Culture, Legal origin and the Asymmetric Earnings timeliness before and after the adoption of IFRSs

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Abstract

Purpose: This paper examines whether culture and legal origin influence the role of IFRS on the asymmetric earnings timeliness.

Design/Methodology/Approach: The research uses panel data of 330 listed firms from four African countries namely; Egypt, South Africa, Kenya and Morocco for a period of eight years from 2002 to 2009. The choice of this period is based on the fact that many African countries started adopting IFRS in 2005 as a result of the European Union accounting regulation number 1606/2002/EC of 2002 which required all public companies listed on stock markets to consolidate their financial accounts using IFRS with effect from January 2005.

Findings: The findings show that firms from common law countries are timelier in recognizing bad news but less timely in recognizing good news compared to firms from code law countries, consistent with prior studies. Nevertheless, the overall recognition timeliness of earnings measured through the adjusted R^2 decreases more in common law than code law firms post-IFRS. Further, the results indicate that culture is associated with a reduction in loss and incremental loss recognition timeliness prior and post IFRS. However, we find that conservative culture is associated with greater gains recognition timeliness particularly before IFRS.

Practical implications: The findings should be of interest to firm managers, policy makers and accounting standard setters such as IASB professional accounting bodies. Further, the results imply that the usefulness of IFRS through asymmetric earnings timeliness and its implementation are affected by culture and legal origin.

Research Limitation: This research is limited to four African countries and 330 listed firms. Future research may increase the sample in order to increase diversity and get more insight on the impact of culture and legal environment on asymmetric earnings timeliness.

Originality/value: The study contributes to the meager literature on the efficacy of IFRS in emerging economies with different institutional settings, culture and legal origin.

Key words: IFRS, Asymmetric Earnings Timeliness, Prudence Accounting Principle, Culture, Legal Origin.

1. Introduction

This paper examines whether International Financial Reporting Standards (IFRS) adoption improves asymmetric timeliness of earnings as a measure of stewardship of management to owners irrespective of the differences in hosting country's institutional settings, culture and legal origins. Earnings timeliness is *the ability of net income to incorporate contemporary economic events* and asymmetric earnings timeliness *is the ability of earnings to recognize economic losses more timely than economic gains due to prudence principle in accounting*. There are two types of prudence accounting principle namely; *news-dependent prudence accounting principle* and *news-independent prudence accounting principle*.[7] This study is based on news-dependent prudence

[7] News-dependent prudence accounting principle refers to; *"the more timely recognition of bad news than good news into earnings" whilst* news-independent prudence accounting principle refers to; *"understatement of assets and revenues and overstatement of liabilities and expenses"*.

accounting principle as accountants require more verifiable evidences to recognize revenues than they do for losses; thus losses are recognized more quickly than revenues. The research objective is important in African settings where culture is conservative (Hofstede, 1980, Gray, 1988), legal origins are mixed and other institutional settings are less established (La Porta *et al.,* 1997, 1998).

IFRS are principles-based accounting standards as opposed to rules- based Financial Accounting Standards issued by the US- based Financial Accounting Standards Board (FASB). Thus, as a result of their flexibilities, their implementations are based on management judgment and discretion. Besides, IFRS use fair value measurement and Anglo-Saxon principles which require the existence of well-established capital markets in order to provide pricing mechanisms on constant and continuous basis. However; African capital markets are epitomized by illiquidity and pricing inefficiencies (Onyema, 2016).

There are competing propositions regarding the impact of IFRS on earnings quality and timeliness. The principles- based rather than the rules-based accounting standards provide avenues for opportunistic behaviour and judgment by managers leading to distortion of reported earnings (Schipper, 2003). On the other hand, 'rules' based accounting standards undermine professional accounting judgment by putting in place well defined rules or guidance on accounting treatment in financial statements (Benston *et al.,* 2006). As a result, it may lead to misrepresentation of firms' underlying economic phenomena and smoothing of income in order to avoid large losses and hence favour the firms' contractual obligations and debt covenants (Barth *et al.,* 2008).

The inefficiency and illiquidity of African capital markets (Onyema, 2016), are likely to hinder the quicker incorporation of accounting information, especially earnings into share prices and the way earnings incorporate economic income (i.e. good and bad news). Furthermore, the less conservative nature of IFRS, culture and mixed legal origins inherent in most African countries are likely to affect the asymmetric earnings timeliness. Many African countries started adopting IFRS in 2005 as a result of the European Union accounting regulation number 1606/2002/EC of 2002 which required all public companies listed on stock markets to consolidate their financial accounts using IFRS with effect from January 2005.

The theoretical and empirical literature on the link between IFRS issues and implementation on one hand and earnings quality through asymmetric earnings timeliness on the hand point out that culture; legal origins and other institutional settings are likely to be the main impediments to the successful implementation of IFRS (See for instance; Zeghal and Lahmar; 2018, Enomoto, 2018, Manganaris *et al.,* 2015, Andrẻ *et al.,* 2013, and Ball 2006). For instance; Ball (2006) argue that; *"the notion that uniform standards alone will produce uniform financial reporting seems naïve, if only because it ignores deep-rooted political and economic factors that influence the incentives of financial statement preparers and that inevitably shape actual financial reporting practice".* This implies that, financial reporting quality is likely to differ from one country to another due to differences in institutional settings, political and economic factors, culture and legal origins.

