period showing a decrease of explanatory power ( $R^2$ ) in the post-adoption period indicating that the value relevance of earnings in the plantation sector has been decreased after the adoption of IFRSs. EPS, total assets and leverage are



significant in the pre-adoption period but only the EPS is significant on explaining share prices in post-adoption period.

When considering the explanatory power ( $R^2$ ) of earnings in pre-adoption period, it is clear that low levered firms have a much higher explanatory power than high levered firms, owing to  $R^2$  values of 0.3091 in high levered firms and 0.5010 in low levered firms. Even though the explanatory power decreases in post-adoption period due to IFRS adoption, it is evident that the same position exists in that period too; Low levered firms having a higher  $R^2$  value of 0.3994 compared to high levered firms where  $R^2$  is 0.2703. Therefore, it can be concluded that financial information in low levered firms are more value relevant than high levered firms.

## **05. Conclusion**

This study has investigated the impact of international financial reporting standards adoption on value relevance of earnings in listed companies of the plantation sector in Sri Lanka. The main objective of the study was to identify whether value of earnings has increased after the adoption IFRSs in listed companies of the plantation sector in Sri Lanka. Results showed that the adoption of IFRSs has not increased the value relevance of earnings of Plantation sector in Sri Lanka. Furthermore results indicated that firms with low leverage have more value relevance in earnings than high levered firms. Meanwhile, large size firms show higher value relevance of earnings when compared with small sized firms. However, this study is limited since it cannot be generalized beyond the Plantation sector. In addition, the study only examined the effect of IFRS adoption on earnings but accounting numbers other than earnings, such as cash flow from operations, and book value per equity should be considered in further research.

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