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Literature Review on the Hellenic Auditing and Accounting Environment before, during and after the Crisis Period

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Abstract

The purpose of this paper is to examine and review the literature regarding the accounting and auditing environment in Hellas; Hellas is a "natural experiment" in the sense that has characteristics that substantially differ from the major European countries. *"For example, the mandatory adoption of International Financial Reporting Standards (IFRS) on January 1, 2005 aimed to improve the quality of financial reporting in Greece, which had been regularly criticized for earnings management and the ineffectiveness of external auditing"*. In addition, Hellas faced a 10-year economic crisis (2008-2018) which affected/ changed the Hellenic corporate and capital market environment. For the years before the crisis and the implementation of IFRS, empirical studies shown that Hellas has the one of the highest levels of earnings management. All these features are examined in this article in order to gain insight regarding the quality of Hellenic financial reporting and to investigate the changes that crisis had on financial statements quality. The conclusion is that crisis exaggerated problems that already existed in Hellenic corporate environment.

Keywords: Accounting, Auditing, Hellas, Athens Stock Exchange (ASE).

Introduction

Last ten years (starting around 2008) Hellas faced three major financial events that affected capital market and Hellenic corporate environment; that is, the:

- implementation of International Financial Reporting Standards on listed companies (for financial statements published after 1st January 2005),
- global financial crisis (started in the USA in 2007) and
- Hellenic debt crisis.

In this research paper, I will review the literature regarding the development of Hellenic capital market (Athens Stock Exchange, ASE) and the quality of audit in publicly listed companies, as prescribed by the term "audit gap". That term specifies and characterizes the growing concern of public, regulators and investors regarding the auditor reporting credibility.

These two topics have been isolated and examined from previous researchers in depth; however, the novel thing of this study is that it examines the "audit gap", which is the gap between the expectations that public has from auditors and what auditors actually do in their reports. This term is also examined in accordance with earnings management, which raises the public concerns about the quality of financial information provided in financial statements by managers and audited by qualified and certified auditors. The topics investigated are crucial

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and extremely important as they affect capital providers' decisions to invest; in addition, these help the regulators to recognize and prevent bad economic behavior that will hurt public trust and confidence over financial reporting.

The number of Hellenic listed companies is diminishing every year and from 350 companies in 2000 now exist less than 200 (the half!!). This phenomenon, "delisting" is based on voluntary and involuntary delisting and happens and in other exchanges internationally ("listing gap"). Regarding Hellas, a study by Balios *et al.* examined for the companies that were listed in ASE on 1st of January 2005 what was their status (listed, delisted voluntarily or delisted involuntarily) on 31 December 2012. Their sample was 239 companies, of which 11 were voluntarily delisted and 42 were delisted by stock market authorities (involuntary delisting). The authors found that *"companies with poor liquidity, high leverage, big stock price decline and lack of interest from the investors for the company (low trading activity) have higher probability to be delisted*".

According to my opinion the main reason for this is poor corporate governance attributed to Hellenic listed on ASE firms and the fact that in the years from 1996 to 2004, and especially 1999 and 2000, many companies entered the stock market but they did not fulfill investors' expectations.

Research studies in Corporate Governance in Hellas have shown medium to low compliance to International Corporate Governance Codes.

Hellas is a small continental Europe country; it has many socio-political features that distinguish the specific country (Hellas) from other European companies. In my opinion, it has been under-researched in these topics and we will try to fill that with our research. Hellenic cultural, political and economic environment is being influenced by Eastern and Western influences.

Hellenic culture, politics and economics have the influences of many forces; *"Hellas is considered to be a low trust society with strong preference for stat regulation"*. In addition, as: i) owners are involved in management and ii) finance is mainly provided mainly by banks, there is lower need for financial information in order to take financial decisions. Owners can themselves monitor and motivate directors without incentive plans and financial reporting is closely linked to taxation.

Regarding earnings management Leuz *et al.* and Bhattacharya *et al*. found that Hellenic companies manipulate their accounting numbers more compared to other European countries.