Previous studies in this strand of literature mainly link culture and asymmetric earnings timeliness only and focus on European countries (See for instance; Zeghal and Lahmar; 2018, Manganaris *et al.,* 2015, Andrẻ *et al.,* 2013) and other developed countries (Enomoto, 2018 and Noravesh *et al.,* 2015, Ball *et al.,* 2000, 2003, Ball and Shivakumar, 2005, Barth *et al.,* 2008, Ball *et al.,* 2008). There are relatively few studies which link culture and legal origin to accounting in Africa and they focus on value relevance and predictive ability of IFRS earnings see for instance; Hillier *et al.* (2015) and Ngole (2016). In a cross-country research on earnings quality, Enomoto (2018) finds that earnings quality varies with the institutional factors (legal tradition, investor protection, tax system, regulation financial development, market competition, accounting standards and enforcement of accounting standards), and cultural factors of the country. Further, Enomoto (2018) calls for future research to examine the impact of IFRS adoption on the contracting role of accounting through the change in earnings quality in an international setting.

This study therefore extends previous studies which examine the impact of IFRS on asymmetric earnings timeliness. Thus, the current study examines the influence of conservative culture and legal origin on asymmetric earnings timeliness role of IFRS. Conservative culture is defined based on Gray's (1988) *conservatism hypothesis* which asserts that; '*countries which are highly ranked in uncertainty avoidance but lower in individualism and masculinity are more likely to rank highly in terms of conservatism'*.

The findings show that firms from common law countries are timelier in recognizing bad news but less timely in recognizing good news than firms from code law countries. However, overall good and bad news timeliness of earnings (measured through the adjusted R^2) decreases to a greater extent in common law than code law countries. Moreover, consistent with prediction, there is evidence showing that conservative culture is associated with a reduction in loss, incremental loss recognition timeliness before and after IFRS. However, the results also suggest that conservative culture leads to greater gains recognition timeliness especially before IFRS adoption. This may be attributed to the behaviour of managers in countries with high degree of conservative culture reporting higher earnings to fulfil their expectations (Risberg, 2005).

One major policy implication of this study is that culture and legal origins matter on the efficacy of IFRS earnings quality and on the way IFRS earnings incorporate economic gains and losses. The study makes two main contributions to the existing literature; one, it examines the impact of culture and legal origins on IFRS earnings quality and timeliness in emerging African economies setting and two, it provides an informed feedback to the standard setters (IASB, FASB and accounting professional bodies) on the efficacy of IFRS in different institutional settings and information environments.

2. Literature Review and Hypotheses Development

2.1 Theoretical Framework

This study is underpinned by the agency theory and contract theory. Agency theory is one of the compensation theories (others being equity theory and Reinforcement/Expectancy theory) which was established by Jensen and Meckling (1976). Fligstein and Choo (2005) argues that; "agency theory views the firm as a nexus of contracts and as such sees the firm as a 'useful fiction". The theory explains the relationship between ownership and management of the firm i.e. *principal- agent relationship*. It suggests that the governance of a company is based on the conflicts of interest between the company's owners (Principals-shareholders), its managers and major providers of debt finance. Each of these groups has different interests and objectives. The owners entrust the management to run companies and the expectation is that managers will act to the best interests of the owners. This is called the stewardship role of the management to owners. However; this expectation is not always fulfilled due to the conflicts of interests between managers and owners. Agency theory is the amplification of the old adage by Smith (1776) that; *"being the managers of other people's money (rather than their own) it cannot be expected that they should watch over it with the same anxious vigilance."*

Due to separation of ownership and management of the firm, owners and lenders are usually less informed about the operations of the company when you compare with managers as the result; they depend greatly on financial reporting. Thus; this is increasing the importance of how quickly (timely) the available information is captured in financial statements. Ball *et al.* (2008) argue that timeliness affects debt contracting because reported financial statement variables affect various covenanted financial ratios including balance sheet leverage, liquidity and earnings-based interest coverage ratios. Moreover; they argue that financial reporting is shaped by debt markets not equity markets and that earnings timeliness is a measure of the stewardship of management and it increases contractual obligations and covenants. Agency theory asserts that, timely loss recognition increases the effectiveness of contractual restrictions on the decision rights of loss-making managers that are based on financial statement outcomes. In summary, the earnings timeliness and asymmetric earnings timeliness measure the stewardship role of the management. The IASB (2010) conceptual framework lists 'timeliness' as one of the enhancing qualitative characteristics of accounting information, others being verifiability, understandability and comparability. The usefulness of accounting information inter alia empirically depends on how timely it incorporates the economic gains or losses (Basu, 1997).

Contract theory guides the development of formal and informal legal agreements in a situation where there is asymmetric information between parties. This is a principal-agent case where agents (management) are more knowledgeable about the operations of firms than principals (owners). Further, Arrow (1984) asserts that; *"contract theory offers insights used in the construction of contracts to guide and influence principal-agent relations in the real world, at the same time it represents an attempt to explain observed phenomena in the empirical economic world, particularly exchange relations that are not explained by more standard economic theory"*. Thus, contract theory draws upon principles of financial and economic behavior as different parties have different incentives to perform or not perform particular actions. In constructing and developing contracts between firms and management, usually owners link the performance of managers to accounting numbers particularly earnings. Say it differently; contract theory aims at designing a metric that will optimize the manager's decisions. Contract theory is categorized into three types or models namely; moral hazard, adverse selection and signaling model.[8]

Earnings which recognize economic losses more timely than economic gains have the ability of increasing contracting efficiencies through several agency relationships such as between shareholders and management, debt holders and shareholders and other firms' contracting parties (Ball *et al.,* 2008). This is done by providing more timely information on bad news than good news (Ball *et al.,* 2000, and Basu, 1997). The concept of recognition timeliness is thoroughly examined empirically in the Basu's (1997) seminal paper. Using a U.S. sample for the period from 1963 to 1990 and a reverse ERC model, Basu (1997) predicts and confirms that earnings respond more rapidly to negative returns than positive returns and refers this phenomenon to as asymmetric timeliness of earnings. He argues that this finding is attributable to the differential accounting treatment on economic gains and losses whereby losses are recognised immediately as they occur while gains are deferred to future periods.[9]

In short, Basu (1997) intends to measure how timely earnings are in recognizing information in stock prices (good and bad news) which are based on investors past

[8] In moral hazard, a principal has an incentive to engage in risky behaviors because the associated costs are incurred by the other contracting party. Adverse selection depicts a principal who has more or better information than the other contracting party and therefore distorts the market process. Signaling depicts transferring of information from one party to the other in order to arrive at a mutual understanding. It occurs when one party adequately conveys knowledge and characteristics about itself to the principal.

