IFRS Monopoly: The Pied Piper of Financial Reporting

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How do we create better markets? The question can be narrowed to creation of better financial reporting, or expanded to creation of better economy, or even better society. Each specification of the scope of the question raises its own clarifying queries. What is better financial reporting, and how do we find out which system of reporting is better, and for whom? Shifting attention from these difficult-to-answer questions simply gives rise to others. What do we mean by better markets? What is the linkage between financial reporting and markets? Are there characteristics that make for better financial reporting but do not necessarily create better markets? We can escape these questions by shifting attention, yet again, from markets to the economy (or society) where the objective of increasing prosperity might be easier to agree on. But even here, troublesome questions arise about the distribution of wealth and about the causal linkage between the choice of financial reporting and the prosperity of society. We, as accountants, are naturally disposed to believe in the existence of such a linkage, and many others believe that some yet-to-be-specified system of financial reporting will generate greater wealth, and perhaps even distribute it more justly among the members of society. However, there is little evidence to support this belief. The desire for and the pursuit of prosperity is understandable; the hope that IFRS—especially IFRS as a monopoly—will help us succeed in this endeavor is not. Let me explore why.

It is useful to subdivide my charge or addressing the downside of IFRS into two modes of its adoption—one as the single standard within and across various legal jurisdictions in the world, and the other as a candidate available, along with other national or international competing alternatives, for use by companies in jurisdictions which may allow such a choice. I welcome and support the development of IFRS as a competing alternative that national authorities may make available to their registrants. However, IFRS-as-an-alternative has not been the direction in which IASB and its supporters have promoted these standards. Their focus has been to persuade national regulators to adopt IFRS as a single set of standards enforced on all registrants through enactment of local and regional laws.

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2 I am grateful to Kai Du for preparing the Appendix and the table on IFRS related research, to Ken Lee, ?? Middleton, Richard Macve, and Brian Singleton-Green, and other conference participants for their comments and suggestions, and to Diane Whitbread for preparation of the manuscript.
and regulations. A large part of my remarks are, therefore, directed to the IFRS monopoly proposal.

In popular imagination, accountants are often thought of as the ultimate professionals as well as unimaginative robots. Popularity, imagination and creativity lose their positive connotations when applied to accountants. As professionals, they are expected to stand firm in their judgment when winds of adverse opinion buffet and move others around them. Human imagination and creativity that enables us to discover solutions to our intractable problems become crafty opportunistic manipulation of financial reports in the context of accounting. Accountants are simply supposed to be different—firm guardians to save us from our own weaker selves. They may sometimes be creative in devising means of persuasion, but are rarely imaginative, and certainly not popular.

Over the past decade, the vociferous and well-financed campaign to manufacture and market IFRS as a "single set of high quality principles based standards for use by all" seems to have been designed to exploit this vein in the image of accounting and accountants. I would like to explain why, given the nature of accountants’ role, the objectives claimed for IFRS are unlikely to be met. To the extent they manage to succeed, I shall explain why and how the consequences will do more harm than good for efficient functioning of organizations and markets. Much has been made of the presumed empirical evidence that supports the virtues claimed for IFRS over the alternatives. A review of this evidence reveals the evidence to be mixed at best, and often irrelevant to policy on IFRS.

Many critiques of IFRS have focused on specific accounting standards issued by the IASB. This paper, instead, analyzes the consequences of the process through which IFRS is created and possibly implemented as a monopoly in the world.

**Weights and measures analogy**

Specification and enforcement of a uniform scheme of weights and measures is one of the earliest functions of even primitive governments in human history. Not surprisingly, the analogy of IFRS as a scheme of uniform weights and measures in the domain of financial reporting for the whole world has been used to sell the idea to lay as well as professional audiences. If the universal use of the metric system helps improve efficiency, so will the universal adoption of IFRS, the argument goes.

The problem is that IFRS has less in common with the metric system, and more in common with the Euro. Once the significant cost of transition from diverse to a single system of weights and measures have been incurred, there is little doubt that a uniform system yields continuing efficiencies which may justify the capital cost of the switch. The scheme of weights and measures, once chosen, implemented and enforced, is invariant to the decisions and choices made by parties to the transactions.

Government issued fiat money, on the other hand, is used not only for facilitating exchange, but also for managing aspects of the macroeconomy such as credit,
income, inflation, employment, trade and growth. Whether the advantages of using a single currency—not having to visit currency exchanges, for example—outweigh the disadvantages of losing control of money as an instrument of fiscal, monetary, and trade policy in all countries in the zone is a more complex question. It cannot be addressed by simply claiming that a single currency is necessarily preferable to local currencies as a single standard of value across Greece, Portugal and France. And yet, this is what the weights-and-measures analogy and the argument to advocate universal adoption of IFRS seeks to do.

