

Păcan, Irina-Doina; Neag, Ramona

Working Paper

Economic consequences of the adoption of the International Financial Reporting Standards: evidences in the research literature

Institute of Economic Research Working Papers, No. 85/2015

Provided in Cooperation with:

Institute of Economic Research (IER), Toruń (Poland)

Suggested Citation: Păcan, Irina-Doina; Neag, Ramona (2015) : Economic consequences of the adoption of the International Financial Reporting Standards: evidences in the research literature, Institute of Economic Research Working Papers, No. 85/2015, Institute of Economic Research (IER), Toruń

This Version is available at:

<https://hdl.handle.net/10419/219701>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.



<https://creativecommons.org/licenses/by/3.0/>



Institute of Economic Research Working Papers

No. 85 /2015

**Economic consequences of the adoption of the
International Financial Reporting Standards: evidences
in the research literature**

**Irina-Doina Pășcan
Ramona Neag**

The paper submitted to

**VIIIth INTERNATIONAL CONFERENCE ON APPLIED
ECONOMICS
CONTEMPORARY ISSUES IN ECONOMY
under the title
MARKET OR GOVERNMENT?**

Institute of Economic Research and Polish Economic Society Branch
in Toruń

18-19 June 18-19, 2015, Toruń, Poland

Toruń, Poland 2015

© Copyright: Creative Commons Attribution 3.0 License

Irina-Doina Pășcan

irina.pascan@ea.upm.ro

Petru Maior University of Tîrgu Mureș, Livezeni Street no. 69, Tîrgu Mureș Postal
Code 540566, România

*Bucharest University of Economic Studies, 6 Piata Romana, District 1, Bucharest,
Postal Code 010374, Romania

Ramona Neag

ramonaneag@yahoo.com

Petru Maior University of Tîrgu Mureș, Livezeni Street no. 69, Tîrgu Mureș Postal
Code 540566, România

Economic consequences of the adoption of the International Financial Reporting Standards: evidences in the research literature

JEL Classification: *G14, M41*

Keywords: *Economic consequences; International Financial Reporting Standards; listed entities; quality of financial information; stakeholders*

Abstract: Along with the economic globalization, the international accounting regulation bodies faced the need to issue internationally accepted global accounting standards. The effect was the issuance and the widespread of the International Financial Reporting Standards (IFRS). At European level, the IFRS gained legitimacy in 2002, when the European Parliament and Council have decided that all European publicly traded entities must prepare their consolidated financial statements in accordance with IFRS starting with January 1st, 2005. The regulation from 2002 on the application of the international standards in EU summarizes the benefits emerging from the adoption and use of IFRS, related to: a high degree of transparency and comparability of financial statements and, as consequence, an efficient functioning capital market. However, the achievement of these expected benefits is based on the assumption that the application of these standards contributes to the increase in the quality of accounting data reported in the financial statements. In this context, our main objective is to summarize, based on the research literature, the economic consequences that emerge from the publication of higher quality accounting data in accordance with IFRS.

Introduction

The contemporary features of the business environment influence the theory and the method of accountancy. Thereby, the need for worldwide financial reporting comparability arise in the context of the expansion of world trade, the spread of multinational corporations, the increasing role of global capital markets and the enhanced foreign direct investment.

In the past decades, the accounting regulating bodies have made efforts in order to address these new challenges and to provide accounting solutions for presenting the accounting information in a common language, understandable for cross-border investors and other stakeholders.

The application of the IFRS registered a continuous progress, from being very little used to becoming nowadays widespread at world level. The number of countries that adopt the international financial reporting standards is increasing, the national accounting regulators allowing or mandating the use of these standards for certain types of entities. According to the information published on the website of IFRS Foundation, today there are over 130 jurisdictions that use the IFRS.

