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A review of the current debate on the determinants and consequences of mandatory IFRS adoption

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Abstract

This review analyzes the economic and financial reporting consequences of International Financial Reporting Standards (IFRS) adoption. The survey of the IFRS adoption literature shows that the implementation of IFRS has been successful in reducing information asymmetry, improving the quality of information for users, enhancing transparency and comparability, and positively influencing capital markets. In general, the positive effects of IFRS are associated with firms in strong enforcement regimes that have incentives to comply. This survey find enforcement of IFRS to be a recurring theme throughout the literature reviewed and is therefore an area which requires development. In particular, there is a need to develop a mechanism for the enforcement of accounting standards internationally. Hence, there is a need for collaboration between the International Accounting Standards Board and regulatory bodies around the world to maximize the effectiveness of international accounting standards.

Keywords

IFRS adoption, enforcement, earnings management, capital market effects, accounting conservatism, and firm performance.

Review of the Current Debate on the Determinants and Consequences of Mandatory IFRS adoption

1. Introduction

The widespread adoption of International Financial Reporting Standards (IFRS), especially since 2005, has arguably been one of the most important developments in the history of accounting. As of April 22, 2016, 131 jurisdictions around the world either permit or require IFRS for domestic listed firms (Delloite, 2016). Certainly, governments, investors, auditors, accountants, business entities, and others have shown a great deal of interest in understanding IFRS. Hence, the purpose of this paper is to review the literature on the determinants and consequences of IFRS adoption.[1] A google scholar search on April 22, 2016 using the term "IFRS adoption" alone produced 23,800 results of which 1,250 papers had the search term IFRS adoption in the title. It is a daunting task to review such a vast and still growing body of literature, so this survey do not review every single paper published in journals (or available in electronic form), but rather, restrict our focus to the key issues identified to have effects on IFRS adoption.

As the economic consequences of adopting a new set of accounting standards (such as IFRS) are intertwined with the institutional setting of the adopting country, any analysis of the economic consequences of IFRS adoption would require knowledge of the institutional backgrounds of the countries which adopted the IFRS (Judge, Li and Pinsker, 2010). Thus, before reviewing the literature on economic consequences, we briefly outline the key country-specific characteristics associated with IFRS adoption. Economic consequences are also related to the intended purpose or expected benefits of IFRS adoption, given that this is what researchers have explored in identifying and recording economic consequences.[2]

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[1] We use the word "adoption" in a broad sense regardless of the process of adoption. We thus do not enter the debate about whether a particular jurisdiction has converged with or has adopted IFRS (Zeff and Nobes, 2010).
[2] Ball (2006) and Brown (2011) provide excellent discussions on this particular issue, so we do not consider it as part of our review.

Despite wide-spread adoption of IFRS, accounting and financial reporting continues to remain diverse across countries. Differences in accounting practice stem from the fact that each country has a diverse set of information needs because of unique legal, economic, social and political contexts (Ball, 2001, Brown, 2011; Brown and Clinch, 1998), and these result in different accounting standards being prepared (Zeff, 2007). Disparate financial reporting and accounting practices make it very difficult for users of accounting and financial reports to consolidate such information and make comparisons of firms that are listed in different countries (Prather-Kinsey, 2006). In addition, as financial markets become ever more interdependent, there is a greater need for the development of internationally recognized and accepted standards dealing with capital market regulation. Mirza, Holt and Orre (2006) find that IFRS represents a useful instrument designed to create and promote a stable and more secure international regulatory environment.[3]

Over the past quarter of a century, there have been robust debates on the desirability and viability of a global single set of accounting standards. Whilst the aim of such debates is to aid users and preparers of financial statements in making more informed decisions in an increasingly globalized economy, there has been some disagreement on the practical use of such an accounting framework.[4] Those in favor argue that a single set of harmonized accounting standards will reduce information asymmetry (Armstrong, Barth, Jagolinzer and Riedl, 2010; Choi and Meek, 2005), enhance capital market efficiency (Horton, Serafeim and Serafeim, 2013), and ensure greater transparency and consistency in financial reporting across national boundaries (Platikanova and Perramon, 2012). Those in opposition argue that the underlying nature of transactions may be lost in translation as communication and interpretation barriers obstruct the process of conveying accounting information according to

[3] Zeghal and Mhedhbi (2006) claim that the strength of the financial markets is expected to increase with the adoption of these international accounting standards.
[4] Globalization can be described as the accelerated movement of goods, services, capital, people, and ideas across national borders (Fosbre, Kraft, Fosbre, 2009).

the requirements detailed by the International Accounting Standards Board (IASB) (Soderstrom and Sun, 2007). In spite of the debates, the increased international interaction in the global economy has led to "complications for preparing, consolidating, auditing, and interpreting published financial statements" (Gyasi, 2010, p. 27). Such complications, along with an increase in cross-border financial activity, have made capital markets more dependent on each other, and have sparked awareness and appreciation that there needs to be a unified accounting language, so in 2001, the IASB responded by developing IFRS (Jermakowicz and Gornik-Tomaszewski, 2006).[5]

The advent of globalization has resulted in a stronger level of impact on international organizations, as well as a stronger influence for large multinational firms than previously. Globalization has also brought about the growth of international financial markets. The forerunner in the global economy, the United States (U.S.), has multinational firms earning more than 50% of their revenue from foreign sales (Fosbre et al. 2009). This not only reflects the growing globalization of U.S. businesses, but also the rapidly changing economic environment of global interactions. Over 3,200 firms worldwide are listed on stock exchanges outside of their home country. As of March 31, 2016 there are also nearly 506 foreign firms from 46 countries listed on the New York Stock Exchange (www.nyse.com), while the NASDAQ 110 foreign firms (www.nasdaq.com) and London Stock Exchange Main Board 273 foreign firms both list over 350 foreign firms (www.londonstockexchange.com). As per the World Trade Organization report (2015), the annual value of cross-border debt and equity transactions exceeded the value of the national gross domestic products in many Western countries such as Canada, France, Germany and the U.S. (Fosbre et al., 2009).

In countries where the regulation of accounting standards is considered to be strongest, particularly OECD countries, firms are more likely to follow IFRS. The rationale for this

[5] Ball (2006) describes IFRS as a set of rules that ideally would apply equally to financial reporting by public firms worldwide.

expectation flows from the realization that with globalization comes increased competition, so it is believed that the consequences of non-compliance with IFRS is extremely high (Zeff, 2007). In contrast, when firms perceive that there will be no serious consequences for non-compliance with IFRS, there is resistance to adopt (Pae, Thornton and Welker, 2008). Thus, it is important to ensure that there is compliance with IFRS to uphold greater comparability of financial information (Zhang, 2010). Certainly, a greater level of comparability is fundamental to investor decision-making and is required for the preparation of firms' financial information and reports. Regulators expect that the use of IFRS will enhance comparability and corporate transparency, thereby increasing the value of financial reports (Daske, Hail, Leuz and Verdi, 2008).

The burgeoning literature on IFRS, often reporting conflicting or mixed results, has prompted a number of researchers most notably, Hail and Leuz (2007), Soderstrom and Sun (2007), Pope and McLeay (2011), and Bruggemann, Hitz and Selhorn (2013) to attempt to synthesize the research evidence. Whilst all of the published papers are useful to readers interested in IFRS-related research, their common underlying theme is the implementation of IFRS in the European Union (E.U). In contrast, this survey focus our attention on global research and therefore review the literature related to both the E.U. and other parts of the world.[6] This survey of the IFRS adoption literature indicates that the implementation of IFRS has been successful in reducing information asymmetry, improving the quality of information for users, enhancing transparency and comparability, and positively influencing capital markets. Overall, the positive effects of IFRS are associated with firms in strong enforcement regimes that have incentives to comply.

[6] We do acknowledge Soderstrom and Sun's (2007) claim that the results based on voluntary adoption of IFRS cannot be generalized to settings where IFRS are mandatory.

This review is organized as follows: Section 2 provides the background and rationale for the areas of review. Section 3 presents the review, and Section 4 suggests several opportunities for future research. Section 5 concludes the paper.

2. Background and rationale for the areas of review

2.1. Background

As new opportunities to interact in the global economy present themselves, and as globalization continues to grow in scale, convergence with the IFRS becomes a more necessary and widely utilized option. As Prather-Kinsey (2006) shows, the U.S. is gearing towards IFRS adoption, having already set out a requirement that overseas listed firms adhere to IFRS. The IASB and the Financial Accounting Standards Board (FASB) have reached agreement to create a single set of high-quality standards (Oliverio, 2001). The frameworks of both of these organizations state that these accounting standards must produce accounting information which is relevant, reliable, and timely (Prather-Kinsey, 2006). This framework, often referred to as the *Conceptual Framework*, sets out the aims, assumptions, characteristics, definitions, and criteria that govern financial reporting (Mirza et al., 2006).