[9] Basu (1997) argues that accountants require a higher degree level of verification for recognizing good news in earnings than bad news.

trading decisions. He assumes a semi-strong efficient market and the idea that accounting data lags stock prices (stock returns) hence accounting information confirms and verifies stock market information (Risberg, 2005). Despite the predictions of theories, institutional settings, culture and legal origins in African countries are different from those in US and the rest of developed countries, thus one would expect earnings timeliness and asymmetric earnings timeliness to be different as well. African countries have mixed legal origins emanating from colonialism, conservative culture and less established institutional settings which are unlikely to foster the usefulness of IFRS.

2.2 Prior Research

2.2.1 Legal Origin and Asymmetric Earnings Timeliness

The influence of legal origin on earnings recognition has been a focus of accounting researchers pioneered by Ball *et al.* (2000, 2003). For example; Ball *et al.* (2000) find that common law countries earnings are significantly timelier in recognizing bad news than earnings in code-law countries.[10] This may be attributable to quicker incorporation of economic losses in common versus code law countries. Ball *et al.* (2000) argue that the demand for accounting income is higher in common than code law countries because the latter takes a stakeholders approach of corporate governance thus solve the effects of asymmetricity of information through the insider channels and family networks.

Ball *et al.* (2003) compare the timeliness recognition of economic gains and losses of the four East Asian countries of Hong Kong, Thailand, Singapore and Malaysia with the matched sample of common and code law countries for the period from 1984 to 1996.[11] Using the Basu (1997) model, they find that the East Asian countries have similar overall earnings timeliness (measured through the adjusted R^2) to code law countries but it is much lower than those of common law countries. The incremental loss recognition coefficient shows that both Asian countries and code law countries have little evidence of incremental loss recognition although code law countries are somewhat better than Asian group. However, the results indicate that common law countries are timelier in recognizing bad news over good news. Ball *et al.,* (2003) attribute these findings to dominance of financial reporting incentives over accounting standards because all four East Asian countries accounting standards are common law in nature.

Ball and Shivakumar (2005) document that timely loss recognition is substantially less prevalent in private companies than in public companies for a U.K. sample. This is despite the fact that both private and public firms face similar regulatory rules. Moreover, Risberg (2005) examines the contractual effectiveness embedded in pubic financial reporting between the firm and the outside investor in nine different countries consisting of eight European code law countries and one Anglo-Saxon country, the U.K. Consistent with Ball *et al.* (2000), she finds that independent firms' earnings incorporate economic losses more timely than firms in

[10] Common law countries include; Australia, Canada, U.K. and U.S. while the code law countries are France, Germany and Japan for the primary sample (Firm year observations exceeding 1000). The secondary sample (with firm year observations between 100 and 1000) consists of eight common law countries including South Africa and ten code law countries (for further detail see Ball *et al.*, 2000, p.20).

[11] The common law sample comprises of Australia, Canada, U.K. and U.S. while the code law sample consists of Germany, France and Japan.

pyramid groups.[12] However, firms in pyramid groups are more aggressive reporters of economic income than independent firms.

In a study involving 78,949 firm-year observations from 22 countries during the period 1992-2003, Ball *et al.* (2008) hypothesize and confirm that debt markets and not equity markets are associated with the level of timely loss recognition.[13] They argue that the demand for financial reporting is primarily triggered by debt markets contrary to the widespread belief that equity markets and not debt markets should shape corporate financial reporting. Moreover, they find that timely gain recognition is independent of equity markets and that legal origin is positively and significantly associated with timely loss recognition. Thus, the incremental loss recognition coefficient confirms the importance of debt markets not equity markets.

Barth *et al.* (2008) examine whether the application of International Financial Reporting Standards (IFRS) is associated with higher loss recognition timeliness than non-U.S. domestic standards. They compare the loss recognition timeliness of IFRS firms and non-IFRS firms before and after adoption periods on a large sample of 1896 firm-year observations (327 firms) for the period spanning from 1994 to 2003 involving 21 countries.[14] They find that IFRS firms recognize large losses more frequently than non-IFRS firms in both periods before and after IFRS adoption. In summary, this strand of literature suggests that legal origin has an impact of asymmetric earnings timeliness and accounting practices in general.

2.2.2 Culture and Asymmetric Earnings Timeliness

The concept that culture is a determinant of accounting practices and institutions is a developing phenomenon in accounting literature. See for instance; Hillier *et al.* (2015) and Ngole (2016). Culture-accounting literature suggests that culture dominates accounting and institutions; in other words; as far as accounting is part of the country's institutional settings, it is more likely to be affected by culture. The theory of national culture was pioneered by Hofstede (1980). The Hofstede's (1980, 1991, and 2001) seminal works remain pivotal in terms of culture related research. Hofstede (1980, p.25) defines culture as *'the collective programming of the mind which distinguishes the members of one human group from another'*.