At European level, IFRS widespread was favoured by the issuance of Regulation no. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (EC, 2002). According to this Regulation, for each financial year starting on or after 1 January 2005, companies governed by the law of a Member State prepare their consolidated financial statements in conformity with the international financial reporting standards if, at their balance sheet date, their securities are admitted to trading on a regulated market of any Member State. Also, Member States have the possibility to allow or to require the use of IFRS for other types of entities (for the individual financial statements of listed entities, for the consolidated and/or individual financial statements of unlisted entities).

The Regulation no. 1606 from 2002 summarizes the benefits of adopting and using the international standards in the EU, regarding the fact that they ensure “a high degree of transparency and comparability of financial statements and hence an efficient functioning of the Community capital market and of the Internal Market” (EC, 2002, article 1).

The research literature conducted in the field of IFRS adoption is generous. Researchers measured the effects of the application of IFRS on accounting numbers (Neag, 2014, pp. 1787–1790; Hung & Subramanyam, 2007, pp. 623-657; Jaruga et al, 2007, pp. 67-78; Jermakowicz, 2004, pp. 51-70), tested the benefits emerging from the transition to IFRS (Armstrong et al., 2010, pp. 31-61; Schleicher et al., 2010, pp. 143-168), pointed out the limits of IFRS implementation (Street & Larson, 2004, pp. 1-29) or

analyzed the impact of IFRS adoption on taxation (Păunescu, 2015, pp. 81-91). Another valuable stream of research is represented by the analysis of controlling tasks in the context of IFRS implementation (Roman et al., 2014, pp. 13-26; Mocanu, 2014, pp. 62-66). Researchers have also investigated the perception regarding the manifestation of accounting judgment and ethics in accounting in the process of IFRS application (Cernușca & Balaciu, 2014, pp. 110-122).

Moreover, we ascertain an emphasis on the research designed to capture the effects on IFRS adoption on the quality of financial reporting, measured by means of value relevance (Filip & Raffournier, 2010, pp. 77-103), earnings management practices (Barth et al., 2008, pp. 467-498; Brad et al., 2014, pp. 871-876; Nichita, 2014, pp. 674-690) or accounting conservatism (Andre et al., 2013, pp. 1-43; Mașca, 2014, pp. 349-355).

The study of the quality of financial reporting subsequent to the adoption of IFRS is important. The expected benefits of the convergence process and of the adoption of the international standards are based on the premises that the application of IFRS contributes to the improvement of the quality of accounting data reported in the financial statements.

However, testing the effects of IFRS adoption on the quality of accounting data is necessary, but not enough; knowing whether IFRS contributed to enhanced accounting quality is not the end of the road. Further research needs to be done in order to investigate the consequences of the increased quality of the information presented in the financial statements (Pășcan, 2014).

In this context, the main objective of our paper is to analyze and summarize, based on the research literature, the economic consequences that emerge from presenting and publishing qualitative accounting data in accordance with the international financial reporting standards.

The paper is structured as follows: next paragraph presents the research methodology; then, we present the pillars of improved accounting quality after the adoption of IFRS and discuss the main economic consequences of using the information in the financial reporting prepared in accordance with IFRS. Concluding remarks are presented at the end of the paper.

Methodology of the research

In order to answer to our stated objective, the research methodology employed in this study is mainly qualitative, based on bibliographic documentation. In order to identify and analyze the economic consequences that emerge from the improved quality of accounting data in the context of IFRS adoption, we have examined the databases containing research literature in the field of accountancy (such as Science Direct, JSTOR, Web

of Science), using terms such as „economic consequences”, „IFRS adoption”, „accounting quality”; we have selected the papers that we consider to be relevant for the purpose of our study and formed a database containing theoretical and empirical papers that analyze the economic consequences of IFRS adoption. Aiming not to leave out valuable papers published in this area, we have analyzed the references of certain papers and searched for the papers that we considered fundamental for our field of interest (we have also considered the number of citations associated to the selected papers). Next, we have reviewed the selected papers and summarized the economic consequences of IFRS adoption. We outline a typology of this economic consequences, according to the context of the adoption of IFRS (mandatory of voluntary) and to the category of stakeholders that benefit from analyzing qualitative accounting information prepared in accordance with the international financial reporting standards.