2.2. Rationale for areas of review

This survey considers academic literature relevant to the adoption of IFRS, empirical analysis of the determinants of adoption, and the associated economic consequences of adoption. In determining which indicators to use to gauge the economic consequences of adoption of IFRS, this paper attempts to identify the benefits that the IASB may have desired when embarking on a harmonization project.

Consitent with the recent studies on the review of IFRS adoption (e.g. De George, et al., 2016; ICAEW, 2014), this survey restrict the focus to the following 11 key issues identified to have effect on IFRS adoption: (i) comparability, (ii) foreign trade and investment, (iii) value relevance, (iv) earnings management, (v) accounting conservatism, (vii) analysts' forecasts, (viii) market liquidity, (ix) cost of equity, (x) cost of debt, and (xi) firm performance. This survey addressed these issues by reviewing articles published in reputable academic journals from 2000-2015. These are discussed in the following section, before a final conclusion is made on the economic consequences of IFRS adoption based on the findings of the studies explored.

3. Review

3.1. Comparability

One of the most important claimed benefits of IFRS adoption is that using a single set of accounting standards makes financial statements across adopting countries comparable. Such comparability should engender other benefits such as increased cross-border trade, increased foreign investment, and increased international portfolio diversification by securities investors.

One of the early debates concerning IFRS was whether it has sufficient quality worthy of consideration by countries with developed capital markets and financial reporting systems (e.g., the U.S.). In fact, many early studies of IFRS focused on whether they were anywhere near the U.S. accounting standards in terms of quality. Barth, Landsman, Lang and Willlams (2012) find that the countries which mandatorily adopted IFRS had accounting numbers more comparable with the U.S. GAAP relative to the countries which applied domestic standards.

However, Brüggemann, Hitz and Sellhorn (2013) argue that although evidence of positive capital market and macroeconomic effects is "plentiful and almost unanimous" (p.2), researchers have failed to document conclusively the increased level of transparency or comparability of financial statements. Nevertheless, whether adopting IFRS makes financial reports more comparable across firms and countries has been investigated in other settings .

In the European setting, Yip and Young (2012) examine information comparability across 17 E.U. countries which implemented mandatory IFRS adoption in 2005. The authors employ three proxies for information comparability, namely, the similarity with which two firms translate their economic events into their financial statements, the degree of information transfer and the similarity of information content of earnings and of the book value of equity. They find that although IFRS adoption improves information comparability by making similar things look more alike, comparability improvement is more likely to occur between firms from similar institutional environments than between firms from different institutional environments. This finding corroborates the views of the critics of IFRS adoption (e.g., Ball, 2006) who argue that institutional environments and improvement in them are more important in improving financial reporting quality than merely leaning on a set of accounting standards.

Brochet, Jagolinzer and Reidl (2013) employ the U.K. setting to investigate the improvement in information comparability following mandatory IFRS adoption. They argue that accounting standards in the U.K. had already been very similar to the IFRS prior to the E.U.'s mandatory IFRS adoption in 2005. Thus, U.K. firms were least likely to show any improvement in information comparability following IFRS adoption. However, Brochet et al. (2013) find that the mandatory adoption of IFRS reduces insiders' abnormal returns following insiders' equity purchases, consistent with the reduction in insiders' private information. Their results hold even for sub-samples of U.K. firms which were likely to have the highest levels of core information quality before IFRS adoption. Hence, evidence provided by Brochet et al. (2013) suggests that even firms having domestic standards similar to IFRS can benefit from IFRS adoption. This evidence significantly increase the range of countries that can potentially benefit from IFRS adoption.

3.2. Effect of IFRS adoption on foreign trade and investment

A direct benefit of increased comparability of financial reports across firms and countries is the broadening of investors' opportunity for cross-country investment and trade. Thus, several researchers have investigated whether IFRS adoption led to increased foreign direct investment (FDI), decreased home bias for equity investors, and greater capital market integration. Analyzing data from 124 countries over the period 1996-2009, Gordon, Jorgensen and Linthicum (2012) find that the mandatory adoption of IFRS leads to enhanced FDI in transition economies. Márquez-Ramos (2008) finds similar results in the E.U. setting. Further, countries with strong uncertainty avoidance stand to benefit most from IFRS adoption in terms of FDI by reducing perceived risks of investing abroad (Márquez-Ramos, 2008). There is also evidence that IFRS adoption leads to a higher degree of capital market integration (Cai and Wong, 2010).

In addition, U.S. investors' home bias decreases for countries which adopt IFRS and the reduction in home bias is greater for countries with larger differences between IFRS and their domestic accounting standards, for countries with a stricter rule of law and a common law origin, and in countries with greater incentives to report high-quality accounting information (Khurana and Michas, 2011). There is also some evidence that foreign mutual fund ownership increases for countries that mandatorily adopt IFRS (DeFond, Hung, Li and Li, 2014; Yu, 2010). Several of the potential drivers of reducing home bias are decreased information processing cost of foreign investors and a reduction of the effect of other barriers on cross-border investments (e.g., geographic distance) (Yu, 2010).

Employing ownership data from around the world, Florou and Pope (2012) find that institutional shareholdings increase following mandatory IFRS adoption, and increased institutional holdings are concentrated in countries in which enforcement and reporting incentives are strongest, and where the differences between local GAAP and IFRS are high. Employing the U.K. and Norway as outsider economies and Italy, Greece, Portugal, and Spain as insider economies, Schleicher, Tahoun and Walker (2010) show that the investment-cash flow sensitivity of insider economies is higher than that of outsider economies in the pre

IFRS era, but IFRS adoption reduces this sensitivity more in insider than in outsider economies. These results are consistent with prior research on IFRS adoption in other areas in that insider economies stand to benefit more than others from the adoption of a set of high-quality standards (such as the IFRS). Finally, using data from the Frankfurt Stock Exchange, Brüggemann, Daske, Homburg and Pope (2012) show that IFRS adoption enhances cross-border equity investments by individual investors.

3.3. Value relevance

A major indicator of the usefulness of IFRS is its effect on the value relevance of firms (Hughes, 2000). Clarkson, Hanna, Richardson and Thompson (2011, p. 3) suggest that "the value relevance of aggregate book value and earnings is a natural place to look for the impact of IFRS adoption on financial reporting quality given the paramount role of equity valuation in the IFRS conceptual framework". Further, a greater value relevance of book value and earnings means that investors rely less on "other information," so the risk of investment declines (Ohlson, 1995). Chalmers, Glinch and Godfrey (2011) claim that although studies generally find that adoption of IFRS leads to decreased earnings management and timelier loss recognition, its effects on value relevance differ from country-to-country. Hence, it is pertinent to analyze each country individually to gauge the international effect of IFRS on value relevance.

Chalmers et al. (2011) examine the effects of mandatory IFRS adoption on value relevance in Australian firms' pre and post 2005. Their results show an increase in the value relevance of earnings, commencing one year prior to IFRS adoption, suggesting that firms begin to manage accounting information in anticipation of IFRS adoption. However, the value relevance of the book value of equity remains constant across pre and post IFRS adoption periods in Australia (Chalmers et al., 2011). These overall improvements in value relevance are consistent with Daske et al.'s (2008) findings that the capital market benefits of

IFRS adoption occur mainly in countries, such as Australia, with strong legal enforcement of financial reporting standards. In studying the effects of IFRS adoption on intangible assets (e.g., goodwill) in Australia, Chalmers, Glinch and Godfrey (2008) find little or no improvement in value relevance following IFRS adoption. The overall empirical results for Australia therefore suggest that value relevance for measures (other than earnings) do not show any marked improvement. This result may be due to the greater degree of fair value measurement introduced under the IFRS regime.