Hofstede (1980) developed four dimensions of culture namely; uncertainty avoidance (UA), power distance (PD), individualism (IND) versus collectivism (COL) and masculinity (MASC) versus femininity (FEM). Later on, Gray (1988) developed a framework that links Hofstede (1980) cultural dimensions (society values) and accounting values and accounting practices. Gray (1988) came up with four hypotheses i.e. the *secrecy*, *conservatism*, *uniformity* and *professionalism* hypotheses.

Using a sample of 800 firm year observations from 21 countries during the period 1993-2001, Kang *et al.* (2004) examine the relationship between conservative culture and news-independent prudence accounting. They use Schwartz (1994) culture conservatism index score. Their findings indicate that conservative culture is

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[12] Risberg (2005) defines independent firms as firms not owned by another firms or with less ownership concentration most found in Anglo-Saxon countries. Pyramid firms are the ones which are owned by other firms, with higher level of ownership concentration and are prevalent in corporate Europe.

[13] The sample included eight common law countries i.e. Australia, Canada, U.K., U.S., South Africa, Malaysia, Singapore and Thailand and fourteen code law countries including; Brazil, Chile, France, Indonesia, Italy, Netherlands, Spain, Germany, Japan, South Korea, Denmark, Finland, Norway, and Sweden.

[14] The countries include; Australia, Austria, Belgium, China, Czech Republic, Denmark, Finland, Germany, Greece, Hong Kong, Hungary, Poland, Portugal, Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, and United Kingdom.

negatively related to non-operating accruals (a proxy for news-independent prudence accounting). This implies that the higher the conservative culture the higher is prudent accounting. Also, they find that culture and legal origin are independent in explaining incremental loss recognition timeliness.

Dragomir *et al.* (2010) examine the relationship between accounting conservatism (using a ratio of provisions to total liability, *PLR* as a proxy) and national accounting culture (countries classified into IFRS complaint, conservative and liberal). The sample comprises of 388 firms (IFRS compliant-147, Conservative-179 and Liberal-62) from 17 European countries during the period between 31st December 2007 and 30th September 2008.[15] The results indicate that firms from conservative culture recognize significantly greater amounts of provisions than firms from IFRS-compliant and Liberal accounting culture. This implies that conservative culture directly relates to news-independent prudence accounting. To this end, there is no study examining the relationship between conservative culture and news-dependent prudence accounting surrogated by incremental loss recognition timeliness. As Risberg (2005) argues that managers in conservative culture tend to report more gains than losses, one would expect conservative culture to adversely affect asymmetric earnings timeliness. This implies that although IFRS provides more incremental loss recognition timeliness than local GAAP (Barth *et al.,* 2008), the conservative culture widespread in African countries is more likely to reduce its usefulness in terms of asymmetric earnings timeliness.

In a cross-country research, Enomoto (2018) finds that cultural and institutional factors affect the quality of earnings. This suggests that a single set of accounting standards (IFRS) that are generally viewed as of high quality does not always improve earnings quality. Moreover; the author argues that the relationship between IFRS adoption and earnings quality is moderated by culture and institutional settings. Zeghal and Lahmar (2018) examine the effect of culture on prudence in accounting during the adoption of IFRS in fifteen European Union countries during the period 2000-2010. Their study finds that the variation of news-dependent prudence accounting is influenced by all six cultural dimensions (individualism, power distance, uncertainty avoidance, masculinity, long term orientation, and indulgence) established by Hofstede (1980) and Hofstede *et al.* (2010) whilst news-independent prudence accounting is only affected by power distance. In another European countries′ study, Manganaris *et al.* (2015) find that country specific features affect both the accounting quality and the relationship between value relevance and news-dependent prudence accounting.

Noravesh *et al.* (2015) test the Gray′s (1988) model in Iran and find that one-half of the Gray hypotheses are supported. They attribute the lack of full support to *abnormal evolution of accounting in Iran*, the impact *of unstable economics*, *inappropriate use of accounting methods and procedures*, *the impact of governmental ownership*, and *the lack of well-developed capital market tradition*.

In summary, prior studies have concentrated in developed economies (for example, U.S., U.K., Germany, Australia, Canada, and France among others). These economies have developed stock markets which are a prerequisite condition for timely incorporation of bad and good news into earnings. Unlike developed countries, African markets are unsophisticated and information inefficient (Onyema, 2016, Smith *et al.,*

[15] IFRS compliant countries include; United Kingdom, Ireland, Norway and Sweden. Conservative countries include; Germany, France, Switzerland, Finland, Netherlands, Belgium, and Austria. Liberal countries include; Spain, Italy, Denmark, Portugal, Greece and Luxembourg. The measurement and recognition of provisions in all firms is done under IFRS regulations.

2002 and Kenny and Moss, 1998), thus earnings may not capture market news in a timely fashion. To conclude; there is a gap in the literature on the studies examining the impact of culture and legal origin on asymmetric earnings timeliness during the accounting regime change from the local GAAP to IFRS.

2.3 Hypotheses Development

2.3.1 Culture

Agency theory and Contract theory are principally explaining the principal-agent relationship in the assumption that information is asymmetric among the contracting parties. Since managers are engaged in daily firm′s operations, they usually possess information which owners do not have, thus asymmetricity of information. The theoretical argument is that managers are expected to act in the best interests of the owners although this is not the case always. One way of solving the agency problems is to ensure that the contract aligns the interests of managers (e.g. salary and other perks) with performance. The performance of managers is usually measured through accounting numbers especially profits or earnings. The higher the earnings, the greater is the performance. Sometimes managers manipulate earnings in order to attain the set performance metrics and improve the principal-agent relationship and this behaviour is even greater in culturally embedded countries (Risberg, 2005). This prediction is confirmed by Kang *et al.* (2004) and Dragomir *et al.,* (2010).