In the next section we will examine the main aspects of the Hellenic corporate environment and then we will discuss the main developments in Athens Stock Exchange. In the fourth section we will review the literature regarding Hellenic capital market, while in the next section we will examine the very important issue (the main contribution of this paper) of "auditor gap" in Hellas. In the sixth section we will show how the adoption of International Financial Reporting Standards (IFRS) on 1st of January 2005 affected the earnings management behavior of Hellenic listed companies; lastly, in the next section we will report the concluding remarks of this study.

Hellenic Corporate Environment

One of the main characteristics of the Hellenic corporate environment is the family control of major listed firms; however, this is not a Hellenic phenomenon. We see it across European countries – especially in Continental Europe. In these countries, where the main ownership structure is control by a family (that also plays a very active role in management), the agency problem of Corporate Governance is how to align the interests of strong controlling and weak minority shareholders.

A very common argument in favor of family firms is the reduction of "classical" principal/agent agency costs as the owner (family) and management belong to the same family. On the contrary, family firms face significant costs; for example, family owners could expropriate minority shareholders [1].

Regarding Corporate Governance (CG) [2] stated *"Although improvements in CG have occurred in Greece, they are mainly confined to a small number of listed companies that are more in tune with the international corporate stage".* A study by Dimitropoulos and Asteriou reaches the same conclusions.

A study by Ballas *et al*. examined the accounting treatment regarding unrealized results (gains or losses) and the capital market reaction to mark to market accounting policy choice of equity investments of Hellenic firms during the period 2002-2004 (before the adoption of IFRS). In order to reduce losses from the decline of ASE General Index of that period most firms choose to adopt different policy for gains and losses. Specifically, listed firms choose to take valuation gains to the income statement and losses through equity; however, this treatment of capital losses affects negatively the stock market investors.

In the next two topics we will describe the capital market environment and capital market research regarding Athens Stock Exchange (ASE).

Capital Market (Athens Stock Exchange - ASE) Developments

Ownership dispersion in Hellas is middle to low; among French civil law countries, in La Porta *et al.* Hellas showed average ownership concentration [3] around 70%. In a similar vein a study of Hellenic Capital Market Commission (HCMC) in 370 listed in 2001 firms showed average dispersion of around 50% when the major shareholder owns at least 5%, while dispersion is 35% when the major shareholders owns at least 1%.

Regarding Corporate Governance (CG) laws [4], Hellas introduced [5] the "comply or explain" principle with Law 3873/2010; this law obliged *"listed companies to disclose an annual corporate governance statement (CGS) in their annual report"*. However, in countries with concentrated ownership structure (like Hellas and Continental Europe countries), large dominant shareholders control management and expropriate minority shareholders in order to extract private control benefits. In that case, the question is how to align the interests of strong block-holders and weak minority shareholders. The cost of involvement with management and control for the minor stockholder is greater than the cost of exit; for that reason, they choose to sell stock (use their exit option) if they do not agree with management choices. However, the lack of market for corporate control (capital market liquidity) poses problems in the effectiveness of the shareholders exit option.

Alexakis *et al.* attempted to relate the mean returns and price volatility of a selected sample of 30 firms [6] listed on ASE to the implementation of CG laws; regarding the periods selected they split their period from September 1999 to February 2004 to three sub-periods based on the time specific CG laws became effective [7]. Their results showed that the volatility during the sample periods differs substantially; specifically, in the mid-CG period, volatility (as measured by the standard deviation – the square root of variance) has decreased. This shows that the market took the introduction of CG laws very seriously.

But what about Hellenic capital market efficiency? Dicle and Levendis show that *"a small percentage of the Greek market may be blamed for market level results that may question market efficiency. These are usually smaller and less liquid stocks*". In addition, previous studies examined then ASE for the day of the week effect. They found "evidence of a persistent DOW effect, however for inconsistent weekdays".

In the next section, the capital market research will show that ASE's listed firms are mainly family firms with at least five major shareholders.

Capital Market Research in ASE

According to Tsipouridou and Spathis "*The significant expansion of the Athens Stock Exchange (ASE) in the late 1990s turned many firms from private-family owned businesses to publicly listed entities without changing the existing relatively high levels of family ownership concentration.*"

Spanos *et al.* exlamined [8] a sample of 120 listed in ASE companies from which 98 were family firms and the rest non-family firms; they found that most of the family firms lack proper corporate governance and especially in: a) risk management, b) board of directors' independence, c) board committees (i.e. audit committee) and directors remuneration information.