Kabir, Laswad and Islam (2010) investigate the impact of IFRS adoption on New Zealand (N.Z.) firms. In particular, they examine the impact of IFRS adoption on items in the financial statements reported in the reconciliations of pre IFRS N.Z. GAAP amounts and IFRS amounts in the comparative information presented in the first annual financial statements under IFRS. They also investigate the impact of IFRS on the value relevance of earnings in N.Z. firms. The analysis of IFRS adoption reveals that the adjustment increased total assets, total liabilities and net profit. This study found no improvement in the value relevance of earnings due to the adoption of IFRS. Kabir et al. (2010) claim that the lack of improvement of value relevance in N.Z. is attributable to strong investor protection and high enforcement of accounting standards that predate IFRS adoption. In reviewing the influences of IFRS adoption on value relevance, Clarkson et al. (2011) differentiate between Code and Common law countries. As Soderstrom and Sun (2007) suggest, legal systems have a major influence on accounting standards; so it is pertinent to view the effects of IFRS adoption on value relevance separately for Code and Common law countries. Clarkson et al. (2011) review the effects of IFRS on the value relevance of earnings for 3,488 firms from 14 E.U. countries and Australia (i.e., 3 Common Law and 12 Code Law countries). Interestingly, their results show that IFRS adoption has a greater influence on the value relevance of earnings and book values for Code Law countries. This finding may be attributable to the fact that, in the past, Common Law countries' accounting standards were administered mainly by private sector bodies, with the intention of satisfying the information needs of users, whereas Code Law countries' standards were administered by the government with the intention of distributing stakeholder profits (Clarkson et al., 2011). In such an environment, the value relevance of earnings and book values should be markedly better in Common law countries due to the intention of the accounting standards. Hence, the results illustrated by Clarkson et al. (2011) are largely intuitive.

In the U.K., Horton and Serafeim (2010) examine the market reaction to, and the value relevance of, information contained in the IFRS reconciliation disclosure during the transition year. They find that the market reacts negatively when reconciliation results in lower earnings. In relation to value relevance, positive adjustments are value relevant both before and after disclosure, but negative adjustments are value relevant only after disclosure. These results suggest that firms withhold bad news until IFRS compliance.[7]

DeFond et al. (2014) investigate whether mandatory IFRS adoption affects the firm-level crash risk (defined as the frequency of extreme negative stock returns) They observe that in a poor information environment, crash risk decreases for industrial firms as a result of improved reporting quality, and increases for financial firms because of increased earnings volatility after the IFRS mandate.

Aharony, Barniv and Falk (2010) find that the adoption of IFRS has increased value relevance of goodwill, research and development expenses, and asset revaluations in the E.U. Moreover, in the year prior to mandatory IFRS adoption, value relevance has been greater in the countries which had local GAAP more compatible with IFRS, whereas value relevance was the highest in the year of IFRS adoption in countries in which the local GAAP had the greatest deviation from the IFRS (Aharony et al. 2010).

[7] Similar results are reported by Cormier, Demaria, Lapointe-Antunes and Teller (2009) in a French setting. They find that mandatory equity adjustment for first-time adoption of IFRS is more value-relevant than equity reported under French GAAP.

3.4. Earnings management

Another major indicator of the usefulness of IFRS is their effect on earnings management.[8] Healy and Wahlen (1999, p. 368) define the occurrence of earnings management as an instance when "managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company, or to influence contractual outcomes that depend on reported accounting numbers". While there has been considerable debate in accounting literature about the effects of IFRS on earnings management, one of the main aims of developing IFRS, as envisaged by the IASB, was to improve transparency and comparability of financial reporting across countries. Comprising a single set of high-quality financial reporting standards, IFRS are expected to remove many allowable accounting alternatives worldwide. Thus, IFRS adoption is likely to limit management discretion to manipulate earnings and improve earnings quality (Daske and Gebhardt, 2006; Ewert and Wagenhofer, 2005; Soderstrom and Sun, 2007).[9]

In recent years, many researchers have argued that the enforcement of accounting standards has been just as important as the accounting standards themselves (e.g., Ball, Robin and Wu, 2003; Holthausen, 2003; Hope 2003 and 2006; Sunder, 1997).[10] Without adequate and uniform enforcement, this may expose IFRS to the risk of adoption in name only. This removes the perceived benefits of IFRS adoption in such countries, and may allow the perceived quality of IFRS to be damaged if these countries (which are perceived to comply) do not comply with the standards. Cai, Rahman and Courtenay (2014) find that IFRS

[8] According to Ball (2008), IFRS are designed to: (i) reflect economic substance more than legal form, (ii) reflect economic gains and losses in a more timely fashion, (iii) make earnings more informative, (iv) provide more useful balance sheets, and (v) curtail the historical Continental European discretion afforded to managers to manipulate provisions, create hidden reserves, smooth earnings, and hide economic losses from public view.

[9] Adopting a common set of accounting standards, such as IFRS, is expected to improve earnings quality through the ease of monitoring and comparison of financial reports across borders. This should put pressure on management to report faithfully and truthfully, and engage in less earnings management (Daske and Gebhardt, 2006; Soderstrom and Sun, 2007).

[10] Enforcement is described by the Committee of European Securities Regulation as the combination of supervision and sanctioning in cases of non-compliance with the rules (Ball et al., 2003).

adoption in countries with weak enforcement mechanisms is likely to damage the perceived quality of IFRS.[11] Leuz, Nanda and Wysocki (2003) infer that countries with strong outsider protection are expected to enact and enforce accounting and security standards in a way that limits the manipulation of accounting information. Cai et al. (2014) examine the effect of IFRS adoption and enforcement on earnings management through a multinational sample comprising over 100,000 firm-year observations from 32 countries between 2000 and 2006. The authors find that countries with stronger enforcement mechanisms generally have less earnings management after the adoption of IFRS.

In assessing the effects of IFRS adoption in firms with regard to earnings management, an important difference can be drawn between accrual-based and real earnings management. Enomoto, kimura and Yamaguchi (2015) define accrual-based earnings management as a "change in the accrual process", and real earnings management as a "deviation from normal business activity". Parbonetti and Ipino (2011) examine whether there is a trade-off between accrual-based and real earnings management after mandatory IFRS adoption in 37 countries. The authors find that tighter accounting standards (i.e., IFRS) do not remove incentives to manipulate earnings. IFRS adoption can decrease instances of accrual-based earnings management. However, managers can simply switch to real earnings management, which IFRS can do little to deter (Parbonetti and Ipino, 2011).

Contrary to these results, Chua, Cheong and Gould (2012) find that the adoption of IFRS in Australia led to decreased pervasiveness of income smoothing towards a positive target. In assessing the findings of Barth, Landsman and Lang (2008), Capkun, Collins and Jeanjean (2016) and Ahmed et al. (2013) posit that instances of earnings management decrease or increase depending on the timing of IFRS (IAS/IFRS) adoption by firms. For example,

[11] Along a similar line, Ahmed, Neel and Wang (2013) predicted that the adoption of mandatory IFRS is likely to result in reduced accounting quality due to three factors: the creation of incentives for managers to manage earnings, delay in loss recognition, and the fact that IFRS are not supported by an adequate enforcement mechanism.

Capkun et al. (2016) find that voluntary adoption by firms prior to 2005 likely decreased instances of earnings management because often those firms adopted IFRS to attract investors and external capital via increased transparency. On the other hand, Capkun et al. (2016) also find that firms which were forced to adopt IFRS shortly after 2005 (i.e., via mandatory adoption) showed an increase in earnings management brought about by temporal changes in IFRS, allowing greater flexibility in accounting treatments. It is difficult, however, to empirically establish infallible results to prove (disprove) IFRS's hand in decreasing earnings management in a country.

Both accounting standards and accounting quality are determined by a country's institutional system and firm incentives regarding financial reporting (Ball, Kothari and Robin, 2000; Soderstrom and Sun, 2007). As Leuz et al. (2003) suggest, there is less earnings management in countries with strong investor protection, largely because strong investor protection limits the insiders' ability to acquire private control benefits and reduces their incentives to mask firm performance. In a similar vein, Houqe, vanZijl, Dunstan and Karim (2012) examine the effects of mandatory IFRS adoption and investor protection on the quality of accounting earnings for 46 countries around the world for the years 1998-2007. They find that despite a substantial reduction in national accounting differences, significant differences in earnings quality continue to survive.

Houqe et al. (2012) find evidence of less earnings management in countries with strong investor protection.[12] They also argue that earnings quality is a joint function of investor protection and the quality of accounting standards, but that IFRS adoption in isolation does not lead to increased earnings quality. This argument is consistent with the idea that accounting does not exist in a vacuum, but, rather, is a product of its environment and

[12] In addition, prior research suggests that strong investor protection, strong legal enforcement, and a common law legal system are fundamental determinants of high quality financial statement numbers. Evidence includes La Porta, Lopez-de-Silanes and Shleifer (1998); La Porta, Lopez-de-Silanes, Shleifer and Vishny (2000); La Porta, Lopez-de-Silanes, and Shleifer (2006), Leuz et al. (2003), Ball et al. (2000, 2003), Nabar and Boonlert U-Thai (2007), Daske et al. (2008), and Francis and Wang (2008).

emphasizes the importance of strong investor protection in promoting earnings quality even with the adoption of high quality accounting standards (Armstrong et al. 2010; Mueller, 1968; Nobes, 1988).[13] Burgstahler, Hail and Leuz (2006) and Ding, Hope, Jeanjean and Stolowy (2007) claim that a country's legal system, economic development, stock markets, and ownership concentration all play an important role in shaping its accounting standards and quality of reporting.