Kang *et al.* (2004) predict and find that conservative culture is directly related to prudence in accounting. Dragomir *et al.* (2010) hypothesize and find that even under IFRS; the national accounting culture still affects prudence in accounting. Kang *et al.,* (2004) use non-operating accruals (NOA) while Dragomir *et al.* (2010) use the ratio of provisions to total liability (PLR) as measure of prudence in accounting. The lower value of NOA and the higher value of PLR are indicative of prudent accounting.

Based on agency and contract theory and the findings by Risberg (2005), Kang *et al.* (2004) and Dragomir *et al.* (2010), we argue that even if IFRS is regarded as a set of high quality accounting standards (Barth *et al.,* 2008), the prevailing conservative culture in Africa may influence firms′ managers to report more gains than losses to avoid being held accountable by external investors. Also, they are likely to anticipate all profits but not losses in order to make income statements look attractive to current and potential investors and of course to improve the principal-agent relationship. Moreover, due to the principles-based nature of IFRS, conservative culture ubiquitous in African countries is likely to facilitate managers to choose accounting choices in their favour rather than exercising professional judgement. Thus, we suggest that conservative culture affects gains and loss recognition timeliness differently. Basing on above theoretical assertions and arguments, we predict and test the following hypothesis:
H1: *Conservative culture positively (negatively) affects gains (loss and incremental loss) recognition timeliness in African capital markets before and after IFRS*

2.3.2 Legal origin

The nexus of the agency theory hinges on whether the separation of ownership from control is the same when firms are banks-oriented or markets oriented.[16] For example; Fligstein and Choo (2005) assert that agency problems and the need for firms to obtain capital are solved differently in different societies because of the opportunities and

[16] The shareholding pattern in banks, family or financial institutions is widespread and concentrated whilst in market based firms is less spread and concentrated. Thus, the focus of agency theory is likely to be different.

constraints of the existing political and legal systems. This implies that the application of agency theory is likely to be based on the cultural tradition of the legal systems, such as civil (code) and common law legal systems.

Common legal systems emphasize on the shareholders protection rules and market-orientations. This implies that; the institutional settings in common legal systems foster the corporate financial reporting as a mechanism for shareholders to monitor the agents and measure their performances. This assertion is supported by Ball *et al.,* (2003) who argue that; timely financial accounts or reports are primarily needed for common law than code law countries users because in code law countries information is also channelled through other private networks and insider dealings. However, in Germany, Hung and Subramanyam (2007) document that IFRS earnings are not exhibiting the incremental loss recognition timeliness over the German GAAP earnings. This study compared asymmetric earnings timeliness under two accounting regimes (IFRS and Germany GAAP) but it did not examine the impact of legal origin on accounting regime change. This calls for more empirical research in this strand of literature.

Generally, many previous studies conclude that; common law earnings are of higher quality than code law earnings (see for instance; Barth *et al.,* 2008, Prather-Kinsey, 2006, Ball *et al.,* 2003 and Ball *et al.,* 2000, Prather-Kinsey, 2006). Thus, they exhibit more earnings timeliness and asymmetric earnings timeliness. For instance, Ball *et al.,* (2003) report higher earnings timeliness for common law countries than East Asian and code law countries.

Based on the above theoretical assertions, we argue that the market infrastructure necessitating the timely incorporation of market news (good or bad) into earnings is better for common law than code law countries. This is accentuated by the adoption of IFRS in African countries. Thus; we predict and test the following hypothesis:

H2: *Asymmetric earnings timeliness increases more significantly after IFRS adoption in African common law countries than African code law countries.*

3. Data and Research Method

3.1 Data

The data spans eight years from 2002 to 2009, and involves four African countries, namely, South Africa, Egypt, Kenya, and Morocco. The sample selection criteria are such that a country must have adopted IFRS during the study period; and firm must have both accounting and financial data. In total, there were 330 firms distributed as follows; South Africa (242), Morocco (24), Kenya (24) and Egypt (40). Botswana had accounting, financial and legal origin data but it lacked culture data thus; it was dropped. The data were obtained from data stream, Thomson one banker (World Scope), www.africanfinancials.com and respective companies' websites. The culture data were obtained from Hofstede (1980, 2001) and House *et al.,* (2004); while legal origins' classifications were found in La Porta *et al.,* (1997, 1998).

3.2. Research Method

The base model is the Basu (1997) reverse ERC model. This model is extended by introducing an IFRS dummy (D) to capture the impact of IFRS on asymmetric earnings timeliness, forming the equation below.

$$E_{i,t} = \alpha_0 + \alpha_1 NEG_{i,t} + \alpha_2 NEG * RET_{i,t} + \alpha_3 D * NEG * RET_{i,t} + \alpha_4 RET_{i,t} + \alpha_5 D * RET_{i,t} + \varepsilon_{i,t}$$

(1)

Where, D is an IFRS dummy equal to 1 if a firm observation is from years following the IFRS adoption year and 0 otherwise. $E_{i,t}$ is the earnings per share deflated by beginning period share price, $NEG_{i,t}$ is a dummy variable equal to 1 if RET < 0, = 0 otherwise, $RET_{i,t}$ is returns calculated as change in price levels divided by original prices on firm i extending from nine months prior to fiscal year end to 3 months after the fiscal year. $NEG_{i,t} * RET_{i,t}$ is an interaction variable capturing the sensitivity of earnings to bad news (negative returns) before IFRS. $D*NEG_{i,t}* RET_{i,t}$ is an interaction variable capturing the incremental effect of IFRS on bad news coefficient. $D* RET_{i,t}$ measures the incremental effect of IFRS on the arrival of news to the market (returns), i and t indicates firm and time respectively and $\varepsilon_{i,t}$ is a random or disturbance term of firm i at the end of the period t. The intercept (α_0) captures prior news incorporated into earnings and is expected to be positive (Pope and Walker, 1999). The coefficients α_4 and α_5 measure the sensitivity of earnings to good news before and after IFRS respectively and represent the cost of capital if all available market information is fully incorporated into earnings. Moreover, α_2 and α_3 measure incremental loss recognition timeliness of earnings before and after IFRS respectively.

