Empirical evidence of the effect of European accounting differences on the stock market valuation of earnings and book value

Miguel Arce and Araceli Mora
Universitat de València

ABSTRACT

Recently, a new dimension has been added to research in accounting harmonization by studying the effects of accounting practices and regulations on share price and return movements. Although there is an agreement of mutual recognition in the European stock markets of financial statements adapted to the directives, the differences between the European countries are still great. The objective of this study is to investigate the value relevance of alternative accounting measures (earnings and book value) constructed under different accounting systems in Europe. We investigate the differences in accounting practices through the relationship between earnings and book value, and the stock market value of the firm. The aim of the study is to answer the following three questions: (1) Are there systematic differences in value relevance between earnings and book value across the different European accounting systems? (2) Do book value and earnings convey different information to stock valuation? (3) Are accounting numbers more value relevant in those countries traditionally orientated to market investors? The sample consists of listed firms from eight European countries (Belgium, France, Germany, Italy, The Netherlands, Switzerland, Spain and the UK). The results obtained could be helpful for the decisions of institutional regulatory bodies since we find evidence of significant differences in the stock market valuation of accounting data not explained by the composition of the sample or macroeconomic factors, but mainly by the differences in reporting philosophies across Europe.

1. INTRODUCTION

Several authors have proposed different classifications of the accounting systems throughout the world taking into account different factors of influence. Traditionally, the European Union countries have been divided into two groups depending on their finance, legal and tax systems. According to many