Harmonising accounting standards across the globe

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Over a decade has passed since the European Union (EU) mandated a uniform set of accounting standards, i.e. International Financial Reporting Standards (IFRS), for all companies listed on the major European stock exchanges in 2005. Since then, over 100 countries are currently requiring their listed firms to prepare financial reports either under IFRS or under a closely linked accounting standard. The simultaneous mandatory adoption of IFRS by many countries has provided empirical researchers with an unprecedented natural experiment on the consequences of accounting standard setting and how these consequences vary across institutional and legal regimes.

However, its effects on academic research have gone beyond simply providing a useful context for researchers. The adoption of IFRS has also kindled interest in cross-country accounting research and provided an opportunity for greater involvement of researchers from across the globe. Not surprisingly, a vast literature has emerged. Now, with the hindsight of over 10 years, we briefly review the academic literature to better understand the consequences of the global harmonisation of accounting standards.

Our full review aims to cohesively evaluate the empirical archival evidence on how IFRS adoption affects capital markets as well as firms' financial reporting quality, corporate decision making, stewardship and governance, debt contracting, and auditing. Our review emphasises similarities and differences across the various studies, not only in terms of their findings and conclusions, but also in their hypothesis development and methodological and sample choices. In addition, we also provide detailed discussions of research design choices and empirical issues with which researchers have grappled when evaluating IFRS adoption effects.

If we had to summarise the literature, the majority of early studies paint IFRS as bringing significant benefits to adopting firms and countries in terms of (i) improved financial reporting transparency, (ii) lower costs of capital, (iii) increased cross-border investing, (iv) better comparability of financial reports, and (v) increased following by foreign analysts. However, these benefits appear to vary significantly across firms and countries. More recent studies now attribute at least some of the earlier documented benefits to factors other than adopting new accounting standards per se, such as concurrent changes in reporting enforcement. Other recent studies examining the effects of IFRS on the inclusion of accounting numbers in formal contracts (which we refer to as the contracting role of accounting)

point out that IFRS has lowered the contractibility of accounting numbers. Specifically, our review reveals the following insights:

- Mandatory IFRS adoption has improved the association between accounting numbers and stock prices (i.e., value relevance), but at the same time has also increased earnings management by firms. IFRS-adopting firms tend to have more income smoothing, more reporting of aggressive earnings, and delayed recognition of losses.
- By harmonising accounting standards across countries, IFRS adoption has improved comparability of listed firms' financial reports across countries, but has worsened comparability of listed firms' financial reports with those of domestic non-IFRS firms (such as EU private firms). Also, IFRS adoption is not sufficient to achieve full comparability of financial reports across firms.
- Cross-country studies document that voluntary IFRS adoptions improve firms' financial reporting quality. But results based on analysis of voluntary adopters need to be cautiously interpreted due to potential biases associated with these firms self-selecting to report under IFRS.
- Early studies on effects of IFRS adoption find that stock liquidity increases and cost of equity capital decreases following mandatory IFRS adoption. However, recent studies point out that these benefits occur only in countries that change enforcement concurrently with IFRS adoption. Therefore, it is unclear whether IFRS adoption alone could have achieved these capital market benefits.
- There is consistent evidence that IFRS adoption triggers greater interest from foreign investors and foreign analysts.
- IFRS adoption has improved investment efficiency, especially for cross-border transactions and has also increased cross-border flow of capital. Studies generally attribute these findings to improved transparency and comparability under IFRS.
- Firms and lenders are more reluctant to use accounting-based covenants in debt contracts following IFRS adoption. Researchers attribute this finding to increased usage of fair value accounting and managerial discretion, leading to less useful contracting role of IFRS numbers in debt market.
- Greater comparability of IFRS financial reports across countries has increased reliance on foreign firms for relative performance evaluation in executive compensation and executive retention decisions.
- The principles-based and fair-value-oriented nature of IFRS has increased the effort needed to audit firms' financial reports, leading to greater audit fees.
- There is substantial variation in empirical research design across studies, which impedes reconciliations of differences in findings and conclusions across these studies.

Notes:

- *This blog post is based on the author's paper A review of the IFRS adoption literature, co-authored with Emmanuel T. De George and Lakshmanan Shivakumar, in the Review of Accounting Studies, September 2016, Volume 21, Issue 3, pp 898–1004*
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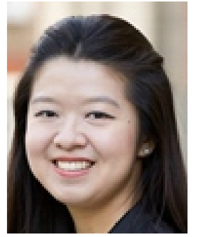

Xi Li is currently Associate Professor of Accounting at the London School of Economics. Before joining the LSE in 2016, she worked at Fox School of Business, Temple University and the Wharton School, University of Pennsylvania. She earned her PhD in accounting from the London Business School in 2010. Dr. Li studies financial reporting and disclosure, corporate social responsibility (CSR), shareholder activism, and debt contracting with a focus on international capital markets. Her papers have been published in leading academic journals in the field of accounting and finance. Her research papers have won several awards, including best paper awards in academic conferences, the Moskowitz Prize for Socially Responsible Investing and the FIR-PRI Award for Best Published Research Article. Her research findings have been cited by various social media, including Harvard Law School Forum on Corporate Governance and Financial Regulation, Financial Times, Wall Street Journal, Pension & Investments, among others. Dr. Li's current research project examines international shareholder engagements on CSR issues. The project has been awarded several research grants, including Risk Institute Research Grant, PRI Research Fund, and INQUIRE Europe Research Grant.

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