To assess the impact of culture on asymmetric earnings timeliness pre and post-IFRS, we extend equation 1 by introducing a culture variable, CON to form equation 2. It is an indicator variable equal to 1 if the conservatism value is greater than its median value and 0 otherwise. The inclusion of this variable is motivated by Kang *et al.,* (2004) and Dragomir *et al.,* (2010) who find that there is a direct relationship between conservative culture and prudent accounting.

$$E_{i,t} = \alpha_0 + \alpha_1 NEG_{i,t} + \alpha_2 NEG * RET_{i,t} + \alpha_3 CON * NEG * RET_{i,t} + \alpha_4 D * NEG * RET_{i,t} + \alpha_5 CON * D * NEG * RET_{i,t} + \alpha_6 RET_{i,t} + \alpha_7 CON * RET_{i,t} + \alpha_8 D * RET_{i,t} + \alpha_9 CON * D * RET_{i,t} + \varepsilon_{i,t} \quad (2)$$

Where conservative culture (CON) is defined as uncertainty avoidance (UA) minus the summation of individualism index (IND) and masculinity index (MASC) (Hope *et al.,* 2008 and Gray, 1988) computed using Hofstede (1980) and House *et al.* (2004) cultural dimension scores. However, consistent with prior studies such as Hope *et al.,* (2008), we exclude the masculinity index because it has insignificant influence on conservatism. Thus, conservatism is computed as, CON = UA –IND. $CON*NEG*RET_{i,t}$ and $CON*RET_{i,t}$ are interaction variables capturing the impact of conservative culture on the sensitivity of earnings to bad and good news respectively before IFRS. $CON*D*NEG*RET_{i,t}$ and $CON*D*RET_{i,t}$ are interaction variables capturing the impact of conservative culture on the sensitivity of earnings to bad and good news respectively after IFRS.

To assess the impact of legal origin on earnings timeliness and conditional conservatism, we introduce *a legal origin dummy*, C on the test variables in equation 1 to form equation 3. C is an indicator variable equal to 1 if a firm observation is from common law countries and zero otherwise.

$$E_{i,t} = \alpha_0 + \alpha_1 NEG_{i,t} + \alpha_2 NEG * RET_{i,t} + \alpha_3 C * NEG * RET_{i,t} + \alpha_4 D * NEG * RET_{i,t} + \alpha_5 C * D * NEG * RET_{i,t} + \alpha_6 RET_{i,t} + \alpha_7 C * RET_{i,t} + \alpha_8 D * RET_{i,t} + \alpha_9 C * D * RET_{i,t} + \varepsilon_{i,t} \quad (3)$$

Where $C*NEG*RET_{i,t}$ and $C*D*NEG*RET_{i,t}$ are interaction variables capturing the Common law legal effect on the sensitivity of earnings to bad news before and after adoption of IFRS. $C*RET_{i,t}$ and $C*D*RET_{i,t}$ are interaction variables capturing the impact of common law legal origin on the sensitivity of earnings to good news before and after IFRS respectively. Consistent with prior studies, this study includes the following control variables; firm size, leverage and accruals ratio. All variables used in this study are winsorized at 5% to mitigate the effect of outliers.

4. Results

This section reports the results on the impact of culture and legal origins on asymmetric earnings timeliness before and after adoption of IFRS.

4.1 Common versus Code Law Countries

Table 1 reports the regression results based on legal origin classification. Panel A represents dummy variable regression results while panel B represents separate sample regression results. Panel A results show that loss and incremental loss recognition timeliness is greater for common law than for code law firms (see Model 1-Model 4). However, gains recognition timeliness is greater for code law than for common law firms. This implies that earnings in common law firms are timelier (untimely) in recognizing bad news (good news) than earnings in code law firms.

While there is no evidence suggesting that loss and incremental loss recognition timeliness increase after IFRS in both groups, there is evidence showing that gains recognition timeliness decreases significantly after IFRS for both common and code law firms. Similarly, Model 6 and Model 7 indicate that the common law legal origin incremental effect coefficient is significantly positive for incremental loss recognition timeliness and negative for gains recognition timeliness before IFRS. However, after IFRS, the common law legal origin incremental coefficient for incremental loss recognition is negative while that of gains recognition timeliness is positive (see Model 7).

The explanatory and predictive power (capturing the overall earnings timeliness) increases from 5% to 5.5% in common law firms and from 9.7% to 10.2% in code law firms (Model1-Model 4). Also, it increases slightly from 6.1% in Model 5 to 6.5% in Model 6 and 7.4% in Model 7. Furthermore, results in panel B are qualitatively similar to results in panel A. Overall earnings timeliness decreases from 9.8% to 4.9% in common law firms and from 14.6% to 8.1% in code law firms. In general, these findings are consistent with prior studies which find no evidence suggesting that IFRS leads to increased gains and loss recognition timeliness (e.g. Hung and Subramanyam, 2007) and those which find evidence that common law earnings exhibit more incremental loss recognition timeliness than code law earnings (e.g. Hung and Subramanyam, 2007 and Ball *et al.,* 2000, 2003).