Corporate financial reporting also has functions that extend well beyond its weights-and-measures function of comparing income, profitability, or value of corporations.\(^3\) As history shows, national governments use corporate financial reporting as instruments of policy on taxation, economic stimulus, compensation, and regulating financial systems. Whether they should do so is not the issue on the table. The question of whether a single currency or a single set of accounting standards should be used in all countries of the European Union (or the world, for that matter) cannot be settled by endlessly repeating the “comparable weights-and-measures” exhortation; such decisions call for more careful analysis of the consequences.

**Which Things/Practices are Best Standardized; which are not?**

Standards have played a critical role in development of human civilization by promoting quality or coordination, or both. Absent standardization, a great deal of our prosperity and comforts would not be achievable. For example, quality and coordination standards for food and hygiene allow us to safely eat food prepared by strangers, and standards for electric current and wireless protocols allow us to recharge our cell phones and communicate with others around the globe.

So, the question is not whether standards in general are good or bad for us. Instead, we need to reflect on (1) which aspects of our lives could benefit from either quality or coordination standards; and (2) in those cases where standards can be beneficial, what is an efficient process for identifying and developing effective and desirable standards.

We benefit from standards when we are reasonably confident that a solution or design has been found which is so efficient that continuing further search for even better solutions is not likely to be worth the effort; or alternatively, when further search for better solutions can continue, largely unhindered, even as we standardize what we believe to be an efficient solution for the time being.

To what extent, and in which respects, can we benefit from standardization of financial reporting? Standards to require disclosure of specific items are a form of

\(^3\) And the evidence that adoption of IFRS results in greater comparability of financial reports across national boundaries, even within the European Union, remains to be adduced; anecdotal evidence in support is accompanied by similar evidence in opposition.
quality standards for financial reports. Standards to require financial reports to follow specific formatting are a form of coordination standards because their value arises from commonality of usage (such as driving on one or the other side of the road). However, measurement standards, which constitute the vast majority of what the IASB and other boards require, combine elements of quality as well as coordination in varying degrees.

Whether meant to improve quality or coordination, there is always a possibility that standards chosen could be good or bad, and therefore bring benefits or harm. Standardization of weights and measures has brought much prosperity to society; standardization of QWERTY keyboard, in spite its early efficiency (in slowing down typists so type bars on mechanical typewriters would not jam) continues by sheer inertia and investment of skills in spite of demonstrated superiority of alternatives such as the Dvorak keyboard. It is therefore important that, in financial reporting also, we are careful in selecting the aspects of financial reporting that should be standardized, and in devising a reliable process to choose the standards that are put into practice.

In financial reporting, in a world dominated by electronic data processing, existence of formatting standards is necessary, but the specific choice of the format is largely a technical matter that need not be of much concern in our present discussion. Further, with changes in technology, these standards can be allowed to co-evolve without much active intervention by accounting regulators.

**Bases for deciding for or against IFRS?**

On what bases can we assess whether an IFRS monopoly will contribute to better markets and better economy? These bases should include contribution to prosperity and wealth of society, inclusion of relevant information from all parts of the economy, stability over time, adaptability to changes in economic environment, robustness against manipulation, and resistance to capture by narrow interest groups. On the flip side, covariation between accounting and stock market data, promotion of IFRS monopoly by firms and groups whose self-interest it may serve, and the count of jurisdictions in which regulators may claim to have adopted IFRS in expectation of attracting investment capital from abroad, should not be the bases for deciding on IFRS. Let us consider each.

**Contribution to the prosperity and wealth of society**

Contribution to the welfare of society is the ultimate criterion for judging adoption of a public policy proposal. However, it is also the most difficult to apply. On occasion, we may be able to find reasonable arguments or evidence on costs and benefits but a comprehensive analysis of identifiable specific costs and benefit consequences is practically out of our reach. Perhaps the best we can do is to draw parallels between the processes used in financial reporting and in other comparable domains. This we shall do in a later section.
Inclusion of relevant information from all parts of the economy

Decisions on standards, whether they relate to the choice of (1) specific standards, (2) institutional structure and process of writing standards, or (3) the scope of standardization, affect most if not all members of society. Information needed for making such choices is dispersed among a very large number of people and institutions. For the chosen policy to have desirable properties, they are best determined on the basis as much of this information as can be gathered and incorporated into policy. Organizations such as the IASB, staffed with a small number of subject matter experts, do not know important pieces of such information such as constituent preferences, alternatives available to them, and new strategies they might devise in response to the chosen standards. Attempts of standards boards to elicit constituent preferences may garner biased responses from the well-organized parts of their audiences. Even the audiences may not know which of the proposals on the table would serve their interests if they do not have prior experience with them. In spite of following due process, standards boards can gain only an approximate assessment of the consequences of proposals, unless they have already been put in practice. To include as much information as possible on decisions about standards, it is better to select from options on which experience from the field is already established. Unfortunately, the IASB (or the FASB) has not imposed this constraint on their choices in the past, often generating unanticipated consequences after implementation of their innovative proposals.