Regarding the interrelationships between ownership structure and board characteristics of Hellenic listed companies Bekiris, for a sample of companies listed in ASE for the period 2000 to 2006, found that in companies where the Chief Executive Officer (CEO) is also Board chairman (weakening Corporate Governance compliance) the independent directors and blockholder ownership tend to be lower. What is more interesting in that research is the fact there is a negative relationship between managerial ownership and board size; this is not in line with agency theory which suggests that managers will generate private profits by adopting a larger board [9].

As far as the compliance of Hellenic listed on ASE companies with IFRS disclosure requirements is concerned, Tsalavoutas and Dionysiou found that for 2005 companies applied the relevant requirements of IFRS regarding goodwill (IFRS 3 and International Accounting Standard (IAS) 36) in 70% and 49% respectively; Ballas and Tzovas found similar results for 2006. Baboukardos and Rimmel examined specifically the relevance of goodwill disclosures under IFRS for the *fiscal* year 2008 (companies listed on ASE on April 30th, 2009); their dependent variable was the market value of equity four months after the company's fiscal year end. They found that purchased goodwill disclosures and "fair value" accounting (FVA) under IFRS were value relevant. A possible explanation of this is that ASE in not "fully efficient" and "the application of FVA may enhance the decision usefulness of financial reporting".

Hellas is a code-law, continental Europe country with a "*stakeholder-oriented and taxation driven national accounting system* [10] examined the determinants of profitability for a sample of Hellenic non-financial firms listed in ASE for the period 1995 to 2003 (before the crisis); they found that firm profitability was positively related with: i) size, ii)sales growth, and iii) investment, while is negatively affected by: i) leverage and ii) current assets. In addition, and contrary to the belief, they found that the adoption of Euro (entrance in the European Monetary Union-EMU) had a negative effect on firm's profitability. Regarding the selection of the specific period, the study of Bakinezou *et al.* showed that Hellenic economy *"showed continuous increase for the period 1996 to 2000 followed by a significant negative change in trend for the rest of the years till 2003"* and the sample covers both of the periods.

Regarding the determinants of firm survival in ASE, Asimakopoulos et al. applied survival models on listed in ASE firms, in line with other relevant studies in different capital markets. They examined the firm-specific determinants of firm survival: i) leverage, ii) size, iii) corporate governance (Board of Directors composition, ownership dispersion and market for corporate control), iv) firm age and market timing "window of opportunity" hypothesis. In addition, they examined the sectoral impact and the effect of macroeconomic environment; their data were the Initial Public Offerings (IPO) of the period 1993 to 2002 and traced these companies if they were listed on the end of 2006. The interesting findings are: i) leverage is negatively related with firm survival, ii) large firms have lower possibility not to survive (negative relation with size), iii) regarding corporate governance the results showed that "agency theory alone cannot explain the factors affecting the survival of firms on the Athex" and iv) as in other studies, "macroeconomic factors do not seem to have significant influence on survival duration.

In the next section I will focus on the corporate audit environment which is fundamental in the relationship between companies, regulatory authorities and investors and had not been examined in the current research.

"Auditor Gap" Research

Hellenic accounting setting is mainly tax-based and conservative. Financial statements are not the main source of information; banks are the main capital providers and "*they often develop personal relationships with the firms. In the relationship-based system, banks may arrive at their credit decisions based on information obtained directly from the owners of the firms, thereby undermining the importance of public accounting information*.

Regarding audit market, in 1955 corporate auditing was first introduced with the establishment of the Body of Sworn Accountants (Soma Orkoton Logiston - SOL in Greek). Individual auditors were described by Ballas as "civil functionaries" [12], entitled to significant privileges [13]. In 1992, auditing profession was liberalized; a new public legal entity was created (Body of Certified Auditors and Accountants, Soma Orkoton Elegkton Logiston – SOEL in Greek). Most of SOL members introduced SOL S.A. a new audit firm, which dominated the audit market, despite "Big 4" and other international and national firms. Audit profession has been criticized regarding their reporting credibility. In 2003, the supervision of auditors was transformed from SOEL to ELTE (Accounting and Auditing Oversight Board).