Table 1 The Impact of Legal Origin on Asymmetric Earnings Timeliness
Panel A Dummy Variable Regressions

	Common Law		Code Law		Whole Sample		
	Before	After	Before	After			
Variable	M1	M2	M3	M4	M5	M6	M7
α_0	0.171***	0.229***	0.259***	0.256***	0.175***	0.179***	0.244***
	(10.85)	(8.367)	(6.702)	(6.551)	(12.287)	(12.502)	(12.669)
$NEG_{i,t}$	-0.065***	-0.065***	-0.009	-0.014	-0.054***	-0.031**	-0.026**
	(-4.786)	(-4.683)	(-0.317)	(-0.487)	(-4.399)	(-2.326)	(-1.962)
$NEG*RET_{i,t}$	0.110***	0.182***	-0.060	-0.088	0.067*	-0.05	-0.014
	(2.833)	(2.748)	(-0.774)	(-0.796)	(1.951)	(-0.936)	(-0.157)
$C*NEG*RET_{i,t}$						0.269***	0.360***
						(3.222)	(2.969)
$D*NEG*RET_{i,t}$		-0.078		0.070			-0.049
		(-1.141)		(0.504)			(-0.576)
$C*D*NEG*RET_{i,t}$							-0.176
							(-1.195)
$RET_{i,t}$	-0.015	-0.006	0.119***	0.153***	0.001	0.066***	0.089***
	(-1.365)	(-0.489)	(3.704)	(4.217)	(0.122)	(2.949)	(4.053)
$C*RET_{i,t}$						-0.073***	-0.094***
						(-2.964)	(-3.790)
$D*RET_{i,t}$		-0.037***		-0.118**			-0.056***
		(-2.592)		(-2.230)			(-4.580)
$C*D*RET_{i,t}$							0.076**
							(2.573)
Year Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	2128	2128	512	512	2640	2640	2640
Adj. R^2 (%)	5.0	5.5	9.7	10.2	6.1	6.5	7.4

Notes: This panel reports results about the impact of legal origin on asymmetric earnings timeliness from dummy variable regressions. The robust t-statistics are in parentheses. ***, ** and * denote robust statistical significance at the 1%, 5% and 10% levels according to a two tailed t-test. M stands for Model.

Panel B Separate Sample Regressions

	Common Law Sample		Code Law Sample	
	Before	After	Before	After
Variable	M1	M2	M3	M4
α_0	0.192***	0.151***	0.215***	0.090***
	(8.894)	(13.654)	(4.763)	(4.836)
$NEG_{i,t}$	-0.122***	-0.035***	-0.017	0.006
	(-3.930)	(-2.602)	(-0.405)	(0.404)
$NEG*RET_{i,t}$	0.236**	0.088***	-0.043	-0.009
	(2.031)	(2.703)	(-0.346)	(-0.247)
$RET_{i,t}$	-0.057***	-0.014	0.108*	0.059***
	(-2.903)	(-1.034)	(1.740)	(3.465)
Year Effects	Yes	Yes	Yes	Yes
Country Effects	Yes	Yes	Yes	Yes
N	798	1330	264	248
Adj. R^2 (%)	9.8	4.9	14.6	8.1

Notes: This panel reports results about the impact of legal origin on asymmetric earnings timeliness from separate sample regressions. The robust t-statistics are in parentheses. ***, ** and * denote robust statistical significance at the 1%, 5% and 10% levels according to a two tailed t-test. M stands for model.

4. 2 Culture and the Asymmetric Earnings Timeliness

Table 2 reports results on the impact of culture on asymmetric earnings timeliness before and after IFRS adoption. Countries with high degree of conservatism in the sample include Morocco, Egypt and Kenya while South Africa is lowly ranked. Model 1 is a base model; Model 2 and Model 3 represent the Hofstede (1980) sample regressions while Model 4 and Model 5 represent House *et al.* (2004) culture sample regressions.

The Hofstede (1980) results indicate that conservative culture is associated with greater gains recognition timeliness before IFRS; however it decreases after IFRS. This finding may be explained by the tendency of managers in culturally embedded societies to report higher earnings than losses and by the lower quality of accounting disclosure in local African GAAP relative to IFRS. However, after IFRS the culture influence on the sensitivity of earnings to good news is likely to decline due to application of a less conservative standard, IFRS. Also, it may be interpreted that the internationalization of accounting standards through IFRS mitigates the influence of conservative culture on gains recognition timeliness.

On the other hand, the House *et al.* (2004) results show positive gains recognition timeliness coefficients before and after IFRS although the coefficient is only statistically significant after IFRS. This may imply that culture still positively influences gains recognition timeliness after IFRS and is consistent with Dahawy *et al.* (2002) who find that culture still affects disclosure of accounting information after IFRS adoption in Egypt.