The economic consequences of the adoption of the International Financial Reporting Standards – a literature review

Some features associated to the international financial reporting standards could determine the enhancement of the accounting quality after the application of these standards and regardless of the incidence of country-specific institutional factors. We present the pillars of improved accounting quality after the adoption of IFRS, in order to explain why we could expect higher-quality accounting information in the context of the application of these standards.

The IFRSs are principle-based standards

It is the objective of IFRS Foundation to develop a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon *clearly articulated principles*.

With fewer pages and less detail compared to the rules-based standards (for example, the United States Generally Accepted Accounting Principles), the IFRSs still address all major accounting issues, from financial statement presentation to business combinations.

The IFRSs are referred as being principle-based standards because they provide general guidance for recognizing, measuring and presenting the elements in the financial statements. The accountants rely on the general principles stated in the IFRSs in order to guide their professional judgment.

The well-known scandals (Enron, WorldCom) could represent an example on how rigid rules can be manipulated in order to produce concealed accounting information. Being principle-based standards, the IFRSs could improve the quality of accounting information because they are more difficult to circumvent.

Also, relying on principles instead of rules, the IFRSs offer the opportunity to appeal to the professional judgment in order to properly reflect the economic reality, instead of struggling for achieving the compliance with the imposed rules.

The IFRSs allow evaluation methods that better reflect the financial position and performance

For example, the use of fair value could contribute to a more appropriate representation of the economic reality, compared to national accounting regulations. Accounting amounts reported using fair value measurement could improve the quality of accounting data since they are more useful to investors in making their investing decisions.

The limitation of allowable accounting options

In order to faithfully reflect the financial position and performance of an entity, since 2001 the International Accounting Standards Board (IASB) aims to eliminate allowable accounting alternatives. Such an endeavour, directed toward reducing the number of allowed accounting options, represents a premise for improving the quality of accounting data following IFRS adoption, because it limits the earnings management practices, for example by restricting the possibilities to manipulate the earnings.

Ewert & Wagenhofer (2005) cited in Barth et al. (2008, pp. 467-498) find that accounting standards that limit the management opportunistic behaviour allow the determination of accounting income which better reflect the economic reality and, accordingly, are more qualitative.

Moreover, the quality of accounting data could be improved if, simultaneously with IFRS adoption, there would be changes in the financial reporting system, for example, a more rigorous enforcement (Barth et al., 2008, p. 468).

However, the research literature provides mixed evidence on the effects of IFRS on the quality of accounting data. The results of the research conducted in this field do not fully sustain the assumption that IFRS adoption determines the publication of more transparent, more comparable and, therefore, more qualitative financial reporting.

And, even if financial reporting practices of entities would become more transparent or more comparable following IFRS application, the economic consequences of such an improvement of accounting quality cannot be beforehand known, nor is there any guarantee that favourable economic consequences will be recorded.

We argue that only knowing the economic consequences arising from the adoption of IFRS, analyzed according to different categories of users of financial reporting, could provide a fully understanding of the effects of international accounting convergence process.

The economic consequences are defined in the research literature as “effects of financial reporting on firm values and on the wealth of those who make or are affected by decisions based on accounting information” or „the impact of accounting reports on the decision-making behaviour of firms and their stakeholders” (Zeff, 1978 cited in Brüggemann et al., 2013, pp. 1-37).

Next, based on the study of the accounting literature, we analyze the economic consequences of increased quality of accounting data following IFRS adoption.

Brüggemann et al. (2013) have classified the economic consequences that emerge from the mandatory adoption of IFRS in relation with the stated objectives from EU Regulation from 2002 on the application of international accounting standards, as follows:

a) financial reporting effects, regarding:

- compliance with IFRS requirements and accounting choices under IFRS.

In our opinion, it is important to test these consequences, because they offer insight into the extent to which the adoption of IFRS facilitates the comparability of financial statements between countries.

- accounting properties, such as earnings quality (expressed by means of earnings smoothing, conditional conservatism, discretionary accruals).