But what was the effect of Arthur Andersen's (AA) collapse in September 2002 in the audit services market shares of Big-4 audit companies in Hellas? A research by Ballas and Fafaliou examined the European Union (EU) audit market, of the EU-15 market countries of that time, for the period 1998 to 2004; for the overall sample they found that "concentration" in the aggregate sample increased over time. Regarding Hellas, the market share of SOL S.A. reduced after 2002, which means that the market share of AA was taken by Big-4 international firms and not by a local audit company.

A study of Dimitras and Iatridis showed *that "firms that are audited by a Big-4 auditor do not necessarily report higher value relevance in the reported financial numbers when confronted with a crisis"*. For that reason, it is very important to increase the credibility of audited financial statements especially during this crisis period.

Ballas et al. concluded *"finally despite the reforms of the audit profession in the early 1990s, the quality of audits in Greece is debatable while quality control* [14]*, legislated in 2004, was never implemented"*. Regarding auditing standards, Hellas is fully harmonized with International Standards of Auditing (ISA) and the European Union Directives.

Regarding auditors report a study by Grant Thornton (2010) showed that the most frequent qualification for 2009 for ASE listed firms is the "*uncertain outcome of future State tax audits*". However, there is "*a particularity of the Greek auditor's report*" in the sense "*that there is not a clear distinction between unqualified and qualified opinion……For instance, a qualified opinion can include, in the explanatory paragraph, remarks about matters that both 'affect' and do not affect the auditor's overall opinion. However, it could end with the phrase such as '….with the exception of the consequences of the above issues, in our opinion, the aforementioned financial statements give a true and fair view of the financial position of the firm as of 31 December 20XX'. Thus, it is in the subjective judgment of the user to decide whether or not the remarks are materially important, and whether or not they should be taken into consideration*".

International research (mainly based in US sample) finds contradicting results regarding the (potential) relationship between earnings management and the likelihood of receiving a qualified opinion. For example, Bradshaw *et al.* find no relationship, while Bartov *et al.*, (2001) find a positive link between the absolute value of discretionary accruals and the possibility to receive a qualified opinion. In the Hellenic setting, Tsipouridou and Spathis divided the qualified opinions in two categories: i) qualified for "going-concern" and ii) qualified for other reasons; in addition, they test that relationship to "financially distressed" companies.

Although there were many improvements in Hellas in the field of Corporate Governance the last fifteen years, empirical studies have shown that these are mainly in a small number of large capitalization listed on ASE firms. The Hellenic accounting system *"has been stakeholder oriented, tax driven and conservative*.

To conclude the financial scandals in Hellas the period 2010-2019 as well as the huge amount of delisting due to financial problems (involuntary delisting) question the credibility of audit profession and increase public worries regarding the quality of audit work [15] and the independence of auditors from company's management. As Tsipouridou and Spathis state "*Unfortunately, ELTE has received considerable criticism because it has not yet become an effective enforcement mechanism. In the Greek environment of weak disciplinary authorities and low probability of litigation by third parties, concerns over auditors' potential opportunistic behavior still remain*". The authors documented that because of: i) Hellas specific characteristics in the economic environment (many medium-sized firms and small number of big firms), ii) institutional setting (family firms, low market for corporate control), iii) code-law country, iv) the relative small audit market (not enough firms for the high number of auditors/audit companies and v) the weak enforcement of audit laws and the weak control on auditor's work by the state (ELTE), auditors *"have weak incentives to prevent earnings management"*.

In the crisis period Iatridis and Dimitras, compared the value relevance of listed firms' financial statements that are being audited by Big-4 audit companies of five European Union countries (Portugal, Ireland, Italy, Hellas and Spain) for the period 2005-2011. They found that Hellenic companies show: i) negative discretionary accruals, ii) if a company is audited by a Big-4 audit company then there is a higher possibility to engage in earnings management, iii) size is negatively related to earnings management, iv) growth is positively related to earnings management and v) "*show lower quality financial numbers during the crisis perhaps in an effort to somewhat influence investors' perceptions and to avoid getting too exposed*".