Gebhardt and Novotny-Farkas (2011) investigate the effect of mandatory IFRS adoption on banks' ability to recognize loan loss provision in 12 E.U. countries. They find that the restriction to recognize only incurred losses under IAS 39 significantly reduces income smoothing and banks appear to recognize the loan losses in a less timely manner. Moreover, firms that have close connections with banks and inside shareholders suffer from the lack of incentives to adopt IFRS and improvement to accounting quality is restricted to firms with incentives to adopt (Christensen, Lee, Walker and Zeng, 2015). Using data from Australia, the U.K. and France, Jeanjean and Stowlowy (2008) find that the frequency of small positive earnings (i.e., income before extraordinary items scaled by total assets) did not decrease in Australia and the U.K., but increased in France. It is likely that French firms had to "learn more" in adopting IFRS relative to firms in Australia and the U.K (Jeanjean and Stowlowy, 2008).[14]

3.5. Accounting conservatism

A key indicator of financial reporting quality following IFRS adoption is its effect on accounting conservatism. Conservatism in financial reporting can be described as a tendency,

[13] These findings are consistent with the suggestion by Soderstrom and Sun (2007) that cross-country differences in accounting quality are likely to remain after IFRS adoption until all institutional differences are removed. Moreover, these findings are also consistent with suggestions by Ball et al. (2003), La Porta et al. (1998); La Porta, Lopez-de-Silanes, Shleifer and Vishny (2000 & 2002), Leuz et al. (2003), La Porta et al. (2006), and Francis and Wang (2008) who conclude that adopting high-quality standards might be a necessary condition for generating high-quality information, without being a sufficient one.

[14] However, we acknowledge that we need to exercise some caution in interpreting the results from Jeanjean and Stowlowy (2008) because they only employ a sole measure of earnings management in their study.

on the part of firms, to be overly cautious when reporting earnings and assets, so as to ensure that their amounts are not exaggerated (Garcia Lara and Mora, 2004). Ball and Shivakumar (2005, p. 93) define convervatism as a "tendency to require a higher degree of verification concerning (the recognition) of good news".[15] Demaria and Dufour (2007) argue that accounting conservatism can aid in avoiding hazardous valuations of total assets, which may lead to dividend payments calculated from fictitious levels of revenue, and the diffusion of overstated financial information. Despite such a benefit, conservatism has potentially negative impacts too, such as the understatement of assets, overstatement of liabilities, postponed recognition of revenue to future periods, and recognition of expenses too early (Hellman, 2008).

Demaria and Dufour (2007) identified two approaches to conservatism, namely balance sheet conservatism and earnings conservatism. According to Demaria and Dufour (2007) the former is more common in Code law countries such as Germany and France, while the latter is common in civil law countries such as the U.K. Accounting in continental Europe is generally perceived to be driven by tax, law, and creditor considerations, and hence is more representative of conservative accounting.[16] Over time, there has also been a major emphasis on income statement conservatism over balance sheet conservatism: "Financial accounting since the mid-1930s has emphasized the income statement, with a corresponding emphasis on conservatism in the income statement" (Basu, 1997, p. 8).

Balance sheet conservatism, as defined by Feltham and Ohlson (1995) and Beaver and Ryan (2000), is the existence of a persistent understatement of the book value figure with respect to the market value of a firm.[17] Balance sheet conservatism is generally described as

[15] In a similar way, prudence has commonly been defined as attentiveness to possible hazard, and when applied to accounting, both prudence and conservatism tend to be expressed with a considerable level of commonality (Demaria and Dufour, 2007).
[16] This emphasis on conservatism is challenged to a significant degree by the inclusion of the fair value approach in IFRS, as was highlighted in the preceding paragraph.
[17] This should imply a market-to-book ratio consistently greater than one (Feltham and Ohlson, 1995).

ex-ante conservatism. Specifically, "the book value of net assets is understated due to predetermined aspects in the accounting process" surrounding adopted accounting methods and policies (Beaver and Ryan, 2005, p. 269).

Despite the potential to move to fair value accounting, a number of IFRS adopting nations, including France and China, have continued to use conservative accounting approaches post-IFRS adoption. In particular, there is a clear reluctance to convert from historical cost measurement to fair value accounting by standard setters and financial statement preparers (Demaria and Dufour, 2007; Peng and Bewley, 2010).[18]

Earnings conservatism is defined as differential verifiability required concerning the recognition of profits versus losses, whereby a firm will "anticipate no profit, but anticipate all losses" (Watts, 2003, p. 207).[19] It is generally described as *ex-post* conservatism. That is, the book value of earnings is written down under adverse circumstances, but not up under favorable circumstances. Hence, accounting methods and policies recognize bad news in earnings on a timelier basis than good news (Beaver and Ryan, 2000). A need for earnings conservatism has stemmed from a number of research investigations that show that revenue is by far the most commonly manipulated line item on income statements.[20]

Earnings conservatism is a term often associated with the reduction of earnings management and an attempt to improve earnings quality.[21] In a study of 21 IFRS adopting countries, Barth et al. (2008) find that firms which adopted IFRS experienced improved accounting and earnings quality. These improvements included less evidence of earnings

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[18] This issue is especially prevalent with the valuation of property, plant, and equipment (IAS 16), intangible assets (IAS 38) and investment property (IAS 40).

[19] Pope and Walker (1999) argue that earnings conservatism decreases with balance sheet conservatism, and claim that if a particular asset in the balance sheet has not been recognized, news about that particular asset will not be included in earnings. It will therefore not create any asymmetry in the news recognition of earnings.

[20] Types of revenue manipulation include front-loading sales from future quarters, creating fictitious sales, incorrect recognition of transactions, and shipping goods without customer authorization (Dechow, Ge, Larson and Sloan, 2011).

[21] White, Sondhi, Fried (2003), as cited by Morais and Curto (2008, p. 105), define earnings quality as "the degree of conservatism in a firm's reported earnings". Earnings quality and earnings management are discussed in more detail in a subsequent section of this paper.

smoothing, less evidence of earnings management towards a target, more timely recognition of losses, and a higher association with share prices.[22] Similarly, Leuz et al. (2003) find that firms which prepared reports using IFRS engaged in less earnings management when they were based in countries with developed equity markets, dispersed ownership structures, strong investor rights, and legal enforcement. These findings support suggestions from Wang (2007) that the IASB should be more tolerant of divergence from IFRS, especially when a firm embraces conservative accounting practices in an emerging equity market. Such displays of prudence in an emerging market should add credibility to earnings information and may act as a form of assurance to investors that earnings have not been manipulated (Peng and Bewley, 2010).

Despite arguments that earnings conservatism could mitigate earnings management and improve earnings information, He, Wong, Young (2012) find evidence that abnormal gains on debt restructuring in China were positively associated with earnings management incentives. Based on a German research setting, van Tendeloo and Vanstraelen (2005) found that IFRS adoption does not necessarily lead to less earnings management. Using discretionary accruals as an indicator of earnings management, "(their) results suggest that adopting IFRS does not constitute a significant constraint on earnings management, as measured by the level of discretionary accruals. On the contrary, adopting IFRS seems to increase the magnitude of discretionary accruals" (van Tendeloo and Vanstraelen, 2005, p. 155).[23]

Hellman (2008) explores two alternative forms of conservatism: consistent conservatism and temporary conservatism. He showed that IFRS reduce consistent conservatism. In

[22] An investigation into the treatment of goodwill (IFRS 3.51) carried out by KPMG (2003) concluded that IFRS requires the use of an impairment test when valuing goodwill. Conversely, Dutch GAAP does not require such a test, resulting in less earnings conservatism and less timely recognition of losses.
[23] In van Tendeloo and Vanstraelen's (2005) study, compared to firms which continue to use German GAAP, IFRS adopters report higher levels of discretionary accruals; therefore it can be implied that they experience greater levels of earnings management.

particular, asset understatements are consistently reduced, which is a common feature of prior accounting treatments. At the same time, IFRS leave more opportunities for temporary conservatism. Temporary conservatism under IFRS includes changes in accounting estimates that temporarily understate net assets, through the creation of hidden or off balance sheet reserves, or excessive provisions which may be reversed at a later date (Hellman, 2008).