Studying accounting properties has, among others, the role of indicating whether the objective regarding financial statement transparency is fulfilled after mandatory IFRS adoption.

- value relevance, referring to the ability of information presented in the financial statements prepared in accordance to IFRS to capture the value of an entity;

b) capital market effects, which could consist in:

- increasing the liquidity of stock market;
 - decreasing the bid-ask spread;
 - decreasing the cost of equity capital;
 - increasing the equity investments by institutional investors;
 - decreasing the cost of public debt;
 - increasing the firm-level capital investment efficiency;
 - increasing the content of earnings announcements;
 - enhancing the quality of analysts' information environment;
- c) macroeconomic effects, such as the increase of foreign direct investment.

Ahmed *et al.* (2013, p. 1346) present the favourable economic consequences associated with mandatory IFRS adoption documented in the research literature, related to the improvements in analyst forecast accuracy, reduction in the cost of equity capital and positive price reactions

to events suggesting an increase in the likelihood of mandatory IFRS adoption. But, contrasting with these findings, in the context of an empirical research conducted on 20 countries that adopted IFRS in 2005 relative to a benchmark group of firms from countries that did not adopt IFRS, Ahmed *et al.* (2013) state that “improved accounting quality is unlikely to be an explanation for these favourable economic consequences”.

Aiming to test whether higher corporate performance is a consequence of better quality of financial information, (Martinez-Ferrero, 2014, pp. 49-88) also find that the increased quality of accounting information facilitates transparency, which in turn reduces the informational asymmetry and satisfies the information needs of investors and other stakeholders.

Amiram (2012, pp. 57–81) find that foreign equity portfolio investments increase in countries that adopt the IFRSs, and Moscariello *et al.* (2014, pp. 63-82) observe positive consequences of mandatory adoption of IFRS on the cost of debt.

A valuable research direction was followed by Daske *et al.* (2013, pp. 495-547), which studied the economic consequences of the adoption of IFRS, by analyzing the heterogeneity among entities regarding the way of implementation of new standards. The surveyed entities were classified as “label adopters” (those which adopted the international standards merely in name, without making material changes to their reporting policies) and “serious adopters” (entities that adopted the international standards as part of a broader strategy to increase their commitment to transparency). Favourable economic consequences, related to increased liquidity and decreased cost of capital, were observed only in case on “serious adopters”.

Another research that propose to test the economic consequences of IFRS adoption in relation to the heterogeneity of analyzed entities was published by Christensen *et al.* (2007, pp. 341–379). The authors have studied the economic consequences of mandatory IFRS adoption in case of the entities from UK, starting from the premise that these consequences depend on whether entities perceive (or not) benefits from the process of IFRS adoption. Thus, mandatory IFRS adoption does not uniformly produce benefits for all entities, but generates winners and losers; the obligation to apply IFRS determines net benefits for entities that would have voluntarily decided to switch to IFRS if they would have the chance, while other entities are forced to comply with the provisions of these standards against their will. The research analyzed two types of economic consequences. First, market reaction (measured by share price) to news regarding the EU decision to mandatory adopt the IFRS was analyzed. Second, the authors considered the relative change of the cost of equity between the time when the EU started to consider IFRS adoption and the

time when the decision to adopt IFRS was effectively final and binding on all member states. The results show that the stock-price reaction of UK firms to news favorable (unfavorable) to mandatory IFRS adoption is positively (negatively) related to UK entities' willingness to adopt IFRS; moreover, the change in the cost of equity is negatively associated to the variables that express UK entities' willingness to adopt IFRS.

The general conclusion of this study is that mandatory IFRS adoption generates significant differences among entities, a very important issue when analyzing the cost and benefits of this process in a certain community. The authors conclude that „implementing mandatory IFRS has the potential to redistribute wealth among agents in society through changes to the cost of capital”.