Table 2 The Impact of Culture on Asymmetric Earnings Timeliness

	Hosftede (1980) Scores			House *et al.,* (2004) Scores	
Variable	M1	M2	M3	M4	M5
α_0	0.177***	0.182***	0.182***	0.167***	0.058
	(12.207)	(12.396)	(10.734)	(11.267)	(1.512)
$NEG_{i,t}$	-0.058***	-0.057***	-0.060***	-0.064***	-0.056***
	(-4.530)	(-4.383)	(-4.433)	(-4.718)	(-4.084)
$NEG*RET_{i,t}$	0.058*	0.073**	0.079**	0.071**	0.100***
	(1.649)	(1.997)	(2.039)	(1.976)	(2.626)
$CON* NEG*RET_{i,t}$		-0.335*	-0.135	-0.909**	-0.511
		(-1.712)	(-0.616)	(-2.305)	(-1.191)
$D* NEG*RET_{i,t}$			0.007		0.019
			(0.168)		(0.445)
$CON* D* NEG*RET_{i,t}$			-0.056		-0.232***
			(-0.748)		(-2.617)
$RET_{i,t}$	-0.002	-0.006	-0.006	-0.006	-0.005
	(-0.155)	(-0.555)	(-0.523)	(-0.556)	(-0.399)
$CON*RET_{i,t}$		0.088**	0.131***	0.078	0.022
		(2.243)	(3.122)	(1.459)	(0.347)
$D*RET_{i,t}$			-0.003		-0.02
			(-0.163)		(-1.068)
$CON* D*RET_{i,t}$			-0.691***		0.085***
			(-3.978)		(2.955)
Year Effects	Yes	Yes	Yes	Yes	Yes
Country Effects	Yes	Yes	Yes	Yes	Yes
N	2640	2640	2640	2448	2448
Adj. R^2 (%)	6.2	6.3	7.1	4.9	5.3

Notes: This table reports the OLS results on the impact of culture on asymmetric earnings timeliness. The robust t-statistics are in parentheses. ***, ** and * denote robust statistical significance at the 1%, 5% and 10% levels according to a two tailed t-test. For Hofstede (1980) culture scores, the sample involves 330 firms from four countries namely; South Africa, Kenya, Egypt and Morocco. However, for House *et al.,* (2004) the sample comprises of from South Africa, Morocco and Egypt. Kenya is dropped out due to lack of culture data. M stands for Model.

The incremental effect of conservative culture leads to a decrease in loss recognition timeliness after IFRS for both Hofstede (1980) and House *et al.,* (2004) culture sample dummy variable regressions (see Model 3 and Model 5). Similarly, due to the same effect, incremental loss recognition timeliness declines across all models before and after IFRS. As predicted, this suggests that conservative culture results in a reduced loss recognition timeliness, and incremental loss recognition timeliness. The findings also suggest that conservative culture facilitates managers to conceal economic losses in order to fulfill their firms' contractual obligations.

Overall earnings timeliness increases marginally in Hosftede (1980) regression results. Furthermore, it decreases in House *et al.* (2004) sample regression results. For instance, the adjusted R^2 increases from 6.2% in Model 1 to 6.3% and 7.1% in Model 2 and Model 3 respectively. However, for House *et al.,* (2004) regressions, overall earnings timeliness decreases from 6.2% in Model 1 to 4.9% and 5.3% in Model 4 and Model 5 respectively. These findings suggest that conservative culture is associated with reduced overall earnings timeliness. While prior studies such as Dragomir *et al.* (2010) and Kang *et al.* (2004) find that conservative culture is directly related to prudent accounting especially news-independent prudence accounting, we find that it is associated with greater (lower) gains recognition timeliness (loss and incremental loss recognition timeliness). Stated differently; conservative culture is associated with a reduction in contracting efficiencies between firm parties (e.g. managers, shareholders and debtholders) and the stewardship role of management to capital providers. In summary, these findings imply that national culture especially conservative culture is an important determinant of asymmetric earnings timeliness. The reported findings are robust to a number of tests including; using a four months period returns, quartile regressions, weighted least squares regressions, earnings persistence tests, fixed effects models, one step GMM and Clarkson *et al.* (2011) model for handling uneven representation of sample. The results for these additional tests are not reported for brevity reasons but are available upon requests.

5. Conclusion

The main objective of this paper is to examine whether culture and legal origin impact on asymmetric earnings timeliness before and after adoption of IFRS in African countries. Two hypotheses are developed and tested.

The results indicate that earnings in common law countries exhibit more incremental loss recognition timeliness than earnings in code law countries consistent with prior studies such as Ball *et al.* (2003). However; the findings show no evidence suggesting that loss and incremental loss recognition timeliness increase after IFRS in both common law and code law countries whilst findings indicate that gains recognition timeliness decreases significantly after IFRS for both common and code law firms. In the case of culture, the findings indicate that culture is associated with greater gains recognition timeliness before but not after IFRS. However, culture leads to reduced loss and incremental loss recognition timeliness before and after IFRS. These findings are consistent with the view that firms from countries with high degree of conservative culture are aggressive reporters of gains rather than losses (Risberg, 2005).

One major policy implication of this study is that culture and legal origins matter on the efficacy of IFRS earnings quality and on the way IFRS earnings incorporate economic gains and losses. The study makes two main contributions to the existing literature; one: unlike previous studies such as Zeghal and Lahmar (2018), Manganaris *et al. (*2015), Andrẻ *et al.* (2013), Enomoto, (2018), Noravesh *et al.,* (2015), Ball *et al.,* (2000, 2003), Ball and Shivakumar, (2005), Barth *et al.* (2008), Ball *et al.* (2008), Hillier *et al.,* (2015) and Ngole (2016), it examines the impact of culture and legal origins on IFRS earnings quality and timeliness in emerging African economies setting. Two, it provides an informed feedback to the standard setters such as IASB and accounting professional bodies on the efficacy of IFRS in different institutional settings and information environments.

Future research may increase the sample size in terms of countries and firms to get more insight on the impact of culture and legal environment on asymmetric earnings timeliness. Also, they may control for individual sophistication of market participants and use the Kaufmann Governance Database (Country wide Rule-of-Law Metric) to distinguish common law from Code law Countries (Dam, 2006). Moreover; future research may examine the moderating effect of audit firms on the relationship between IFRS adoption and asymmetric earnings timeliness in presence of cultural and legal origin differences.

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