Although conservatism may be a desirable attribute for assets and earnings, discussions between the IASB and FASB on the Joint Conceptual framework project has led the two standards setters "to exclude conservatism as a separate qualitative characteristic, (and) future standards may move away from conservative practices" (Demaria and Dufour, 2007, p. 7).[24] Despite the acceptance that fair value accounting is non-conservative, there is also acceptance that conservative measures are incompatible with neutrality. This acceptance is evident as a choice between historical cost and fair value, and implies a bias in financial reporting (Raghavan and Zampelli, 2010). Additional rationale for this decision comes from the issue of information quality. Historical costing is considered not to achieve a relevant quality of information and so fair value accounting provides greater transparency compared to historical cost measurements (Demaria and Dufour, 2007; Hellman, 2008). Consequently, historical cost, a method typically utilized from the conservative approach, is widely questioned as a valuation practice by the introduction of fair value accounting.[25]

3.6. Analysts' forecasts

Financial analysts are among the most educated and important users of financial information (Tan, Wang and Welker, 2011). Therefore, a review of the effects of IFRS

[24] Demaria and Dufour (2007) expand on this point, stating that a degree of caution may be needed when exercising judgment to make estimates under conditions of uncertainty; however, the qualitative characteristic of prudence does not justify deliberate understatement of assets and income and/or overstatement of expenses and liabilities. Richard (2005) reiterates this point, stating that IASB conservatism was meaningless as it was not expressed mandatorily as a requirement, only included potential losses, excluded latent value increases, and had a major limitation in the degree of caution expressed by preparers in their judgments.

[25] Conversely, fair value accounting is often criticized as a difficult method to approach, as a measure that intensifies volatility, and gives a value of breakage of a firm (Raffournier and Dumontier, 2005).

adoption on analysts' forecast accuracy provides a strong indication of the value of accounting standards harmonization as a result of IFRS. In reviewing the effects of mandatory IFRS adoption on analyst's forecast accuracy, Tan et al. (2011) suggest that expected results are not obvious. Although it seems logical that a harmonized set of international accounting standards should improve analysts' ability to forecast results, particularly with foreign firms, IFRS opponents argue that a country's optimal accounting standards are determined instead by its history, culture, and institutional setting (Tan et al., 2011). Further, opponents criticize IFRS for allowing greater subjectivity in fair value measurements, potentially decreasing analysts' ability to generate accurate forecasts of firm performance (Tan et al., 2011). However, contrary to critics' beliefs, the empirical findings in Tan et al. (2011) show that mandatory IFRS adoption leads to improved forecast accuracy for foreign analysts. Bae, Tan and Welker (2008) also find that differences in accounting standards deter analysts from following firms in foreign countries. Overall, these findings illustrate the idea that harmonized accounting standards lead to greater forecast accuracy with regard to foreign firms, both by increasing (or maintaining) the number of analysts following their performance and by allowing analysts to better understand the assumptions on which financial reports are prepared (Tan et al., 2011).[26]

Whilst investigating the effects of IFRS adoption on analysts' forecast accuracy, Cotter, Tarca and Wee (2012) seek to illustrate any significant effects on analysts as a result of disclosures about the effect of IFRS adoption in firms' financial statements. Although prior research (e.g., Hope, 2003) illustrates the importance of disclosure in financial reports, Cotter et al. (2012) find no positive association between disclosure of IFRS adoption in Australian firms and improved forecast accuracy from analysts. This is possibly due to the fact that firms will often announce their convergence to IFRS via channels other than financial reports

[26] However, Tan et al. (2011) suggest that mandatory IFRS adoption does not improve the accuracy of analysts in their own countries.

(Cotter et al., 2012). Contrary to the findings of Tan et al. (2011), Cotter et al. (2012) find increased forecast accuracy of Australian firms by local analysts, mainly in the year of IFRS adoption. However, this finding must be treated with some caution because while the results show improved forecast accuracy in the year of IFRS adoption, this may be triggered by greater care taken by firms and analysts alike due to the knowledge of changing accounting standards.

Although a large body of research documents the impact of mandatory IFRS adoption on forecast accuracy, there is little research on the effects of voluntary adoption. Kim and Shi (2012) find that accounting standards convergence through voluntary IFRS adoption leads to an improvement in the overall information environment faced by analysts. Daske and Gebhardt (2006) observe that the quality and quantity of disclosure improved with voluntary IFRS adoption in Austria, Switzerland, and Germany. Capkun et al. (2016) argue that voluntary adoption of IFRS is often made in an effort to increase transparency and thus attract shareholders and external capital. Greater transparency and disclosure in financial reports explains Kim, Shi and Zhou (2014) finding, as in such instances analysts have a greater depth of information with which to make forecasts.

In a cross-country study of 46 countries around the world including many E.U. countries and the U.S., Canada, and Australia, Horton et al. (2013) provide evidence that analysts' forecast accuracy and other measures of the quality of the information environment improve significantly more for mandatory adopters than for voluntary or non-adopters. This increased accuracy of forecasting is not due to earnings management, but is a result of higher-quality information and increased comparability following mandatory IFRS adoption. Horton et al. (2013) also observe that the larger the gap between IFRS earnings and local GAAP earnings, the larger the improvement in forecast accuracy.

Landsman, Maydew and Thornock (2012) show that information content of annual earnings announcements, measured as the abnormal return volatility and abnormal trading volume, increased in 16 countries in their sample relative to 11 countries that maintained domestic accounting standards. They also find that information content of earnings increases via three mechanisms: reducing reporting lag, increasing analyst following, and increasing foreign investment.

In the E.U. setting, Byard, Li and Yu (2011) find that analysts' absolute forecast errors and forecast dispersion decrease only for those mandatory IFRS adopters (relative to voluntary adopters) who are domiciled in countries with strong enforcement regimes and where domestic accounting standards differ significantly from IFRS. On the other hand, in weak enforcement regimes where domestic accounting standards differ significantly from IFRS, forecast errors and dispersion decline more for firms with incentives for transparent financial reporting (Byard et al., 2011).

3.7. Capital market effects

3.7.1. Market liquidity

Platikanova and Perramon (2012) argues that studies such as those by Hail and Leuz (2007) and Daske et al. (2008) have faced several empirical challenges when attempting to study the capital market effects of IFRS adoption. One of the main challenges involves finding an appropriate and reliable benchmark. As Platikanova and Perramon (2012) states "IFRS reporting is mandated for all publicly traded companies in a particular country and thus it is hard to find an appropriate benchmark against which to evaluate and attribute the market response to the IFRS introduction". Moreover, if a benchmark group does not permit the actual impact of IFRS reporting to be observed, there is scant or even no opportunity to empirically measure the effects of IFRS (Hail and Leuz, 2007; Platikanova and Perramon, 2012).[27]

Another challenge is that the first-time application of IFRS may generate short-lived adoption effects and inconsistencies which could hamper the usefulness of IFRS temporarily, even though IFRS reporting may be more informative (Daske et al. 2008). Moreover, some financial analysts may find it difficult to perform their future profitability analysis accurately. Conversely, sophisticated and well-informed investors may be in a better position to understand and unravel the one-time effect of IFRS adoption.

A final challenge regarding the understanding and calculation of capital market effects emerges in the form of voluntary adoption of IFRS. As Platikanova and Perramon (2012) explains, mandatory adoption of IFRS is an international attempt to harmonize accounting, yet numerous cases of voluntary application occurred prior to the 2005 mandate. "The application of international standards by voluntary adopters creates the possibility that investors more than likely only partially anticipate the effect of IFRS reporting requirements on the financial accounts that were previously reported on under the domestic accounting regime" (Platikanova and Perramon, 2012). Hence, investors may make decisions based on information that is not representative of the full effect of IFRS, potentially distorting capital market effects of IFRS overall.

Armstrong et al. (2010) examine European stock market reactions to events associated with the 2005 adoption of IFRS in Europe. They argued that investors might believe that IFRS application enables capital markets to become more globally competitive, with consequent increases in liquidity for firms. Further, despite the challenges associated with empirical research into the capital market effects of IFRS, several studies have been

[27] "In the cases where a benchmark group does not exist, we may attribute the change in market liquidity to the IFRS accounts, while other regulatory changes or management choices that happen simultaneously with the adoption of international standards may actually be what explain the changes" (Platikanova and Perramon , 2012).

conducted. Using a large set of voluntary IFRS adopters from around the world, Daske, Hail, Leuz and Verdi (2013) document that the average effects on the cost of capital and market liquidity are generally modest, especially when compared to other forms of commitment such as cross-listing in the U.S. In line with their predictions, Daske et al. (2008) also find that "serious" adopters experienced significantly stronger effects on their cost of capital and market liquidity than "label" adopters, suggesting that for some firms the quality of financial reporting improves in association with voluntary IFRS adoption.