Stability over time

Like other bodies of law, rules and regulations, financial reporting standards also change the operating environment (payoffs, constraints, strategy sets, players) of the participants. Therefore, as a general rule, we should expect them to re-evaluate their strategies, and potentially alter their behavior. Since participants constitute important aspects of the environment for the others, changes in behavior by some call for potential changes in behavior of others. Over time, this action-reaction sequence may settle down into a stable pattern of behavior, until new changes in standards are introduced.

The point is that each change in financial reporting standards is a source of new strategic uncertainty and therefore calls for adjustments by the participants. To the extent stability and reduction in uncertainty is a goal of standard-setters, they should be biased in favor of a stable set of standards, and introduce new standards only after they have considered this additional “cost” of creating new turbulence in the financial reporting system.

If IFRS is promulgated by a permanent board with an establishment, there is a natural inclination in the organization to keep a full docket, and to publish new standards as evidence of its productivity and value for the resources spent on it. While some such new standards may be well-justified, excessive standard-setting that continually introduces new perturbations in the reporting environment is an inevitable consequence of a permanent institution like IASB or FASB (Sunder 1981). In deciding on IFRS monopoly, this tendency of the institution that writes them
should be kept in mind. IFRS has been promoted on grounds of being principles based (because its rule book is thinner—a mere 2700 pages—as compared to some 15,000-plus pages for the U.S. FAS). Is it not possible that its rulebook is thinner only because the IASB started later and had fewer resources; given time and staff it, too, will catch up with the FAS. Similar structures should be expected to yield similar outcomes.

**Adaptability to changes in economic environment**

Environment of financial reporting is in a flux due to myriads of events in the economy, markets, and organizations. Even an organization which is fully aware of the need for stability must respond to some of the changes in environment by issuing new standards, or modifying the existing ones. The IASB, like the FASB and many other national boards is designed for responsiveness to calls for action from regulators and constituents. However, the IASB has no advantage over the others in responsiveness. If anything, its ability to respond is attenuated by its global composition and coverage of a diverse set of conditions prevailing in various parts of the world. It cannot adapt its standards to changes in economic environment confined to only a limited part of the world.

**Robustness against manipulation**

Several kinds of threats of manipulation of IFRS can be considered. Undue influence of a single country can be controlled through representation from major economies of the world on the IASB. However, it is possible that most of these countries may choose a professional accountant to represent them, thus creating an aggregate imbalance among various constituencies in the Board. A third kind of manipulation threat arises in the form of existential challenges to organization itself by powerful lobbies and politicians. A corporate body, especially one endowed with monopoly powers, is more vulnerable to such challenges. In comparison, when multiple standard setting bodies coexist with one another and with social norms, their power to hold their ground against political and interest-group pressures increases; they can tell the challengers to use the alternatives available from other sources.

**Resistance to capture by narrow interest groups**

In his seminal work, Stigler pointed out the ever-present threat of regulators being captured by the parties they seek to regulate. Capturing parties have to have an interest, power, and concentration to succeed. Both the professional accountants as well as business corporations, especially in the financial industry, seem to satisfy these conditions. Dependence of the IASB on these groups for funding its operations increases the risk of capture. In recent years, taxation of public corporations has been proposed (and implemented in case of the FASB) as a solution to this risk. Since taxation deprives the monopoly standard setters of the information feedback, I suggest royalties gathered from reporting entities who may choose to report on the basis of a competing set of standards as a better solution. Any tendency of corporate managers to choose “cheap” standards for their reporting would be counterbalanced by the vigilance of the investment community; they can use such
management behavior as a signal about the latter’s competence and confidence (see Dye (1985), and Levine (1996).

The above six factors have a reasonable claim to be considered in assessing whether or not to adopt IFRS monopoly. There are also several other considerations often mentioned in the literature as bases for this assessment. The following paragraphs examine these arguments.

**Correlation between accounting and stock market data**

A large amount of research effort on objective assessment of IFRS has been devoted to estimating the statistical relationships between stock prices on one hand, and accounting data generated under IFRS and other accounting regimes on the other. A higher (lower) correlation between stock prices and the accounting data generated by IFRS as compared to the data generated by, say, the US FAS would supply objective evidence that the stock markets find the former more (or less) informative than the latter. Since neither the data nor the statistical estimates are influenced by the identity of the researcher, this well-meaning argument goes, such analyses provide an objective basis for assessing alternative standard sets.