The study of the research literature give us the opportunity to identify the main economic consequences of improved accounting quality following IFRS adoption and to differentiate a typology of these consequences; the economic consequences can be analyzed in the context of voluntary or mandatory IFRS adoption, according to the measure of achieving the objectives of the European and international accounting convergence, and according to the benefits perceived by each category of stakeholders that uses the information published in the financial reporting prepared in the spirit of IFRS standards.

Conclusions

Global accounting standards could represent one of the most important changes of accounting regulation. The decision of the European Commission to mandate IFRS adoption for all the entities listed on EU's regulated markets, the efforts made by different jurisdictions in order to achieve the convergence of national accounting regulations with IFRS, and the recent debates regarding the use of IFRS for US listed entities suggest that the international financial reporting standards represent a set of high-quality accounting standards. However, the economic consequences of this change are still debatable.

The research literature offers mixed evidence on the effects of IFRS adoption on the quality of accounting data. We consider that the effects of IFRS adoption on accounting quality must be interpreted in the context of country-specific factors, as well as entity-specific factors.

Testing the effects of IFRS adoption on accounting quality is an important endeavour, but not sufficient; such research should also investigate the economic consequences emerging from the publication of increased quality accounting data prepared and presented in accordance with IFRS. The study of the economic consequences of IFRS adoption

must consider, on the one hand, the direct benefits for the entities that report this information and, on the other hand, the perceived benefits for different users of accounting data.

***Acknowledgement**

This work was cofinanced from the European Social Fund through Sectoral Operational Programme Human Resources Development 2007-2013, project number POSDRU/159/1.5/S/142115 „Performance and excellence in doctoral and postdoctoral research in Romanian economics science domain”.

References

- Ahmed, A. S., Neel, M. & Wang, D. (2013). Does Mandatory Adoption of IFRS Improve Accounting Quality? Preliminary Evidence, *Contemporary Accounting Research*, 30(4). <http://dx.doi.org/10.1111/j.1911-3846.2012.01193.x>.
- Amiram, D. (2012). Financial Information Globalization and Foreign Investment Decisions, *Journal of International Accounting Research*, 11(2). <http://dx.doi.org/10.2308/jiar-50282>.
- Andre, P., Filip, A. & Paugam, L. (2013). Impact of Mandatory IFRS Adoption on Conditional Conservatism in Europe, ESSEC Working Papers from ESSEC Research Center, ESSEC Business School, 27 August.
- Armstrong, C. S., Barth, M. E., Jagolinzer, A. D. & Riedl, E. J. (2010). Market Reaction to the Adoption of IFRS in Europe, *The Accounting Review*, 85(1). <http://dx.doi.org/10.2308/accr.2010.85.1.31>.
- Barth, M. E., Landsman, W. R. & Lang, M. H. (2008). International accounting standards and accounting quality, *Journal of Accounting Research*, 46(3). <http://dx.doi.org/10.1111/j.1475-679X.2008.00287.x>.
- Brad, L., Dobre, F., Țurlea, C. & Brașoveanu, I. V. (2014). The impact of IFRS adoption in Romania upon the earnings management of the Bucharest Stock Exchange entities, *Procedia Economics and Finance*, 15.
- Brüggenmann, U., Hitz, J-M. & Sellhorn, T. (2013). Intended and Unintended Consequences of Mandatory IFRS Adoption: A Review of Extant Evidence and Suggestions for Future Research, *European Accounting Review*, 22(1). <http://dx.doi.org/10.1080/09638180.2012.718487>.
- Cernușca, L. & Balaciu, D. E. (2014). Accounting students' perceptions on the expression of professional judgement and ethics in the accounting field. *Annales Universitatis Apulensis Series Oeconomica*, 16(2).
- Christensen, H. B., Lee, E. & Walker, M. (2007). Cross-sectional variation in the economic consequences of international accounting harmonization: The case of mandatory IFRS adoption in the UK, *The International Journal of Accounting*, 42. <http://dx.doi.org/10.1016/j.intacc.2007.09.007>.