Daske et al. (2008) examine the economic consequences of mandatory IFRS reporting around the world using a large sample of firms from 26 countries that mandated IFRS adoption. For the purposes of the study, they employ four proxies for market liquidity before aggregating them into a single liquidity factor. These proxies include: zero returns (which is the proportion of trading days with zero daily stock returns out of all potential trading days in a given year), price impact (which is the yearly median of the Amihud (2002) illiquidity measure),[28] total trading costs (which are an estimate of total round trip transaction costs based on a yearly time-series regression of daily stock returns on the aggregate market returns), and bid-ask spread (which is the yearly median of daily quoted spreads, measured at the end of each trading day as the difference between the bid and ask price divided by the midpoint).

Daske et al. (2008) use a difference-in-differences approach and found that mandatory adopters exhibit a significantly larger increase in market liquidity than a random sample of non-adopting benchmark firms from around the world. They also ran firm-level panel regressions that control for time-varying firm characteristics, market wide changes in the dependent variable, industry year-fixed and firm-fixed effects. Overall, the results indicate that market liquidity increases for firms that adopt IFRS reporting when it becomes

[28] This is calculated by daily absolute stock return divided by US$ trading volume (Daske et al., 2008).

mandatory. "For parsimony and to reduce measurement error all four liquidity proxies (are aggregated) into a single liquidity factor and again a statistically significant increase in liquidity for mandatory IFRS adopters (is found)" (Daske et al., 2008, p. 1088).[29] Although the results show that liquidity, cost of capital and valuation effects for mandatory adopters are economically significant, these capital market effects are generally smaller than the corresponding effects of voluntary IFRS adopters. In essence, voluntary IFRS adopters exhibit significant liquidity, valuation, and cost of capital effects during both pre-and post-adoption of mandatory IFRS reporting (Daske et al., 2008).

Platikanova and Perramon (2012) analyze market liquidity effects of IFRS introduction in Europe[30]. To determine market liquidity costs, Platikanova and Perramon (2012) use a relatively new source of accounting information: reported accounting reconciliations from domestic regimes to IFRS[31]. To assist the determination of market liquidity costs, Platikanova and Perramon (2012 utilize three popular proxies namely the proportion of zero returns (as expressed by the Amihud (2002) illiquidity measure), the price impact of trades, and the bid ask spread. With recognition that accounting regimes of adopting countries differ significantly, Platikanova and Perramon (2012) also focuse on the heterogeneous IFRS effects across adopting countries in Europe. In terms of this study, the sample was restricted to firms with accounting reconciliations available in the Thomson DataStream as of February

[29] Daske et al. (2008) find that liquidity improves when IFRS is mandated for all proxies, however, the results for price impact are not statistically significant.

[30] Platikanova and Perramon (2012) measured the IFRS effect as the marginal response of liquidity costs to accounting restatements in total assets, shareholders equity, and net income under IFRS. Moreover, Platikanova and Perramon (2012) was influenced by prior empirical studies that supported the view that legal tradition and institutions have a very strong role in shaping capital market effects and their stage of development. These studies suggest that good institutions are rewarded in financial markets as firms from countries with better legal institutions are larger in terms of sales and assets (Rajan, Zingales and Kumar, 2001), have higher valuation relative to their assets (La Porta et al., 2002), have a lower concentration of ownership and control (La Porta Lopez-de-Silanes and Shliifer, 1999), are most likely to suffer from accrual anomaly (Pincus, Rajgopal and Venkatachal, 2007), have better access to external finance (Demirgue-Kunt and Maksimovic, 2002), and have lower trading costs (Elcswarapu and Venkataraman, 2006).

[31] This choice was based on the conjecture that reported accounting differences could more precisely distinguish the IFRS effect on liquidity costs post IFRS introduction.

2009, and comprised firms from France (330), Germany (290), Sweden (330), and the U.K (489).[32]

In contrast to the findings of Daske et al. (2008), the results documented by Platikanova and Perramon (2012) reveal that IFRS restatements have strongly and negatively affected liquidity costs of U.K. firms, while the effect on French firms is present, but considerably weaker. Platikanova and Perramon (2012) also found no significant effect on liquidity costs from accounting restatements for German and Swedish firms. The empirical evidence found by Platikanova and Perramon (2012) suggests that investors anticipate the IFRS effect, but do not adjust price levels immediately. Most likely, uncertainty around the application of IFRS, from a long-term perspective, explains the significant adjustment effect for U.K. firms through net income restatements and French firms through total asset restatements. In addition, despite the negative effect of equity and net income restatements, this does not necessarily signify that IFRS reports are of a lower quality. The introduction of IFRS was intended to improve accounting quality, and the larger liquidity costs associated with larger restatements for U.K. and French firms could be attributed to insufficient disclosure about the IFRS effect on firms' financial position, rather than the lower quality of financial reports. Finally, Platikanova and Perramon (2012) finds heterogeneous effects across adopting countries which differ in legal traditions.[33]

3.7.2. Cost of equity

Proponents of IFRS have argued that a common financial language, when applied properly, can impact a firm's cost of equity capital via two mechanisms: improved financial disclosure and enhanced comparability of financial information (Daske et al., 2008; Leuz,

[32] Recognizing the fact that voluntary adopters would have provided accounting restatements before mandatory IFRS introduction in 2005, the sample did not include early adopters.
[33] Similarly, Comprix, Muller and Standford-Harris (2003) examined abnormal returns of E.U. firms in terms of four key event dates in 2000 that increased the likelihood of mandatory IFRS reporting, and find significantly positive returns for firms in countries subject to a high level of legal enforcement.

2006; Li, 2010).[34] Armstrong et al. (2010) argue that one set of uniform accounting standards is likely to improve information comparability across firms leading to an expected reduction in the cost of equity. In the same way, Lambert, Leuz and Verrecchia (2007) also find that increased disclosure reduces the cost of equity. Subsequently, in a sample of 1084 firms across 18 E.U. countries over 1995 to 2006 period, Li (2010) observe that mandatory IFRS adoption was associated with a significant reduction in the cost of equity by around 47 basis points.[35] Finally, Li (2010) find no evidence of any significant reduction in the cost of equity for voluntary adopters of IFRS since 2005, the year of mandatory adoption of IFRS in the E.U.

The global movement towards IFRS may facilitate the integration of capital markets as well as cross-border investments. The result is that foreign investment in firms will be much easier to orchestrate internationally. This could result in improvements to the liquidity of capital markets as well as enlarging the investor base, which could give rise to a lower cost of equity capital (Daske et al. 2008).

Consistent with Daske et al. (2008), research by Hail and Leuz (2007) also find some evidence that the cost of equity was lower for all firms reporting under IFRS. Moreover, Hail and Leuz (2007) observe that the cost of equity for firms that adopted IFRS for the first time in 2005 was lower relative to non-IFRS firms. Despite these findings, the overall effects were found to be small in magnitude, dependent on the choice of benchmark sample, and not robust to the introduction of firm-fixed effects. In accordance with the views of Daske et al. (2008), Hail and Leuz (2007) claimed that there was a possibility that their results were weakened by anticipation effects in the markets prior to mandatory IFRS reporting. In

[34] Leuz (2006) shows that more extensive financial disclosures and higher quality reporting are negatively related to a firm’s implied cost of equity. Further, Daske et al. (2008) and Li (2010) argue that a common set of accounting standards could help investors to differentiate between lower and higher quality firms which, in turn, would reduce information asymmetries among investors. As the information asymmetries among investors are lowered, this results in a lower cost of equity.

[35] Consistent with Daske et al. (2008), Li (2010) also find that the reduction in cost of equity after the mandatory adoption of IFRS was significant only in countries with strong legal enforcement mechanisms.

addition, E.U. countries have been "making continuous efforts to strengthen their legal and enforcement systems" during the IFRS adoption years (Hail and Leuz, 2007). Further, in Li's (2010) sample, mandatory adoption period was restricted to only two years. Thus, the long run consequence of IFRS adoption on the cost of equity is still an open question.