This effect of earnings management on financial reporting, as well as the specific accounting and corporate environment characteristics that affected Hellas transformation to International Financial Reporting Standards (IFRS) will be examined in next section. In addition, we will evaluate whether there was a benefit to users of accounting information (i.e. current and potential investors, tax authorities, capital market authorities) from this transformation.

Earnings Management Research [16]– IFRS Adoption Effect

A study of Bae *et al.* showed that Hellas, among the 15 "old" European Union members, had the second largest difference between its national accounting system and IFRS. For that reason, the change of corporate accounting system was very difficult for accountants and auditors. As Baboukardos and Rimmel *state "In addition, because Greece is a low-trust society* [17]*, its accounting environment is highly formalistic……. Another important consequence of the highly formalistic environment in Greece is the absence of extensive supplementary disclosure requirements*". The first study that analyzed and examined the effect of IFRS adoption in financial statements of listed companies was that of an audit company, Grant Thornton in 2006; this study, by taking the published financial statements of 2004-2005 showed that IFRS adoption had: i) an overall [18] positive impact of around 5% in equity, ii) a positive impact in firms' annual results through the increase of the useful lives of depreciable fixed assets and iii) a negative impact on financial results through the recognition of deferred tax liabilities and the creation of provision for contingent income tax.

A study of Ballas *et al.* examined, for a sample of Hellenic listed in ASE companies for the years 2002 to 2004, the market reaction to investment valuation adjustments; stock prices do not follow firm's decision to charge investments' valuation adjustments to equity instead of the income statement [19]. This means that ASE is an efficient stock market and "investors in the Athens Stock Exchange react negatively to the valuation adjustment that has no cash flow implications and they react negatively to opaqueness in the financial statements, at least with regard to share valuation adjustment".

The compulsory transition of financial statements from Hellenic Generally Agreed Accounting Practices (HGAAP) to International Financial Reporting Standards (IFRS) increased their reliability, transparency and comparability. However, the study of Karampinis and Hevas (2011) showed that the value relevance of Hellenic financial statements has slightly only improved; specifically, they compared earnings' value relevance and conditional conservatism between i) the last three years of the application of Greek accounting standards and the first three years of IFRS implementation in ASE listed companies and they found insufficient evidence of improvements in these accounting properties after the mandatory adoption of IFRS. On the contrary, Iatridis and Rouvolis found that the book value of equity and net profit of companies listed on ASE were more value relevant in the first two years of mandatory adoption of IFRS than in 2004, the last year of application of Hellenic Generally Agreed Accounting Principles.

Tsipouridou and Spathis examined the relation between earnings management and the likelihood of receiving a qualified opinion from the beginning of 2005 till the end of 2011; the companies (around 1500 firm-year observations) belong to nine sectors: metals, construction and materials of construction, food and beverages, travelling and leisure, information technology, communication, trade, personal and domestic products and industrial products and services. The sample showed that unqualified opinions increased, almost doubled, from 2005 to 2010 and then were reduced significantly. This may be explained by the economic crisis that affected companies' sales and profitability and raised qualified audit opinions; regarding the association between earnings management and the likelihood of receiving a qualified (going-concern) opinion the authors do not find supporting evidence.

But what is the effect of financial crisis on earnings manipulation and the quality of published accounting statements? A study by Iatridis and Dimitras covering the period 2005 to 2011 [20], examined five countries in crisis (Portugal, Ireland, Italy, Hellas and Spain) and the effect of IFRS compulsory adoption in 2005; the authors showed that Hellas after the crisis tend to engage in more earnings management in order to improve their profitability which id diminishing due to the crisis/consumption reduction/ recession.

The result of the empirical test is that Hellenic companies' financial statements had a *"deterioration of value relevance and quality of reported financial numbers during the crisis"*. In addition, they showed that Hellenic listed companies that are audited by Big-4 audit company are less likely to follow earnings management procedures especially *before* the crisis. However, the European evidence regarding the Big-4 effect on earnings management is inconclusive; Van Tendeloo and Vanstraelen show that companies audited by Big-4 audit companies engage in less earnings management, while Maijoor and Vanstraelen find no evidence regarding the effect of audit by a Big-4 audit company on earnings management.