- Daske, H., Hail, L. & Leuz, C. (2013). Adopting a label: heterogeneity in the economic consequences around IAS/IFRS adoptions, *Journal of Accounting Research*, 51(3). <http://dx.doi.org/10.1111/1475-679X.12005>.
- European Council, (2002). Regulation (EC) No. 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, Retrived from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2002R1606:20080410:en:PDF>.
- Filip, A. & Raffournier, B. (2010). The value relevance of earnings in a transition economy: The case of Romania, *The International Journal of Accounting*, 45. <http://dx.doi.org/10.1016/j.intacc.2010.01.004>.
- Hung, M. & Subramanyam, K. R. (2007). Financial statement effects of adopting international accounting standards: the case of Germany, *Review of Accounting Studies*, 12. <http://dx.doi.org/10.1007/s11142-007-9049-9>.
- Jaruga, A., Fijalkowska, J., Jaruga-Baranowska, M. & Frendzel, M. (2007). The Impact of IAS/IFRS on Polish Accounting Regulations and their Practical Implementation in Poland, *Accounting in Europe*, 4(1). <http://dx.doi.org/10.1080/17449480701308675>.
- Jermakowicz, E. K. (2004). Effects of Adoption of International Financial Reporting Standards in Belgium: The Evidence from BEL-20 Companies. *Accounting in Europe*, 1(1). <http://dx.doi.org/10.1080/0963818042000270811>.
- Martínez-Ferrero, J. (2014). Consequences of financial reporting quality on corporate performance. Evidence at the international level, *Estudios de Economía*, 41(1). <http://dx.doi.org/10.4067/S0718-52862014000100002>.
- Maşca, E. (2014). Limitations of accounting conservatism research in Europe: ante and after IFRS adoption. In Batzias, F., Mastorakis, N. E. & Guarnaccia, C. (Ed.) Recent Advances in Energy, Environment and Financial Planning, Proceedings of the 5th International Conference on Development, Energy, Environment, Economics (DEEE '14), Florence: WSEAS Press.
- Mocanu, M. (2014). Towards a Definition of Controlling, *Studies and Scientific Researches. Economics Edition*, 20.
- Moscariello, N., Skerratt, L. & Pizzo, M. (2014). Mandatory IFRS adoption and the cost of debt in Italy and UK, *Accounting and Business Research*, 44(1). <http://dx.doi.org/10.1080/00014788.2013.867402>.
- Neag, R. (2014). The Effects of IFRS on Net Income and Equity: Evidence from Romanian Listed Companies. *Procedia Economics and Finance*, 15. [http://dx.doi.org/10.1016/S2212-5671\(14\)00860-0](http://dx.doi.org/10.1016/S2212-5671(14)00860-0).
- Nichita, E. (2014). Earnings management analysis after IFRS adoption: evidence from Bucharest Stock Exchange listed companies. *Proceedings of the 9th International Conference Accounting and Management Information Systems (AMIS 2014)*, June 11-12, 2014, Bucharest.
- Păşcan, I. (2014). Measuring the effects of IFRS adoption on accounting quality: a review. International conference Emerging Markets Queries in Finance and Business (EMQFB 2014), third edition, 24-25 October, 2014, Bucharest.
- Păunescu, M. (2015). Revenue recognition and measurement. Accounting vs. tax rules for Romanian entities, *Revista Audit Financiar*, 1(121).

- Roman, C., Roman, A.-G., Meier, E. & Mocanu, M. (2014). Research on the evolution of controlling tasks and their delimitation from audit tasks. *Theoretical and Applied Economics*, 12(601).
- Schleicher, T., Tahoun, A. & Walker, M. (2010). IFRS adoption in Europe and investment-cash flow sensitivity: Outsider versus insider economies, *The International Journal of Accounting*, 45. <http://dx.doi.org/10.1016/j.intacc.2010.04.007>.
- Street, D. L. & Larson, R. K. (2004). Large accounting firms' survey reveals emergence of "two standard" system in the European Union, *Advances in International Accounting*, 17. [http://dx.doi.org/10.1016/S0897-3660\(04\)17001-3](http://dx.doi.org/10.1016/S0897-3660(04)17001-3).