Using firm level data from 34 countries over the 1998-2004 period, Kim et al. (2014) find that cost of equity was lower in IFRS adopting firms compared with non adopting firms. Moreover, their results were robust to controlling for cross country differences in institutional infrastructure such as country level corporate governance and enforcement mechanism (i.e. disclosure regulations, auditing environment, and investor protection). Interestingly, in Kim et al. (2014) sample, countries with weak institutional infrastructure benefitted more from IFRS adoption in terms of greater reduction in the cost of equity compared with the firms in countries with strong institutional infrastructure. Overall, these results show that adopting a set of higher-quality standards (e.g., IFRS) could be a substitute for stronger institutional infrastructure in capital market development.

In a single country setting, using a small sample of 354 firm year observations related to the period 1998 to 2009, Hoque, Monem and vanZijl (2016) find that cost of capital declined in N.Z. by 11 basis points and 14 basis points for all IFRS adopters and voluntary IFRS adopters, respectively. In the context of Greece, Iatridis and Rouvolis (2010) find that, while the adoption of IFRS introduces volatility in key income statement and balance sheet measures, these financial measures subsequently improve significantly. Iatridis and Rouvolis (2010) results may help explain why Jeanjean and Stolowy (2008) find increases in earnings management in French firms following IFRS adoption. Moreover, contrary to their expectation, Calloo Gastón, Ferrer Garcca, Jarne and Lainez Gadea (2010) find that IFRS adoption had a larger impact on financial statement numbers in the U.K. compared to Spain. Using German firms' actual accounting-standard choices as a proxy for U.K. firms' willingness to adopt IFRS, Christensen, Lee and Walker (2007) find that the economic consequences of mandatory IFRS adoption varies across firms and is conditional upon perceived benefits. Finally, mandatory IFRS adoption does not benefit all firms in a uniform way, but leads to winners and losers (Christensen et al., 2007).

3.7.3. Cost of debt

The effect that IFRS has on information asymmetry and the cost of debt is extremely important to capital market efficiency. When lenders assess firms as prospective borrowers, they constantly face information asymmetry problems surrounding moral hazard and adverse selection.[36] This creates a crucial role for accounting information in mitigating adverse selection and moral hazard problems between borrowers and lenders. Thus, it is expected that IFRS will to lead to less information asymmetry and reduced adverse selection, which results in a lower cost of capital and enlarged investor base. This expectation stems from a belief that the application of IFRS provides higher levels of disclosure and more precise accounting information (Daske et al., 2008; Leuz, 2006; Li, 2010). Bharath, Sunder and Sunder (2008) reiterate this point, claiming that the higher the accounting quality, the lower the cost of debt. To the extent that mandatory adoption of IFRS enhances the quality and comparability of accounting information, mandatory adopters will incur a lower cost of debt.

The economic consequences of mandatory IFRS adoption for debt financing are expected to differ between public and private debt markets. Moreover, several significant institutional differences exist between private and public debt markets. Specifically, private debt markets have concentrated lenders such as banks and lower costs of renegotiating debt contracts, whereas public debt markets have dispersed lenders such as bondholders. Private lenders also have greater access to information giving them greater ability to process information and monitor borrowers (Denis and Mihov, 2003). In light of these institutional differences, firms

[36] Moral hazard arises when the action undertaken by the agent is unobservable and has a differential value to the agent as compared to the principal. Adverse selection problems occur when the agent has more information than the principal (Darrough and Stoughton, 1986).

with higher levels of information asymmetry are more likely to borrow in the private debt market than to raise funds in the public debt market (Denis and Mihov, 2003). This point is reiterated by Bharath et al. (2008), who suggest that firms with lower accounting quality have higher adverse selection costs in the public debt market and thus are more likely to borrow from banks than to issue public bonds.[37]

The findings of Florou and Kosi (2015) suggest that mandatory IFRS adopters pay lower bond yield spreads, are more likely to issue bonds than to borrow privately in the post-IFRS period, and are able to raise debt from a larger pool of capital at a lower cost after the mandate. Although materialization of such benefits as lower cost of debt is likely to be contingent on institutional characteristics of the mandatory IFRS adopting country, interestingly, Florou and Kosi's (2015) results hold even after focusing on countries which did not experience institutional changes. These findings are consistent with bondholders perceiving mandatory IFRS adoption as a solution to information asymmetry and a mechanism for enhancing comparability.

3.7.4. Firm performance

Generally, there are only two forms of accounting standards which can be developed: principles-based standards and rules based standards. An important feature of IFRS is that they are mainly principles based.[38] Principles based standards establish rules and guidance on a conceptual basis for accountants to follow, instead of specifically outlined rules. The overall expectation about principles based standards is that their use is more likely to give rise to transactions that reflect true economic substance (Carmona and Trombetta, 2008). Australia, N.Z. and the U.K. are all advocates of a more principles based philosophy. While

[37] Florou and Kosi (2015) reaffirm these suggestions, finding that mandatory IFRS adopters are more likely to issue public bonds than to borrow privately.

[38] Principles-based standards can be highly useful as they provide greater freedom to exercise professional judgment. This can be crucial when applying IFRS on an international scale, as effective use of IFRS will vary with context (Carmona and Trombetta, 2008).

principles based standards can be more useful in certain situations, rules are not necessarily unavoidable.

Unlike other Western countries, the U.S. has tended to opt for a more ruled based philosophy regarding accounting, focusing on the application of a fairly rigorous set of rules (Lee, 2006). As one of the strongest advocates of rule-based reporting, the U.S. accounting profession has also been involuntarily placed in the spotlight, particularly because of several spectacular and well-publicized corporate collapses such as Enron and WorldCom, with the former utilizing special purpose entities to hide substantial losses (Lee, 2006)[39]. Proponents of a rule-based system argue that explicit rules eliminate choices and hence standards are consistently applied. Such accounting standards will also tend to ensure that a given event will be reported in the same way by different firms, allowing for improved comparability (Phillips, Drake and Luehlfing, 2010). Whilst this may be true, critics argue that rules-based standards are insufficiently flexible to accommodate future developments in the marketplace and their propensity to encourage pro forma reporting is inadequate.[40] A further argument against rules-based standards is that they tend to constrain management reporting choices regarding certain activities. This can possibly hamper stakeholder efforts to value a firm if such rules preclude it from reporting the true economic substance of transactions (Carmona and Trombetta, 2008).[41]

[39] The Enron Corporation disclosed its reporting fraud in 2001 and sought Chapter 11 bankruptcy with accounting manipulations of more than one billion dollars. This scandal generated a violent tremor that struck swiftly through the stock market; a tremor that was exacerbated by Arthur Andersen, after admitting that they shredded Enron audit papers shortly after the fraud was unveiled (Lee, 2006).

[40] Pro forma reporting has traditionally been associated with reporting infrequent events such as a change in accounting principles, a change in normal operations or a change in the entity. While pro-forma reporting can cut through some of the uncertainties surrounding one-time transactions and events, it could also mislead financial statement users through somewhat dubious one-time charges or credits related to events that have not occurred or may never occur (Phillips et al., 2010).

[41] Although principles-based standards give management the responsibility and flexibility to report an event in a manner which reflects true economic value, this flexibility may also lead to earnings manipulation. Such manipulations will hinder the ability to report truthfully, especially if managers believe there are benefits to smoothing earnings or meeting earnings analyst forecasts (Barth et al., 2008).

Having discussed the pros and cons associated with rules-based standards and principles-based standards, there is a need to explore literature on firm performance following the introduction and application of IFRS. One study, conducted by Stergios, Athanasios and Nikolasos (2005), examine the effects of IFRS adoption in Greece. In particular, this study examines IFRS value relevance based on a sample of Greek financial statements during 2003 and 2004 by comparing the accounting results reported under Greek GAAP with those under IAS. Using IAS, Stergios et al. (2005) find that numbers for total assets and book value of equity, as well as the variability of book value and net income, would be significantly higher compared with numbers using Greek GAAP. Overall, Stergios et al. (2005) find that IAS adjustments to book value were generally value relevant, whereas the adjustments to net income were generally value irrelevant.[42] Expanding on these findings, Morais and Curto (2007) find that mandatory IFRS adopters in the E.U. experience increased value relevance of accounting numbers. Finally, a study into German firms, conducted by Lin and Paananen (2007), compares value relevance over time using IFRS, and finds a strengthened association between the book value of equity, earnings, and market prices over time.

Hughes and Sander (2007) examine the issue of accounting standards convergence by analyzing the performance of 40 cross-listed firms in the E.U. The purpose of this study was to determine whether U.S. GAAP reconciliation amounts for net income decreased under IFRS relative to local GAAP numbers in 2004. They find that IFRS reporting has not resulted in convergence with U.S. GAAP. In a study of 83 cross-listed firms, Gordon, Jorgensen and Linthicum. (2008) examine the association between local GAAP, IFRS and U.S. GAAP earnings with stock returns, relative to firms' cash flows from operations. Using an incremental value relevance approach, the results of this study show that reconciliation

[42] Conversely, Bellas, Toludas, Papadakos (2007) found higher value relevance for IFRS earnings than Greek GAAP earnings.

amounts are incrementally value relevant over and above IFRS and U.S. GAAP earnings. This suggests that the reconciliation itself captures value relevant information (Gordon et al., 2008).