Conclusion

Hellas industrialized after World War II and although in early years had a very rapid growth after it faced structural economic problems and stagnation. This was the case until 2001, when Hellas entered the European Monetary Union (EMU); this resulted in the establishment of stable macroeconomic environment with low currency risk. The Athens Stock Exchange was upgraded to a mature capital market in 2001; for the period 1996 to 1999 ASE shown the highest growth of any other capital market in the developed world and the number of listed companies increased substantially.

Regarding ownership structure Hellas ranks in the middle of around 50 countries, when ownership is being measured by adding the percentage share of the three largest shareholders in the ten non-financial listed companies. A study in 2001 by Hellenic Capital Market Commission showed stockholders that own less than 1% account for almost 35% of listed companies' share capital; so, dispersion in Hellas is considered lower than the average.

Regarding Corporate Governance enforcement, a study by Tsipouri and Xanthakis (2004), using questionnaire, showed that *"there is a weaker compliance on average concerning the role of stakeholders and corporate social responsibility, the organization of CG, the effective role of the independent members of the board (which could be attributed to companies with family control and the small pool of potential independent board members), disclosure of remuneration and risk management"*. The same results were also in studies of: i) Florou and Galarniotis (2007), ii) Lazarides and Drimpetas (2011), and iii) Neratzidis (2015).

However, Neratzidis and Filos suggest that "*a plethora of European Union Directives were incorporate in the Greek law system with the direct effect of transformation of the whole system of CG. An immediate enforcement of transparency and disclosure and an increase of the rights of retail investors comprise the evolution of CG in Greece*".

The main characteristics of Hellenic corporate environment are:

- *"High ownership concentration*
- *Weak investor protection and enforcement*
- *Insider governance*
- *Limited capital market*
- *Not active external mechanisms (e.g. market for corporate control and labor market)*
- *No distinction between management and ownership*
- *One-tier boardroom and*
- *Not active involvement of institutional investors in management or controlling"*

The main finding of this study is that Hellenic companies engage in more earnings management than other European countries; in addition, this is not diminishing when the company is audited by a Big-4 audit company.

Regarding CG, the disclosure framework is in line with all European directives and there is significant improvement in the adoption of CG in the, *remaining* [21], listed firms in ASE. All these reforms started in 1999 with the *"increasingly influential report: Principles of Corporate Governance in Greece: Recommendations for Best Corporate Practice (1999). The report is the result of the work of the Committee on Corporate Governance in Greece, which was formed by the Hellenic Capital Market Commission, and suggests ways to improve director and manager accountability and transparency"*.

The research is useful for capital market and audit authorities as they should focus more on improving audit work and preparing accounting and auditing standards that prevent earnings management. In addition, this research would be beneficial by potential investors who base their investment decision to reported financial statements which are biased by earnings management.

However, our study has the limitation that it examines the capital market, audit and accounting environment of a single country, Hellas. Future research can compare the Hellenic phenomenon with a continental Europe country with the same fundamental characteristics (low ownership dispersion, code law country, not advanced market for capital control) , such as Portugal or even Spain or Italy [22]; in addition, another stream of research could examine how Hellenic capital market react to companies' earnings management procedures. Last but not least, another issue of great importance that is under-researched is the Initial Public Offering (IPO) delisting [23], because for the period 1996 to 2004 more than 150 companies had IPO and entered in ASE, reaching the number of listed companies from around 200 to 350 the years after 2000; however, the number of listed companies now is around 250. So there was a massive delisting (both voluntary and involuntary) the reasons of which should be carefully examined.

To conclude: *"The increasing maturity of capital market conditions and the gradual globalization of financial transactions laid the foundation for the structural transformation of the Greek economy. The changes are already underway. They will be successful if they are fully supported and systematically absorbed by the general business establishment. The particularities in the Greek corporate structure should be respected, but should not stand as an impediment to the structure's competitive transformation".*

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