Ernst and Young (2007) carried out an extensive study which examined financial statements from 65 large European firms to determine how some of the standards have impacted on firm performance. They report significant changes in accounting numbers both in terms of equity and revenue consequent to the adoption of IFRS. This study reports that although the 2005 implementation of IFRS has been a resounding success, it has also significantly increased the complexity of accounting in such areas as financial instruments, pensions, impairment testing, and share based payments. Demaria and Dufour (2007) analyze French firms to ascertain the transitional effects and the adoption of fair value options as firms switch from local GAAP to IFRS. They find that a majority of French firms maintained historical cost for the valuation of assets. These findings are consistent with the evidence for U.S. cross-listed firms found in Lang, Ready and Wilson (2006) and Leuz (2006), which shows that the home country institutional environment has a significant influence on firms reporting practices.

Major and Marquez (2009) analyze the effects of IFRS adoption in Portugal with reference to corporate governance and firm performance. In line with research by Subramanyam, Hodge and Ratnatunga (2006), the authors find a link between managerial accounting practices aimed at increasing firm performance with good governance and financial reporting requirements. But their results do not show that IFRS adoption is positively associated with good corporate governance practices. Instead, the authors find that IFRS adoption is an inefficient condition for enhancing corporate governance in a country with weak enforcement capability (Major and Marquez, 2009).

4. Opportunities for future research

In this section, this survey provide some guidance on the fruitful avenues for future research. In its early development, the IFRS adoption literature has been focused on exploring whether IFRS are of high quality (relative to standards in developed western countries) and whether the adoption of IFRS really delivered the benefits claimed by the IASB. Naturally, researchers explores whether IFRS adoption improved comparability of financial statements, foreign trade and investment, value relevance, and earnings quality. Researchers also investigated the capital market effects of IFRS adoption in terms liquidity and costs of equity and debt.

As indicated in section 3, whilst literature on economic consequences has seen substantial growth in recent years, contracting effects of mandatory IFRS adoption has remained a heavily under researched area. Given that accounting information plays a pivotal role in monitoring a firm's contracts, it is quite likely that, through its impact on reported accounting numbers, mandatory adoption of IFRS also influences numerous contracts which are in place in a firm. Thus, exploring how IFRS adoption changes debt and other contracts (such as compensation contracts) may help us understand the overall impact of IFRS adoption. Specifically, it is worth investigating whether and how debt covenants and performance based compensation contracts changed following IFRS adoption (Beneish, Miller and Yohn, 2015, Christensen, Lee and Wlker, 2007, Ozkan, Singer and You, 2012).

Due to IFRS' focus on fair value accounting and the consequent volatility of earnings, it is worth exploring whether and how transactions with equity holders (e.g., dividend payments) are effected by mandatory IFRS adoption. It is also likely to be fruitful to investigate if IFRS adopters changed their capital structure following IFRS adoption.

Most of the adopters of IFRS have been developing countries. These are the countries with weak rule of law, weak investor protection, weak political institutions, and lower levels of education. Critics of IFRS adoption have argued (e.g., Ball, 2006) that adopting just higher-quality accounting standards (without changes in the legal and economic environments) is not going to bring any credible benefits to IFRS adopters in the developing world. Due to the wide adoption of IFRS adoption in developing countries along with a myriad of complex legal and economic systems, developing countries offer a fertile ground for researching the consequences of IFRS adoption. More importantly, developing country setting for IFRS related studies is likely to produce knowledge on the minimum conditions (in terms of institutional environment) to derive any benefit from IFRS adoption (Chamisa, 2000). A natural extension of this area would be to explore how culture interacts with IFRS adoption. In a recent study, Houqe and Monem (2016) document that the length of IFRS experience is inversely related to perceived corruption in a country. More importantly, the authors find that developing countries stand to benefit more from IFRS adoption than developed countries in terms of reduction in perceived corruption.

Another potential avenue for research is whether benefits from IFRS adoption are contingent on the actual process of adoption. Zeff and Nobes (2007) argue that the actual 'adoptio process' might vary across countries. That is, it an open debate whether a specific country 'adopted' IFRS or 'converged' with IFRS. Such adoption processes could influence how we measure the benefits of IFRS adoption and what 'process of adoption' is likely to be least costly and most benecifial.

A highly neglected area of research is cost of IFRS adoption. Understandably, this is due to the non availablity of measurable costs associated with IFRS adoption. Nevertheless, De George, Ferguson and Spear (2013) provided evidence on the cost of IFRS adoption by examining statutory audit fees in Australia during the transition to IFRS adoption. More work is needed in this area. A natural extension of De George et al. (2013) would be whether there was an increasure in non-audit services surrounding the transition to IFRS.

Prior literature finds that IFRS adoption improves the information environment in terms of transparency, comparability, cost of capital, and liquidity for adopters. Counterparties of contracts may rely more on the financial information provided with less independent confirmation from a third party. This reliance may imply that the counterparties agree with IFRS adopters on some riskier contracts compared to non-adopters. This may be as a result of the reduction of default and expropriation risks. The impact is expected to be more significant and observable for unilateral contracts than for bilateral contracts.

Another potential avenue for future research involves contract terms, that is time components. Consistent with the findings on debt contracts, contract terms of time can become shorter because of uncertainty associated with the subjective fair value method. Notwithstanding the shorter time terms, adopters may experience an improved negotiation and modification power as a result of more informative and creditable disclosure. However, there may have another explanation which is the forward looking; that is, IFRS enhances the predictability of analysts and allows a longer time term of contracts.

Future research could also examine the association between commitment and disclosure quality. Consideration of parties' contractual obligations could also possibly reveal evidence about whether disclosure quality is actually improved and is more reliable. In certain circumstances, the default signals convergence of IFRS adoption when it allows firms to manipulate their annual reports by using subjective accounting choices and measurements.

However, as firms have divergent information environment in countries with different enforcement regimes, the effect on firms may be inconsistent with the overall effects on the E.U. countries. In general, firms may benefit unevenly from IFRS adoption. To ensure appropriate conclusions, future research could attempt to eliminate the joint effect of institutional changes in the E.U.

5. Conclusion

This review analyzes the economic and financial reporting consequences of IFRS adoption. Specifically, it provides an ordered documentation of archival literature on how IFRS adoption has impacted financial reporting with respect to comparability, foreign trade and investment, value relevance, earnings management, accounting conservatism, analysts' forecasts, market liquidity, cost of equity, cost of debt, and firm performance. Overall, the positive effects of IFRS are associated with firms in strong enforcement regimes that have incentives to comply. This survey find enforcement of IFRS to be a recurrent theme throughout the literature reviewed and, thus an area, which requires development. More specifically, there is a need to develop a mechanism for the enforcement of accounting standards internationally. Hence, to maximize the effectiveness of international accounting standards, there is a need for collaboration between standard setters and regulatory bodies around the world.

Standard setting is a process that is constantly changing and it is clear that, from an international perspective, there are benefits to harmonizing accounting standards. Another area of concern which emerged in the literature is the ability for standards to be applied differently, jeopardizing the efficacy of IFRS as a unified means of providing comparable and transparent information. To combat potential issues of standard abuse and inconsistent application, the IASB may wish to consider reducing some of the complexities and volume of disclosures that are presently required. To avoid uncertainty and translation issues, the IASB may also wish to issue more detailed interpretation of standards. The benefits of such measures may be observed through the elimination of the likely abuse of various options available in the standards, so that users of financial information will have more faith in the integrity of a firm's reports.

Summarizing the IFRS related research in the context of E.U., Pope and McLeay (2011) comment "IFRS appear not to have been the panacea some policymakers might have hoped for" (p. 254). They conclude that in terms of accounting quality, the effect of IFRS adoption is context specific. To be precise, IFRS are only one of the three components in determining financial reporting outcomes. The other two components, preparer incentives and the quality of enforcement regime in which financial reporting takes place are important or could even be the dominating factors for ascertaining accounting quality.

Given that accounting quality is jointly determined by the quality of accounting standards (such as IFRS), preparer incentives, and institutional infrastructure including political and legal systems, countries that have already adopted IFRS stand to benefit to a greater extent only when improvement in incentives and institutional infrastructures are achieved.

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