This argument has two weaknesses. First, it assumes that the stock market is the critical if not the sole criterion for selecting a financial reporting regime. If, as mentioned above, the choice of financial reporting is to be based on enhancing the welfare and prosperity of society, the stock market is not sufficient for this purpose unless the welfare of all others were invariant with respect to the choice. There are other markets including bond markets, markets for managerial and other labor, as well as markets for various goods and services that constitute the economy. Financial reporting plays varied but important roles in them all. An argument that justifies choosing accounting regime on the basis of better functioning stock market alone is not defensible.

Even if one were to concede to the stock market complete sovereignty over all matters of financial reporting, the statistical method does not deliver the promised goods. Consider a simple illustration.

Attempts to produce policy-relevant empirical research often take the following form: Let us posit Financial Reporting System A as the status quo which generates Price System A through a causal impact of accounting on markets (such causation is a maintained hypothesis reflected in the title of this conference)

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\text{Financial Reporting System A} \rightarrow \text{Price System A} \quad (1)
\]

Since it is the status quo, the policy makers (and the researchers who may be engaged to assist them) have available to them data on financial reports as well as the stock market (prices, volume, etc.) generated under System A. They can use research tools to estimate statistical relationship such as correlation between the accounting and the market data. Let us denote this estimated statistical relationship by \( R(A) \). Note that the estimated statistical relationship has no directionality.
Now suppose that the policy maker considers an alternative financial reporting system B which will change the status quo to a different reporting standard. Again, under the maintained hypothesis of causal impact of the changes in financial reporting on the stock market, we admit to the possibility that it could generate a different Price System B:

Financial Reporting System B \( \rightarrow \) Price System B \( (3) \)

Note that if we do not even admit to the possibility of a change in financial reporting causing a change in the price system, we would reject, ex ante, any relevance financial reporting might have for stock markets. Before changing the financial reporting from its status quo, the policy maker may want to know its consequences for stock prices. Let us suppose for now (we shall relax this assumption shortly) that we are able to observe both the financial reporting as well as stock market data under System B, and use this data to estimate the statistical relationship, denoted by \( R(B) \), between financing reporting and the stock market under the proposed system.

Financial Reporting System B \( \rightarrow \) Price System B \( (4) \)

The first question we ask is: What inferences about the relative desirability of systems A and B can we draw on the basis of comparing \( R(A) \) and \( R(B) \)? Suppose \( R(.) \) is linear correlation or coefficient of determination of a linear regression, or some such measure of statistical proximity of the financial reports and the resultant stock prices. It is tempting, at first glance, to say that a financial reporting system that has greater statistical proximity to the corresponding stock prices should be preferred. Indeed, that is the so-called “information content” criterion which has been, and continues to be used extensively in accounting literature of the past four decades.

However, if the desirability of a financial reporting system were to be judged by the statistical proximity of the relevant accounting and market data, it is trivially simple to achieve the financial reporting nirvana. All one has to do is to use the market data to prepare the financial reports. For example, if the change in market capitalization over the year were reported as the income of the firm for that year, accounting and market data would be not merely proximate statistically, but will be identical. Simply feeding the market data back to the markets through financial reports would be silly, because such reports will be worthless in providing any information to the market. In such a world, having turned financial reporting for the markets on its head, we shall have financial reporting from the markets. Absent other sources of information, prices in an economy with “market-based” reports would be indeterminate and therefore inefficient. Consequently, one cannot usefully assess
the relative desirability of alternative financial reporting systems on the basis of the statistical correlation between the respective sets of accounting and market data.4

The above analysis is based on the assumption that the data from System B, the alternative to the status quo System A, are available to estimate R(B). For many accounting policy problems, it is possible to estimate hypothetical accounting numbers that would be reported under the policy alternative provided that the real decisions of the managers (e.g., research and development, investment, etc.,) would not be influenced by a switch to the alternative reporting regime, and if sufficient information on parameters of the firm were available to the analyst. However, stock market data under the alternative regime cannot be available before it is implemented, nor can it be constructed through either contemplation or analysis. What can one do to estimate R(B) in (4) above (assuming that would be useful in some way)?

This additional difficulty has led many analysts to simply replace Price System B by Price System A, and estimate the statistical proximity R*(B) of accounting data B with market data A, and draw inference about the desirability of financial reporting systems on the basis of comparing R(A) with R*(B), instead of R(B) which is unavailable, as shown below in (5).

<table>
<thead>
<tr>
<th>Financial Reporting System A</th>
<th>R(A)</th>
<th>Price System A</th>
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<tr>
<td>Financial Reporting System B</td>
<td>R*(B)</td>
<td>Price System B</td>
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Doubtful as it is to assess the relative desirability of A versus B on the basis of comparing R(A) and R(B), doing so on the basis of comparing R(A) to R*(B) is even more difficult to defend. What is the meaning and significance of R*(B), and what can its comparison to R(A) possibly tell the policy makers about the relative merits of these reporting regimes. One could defend the use of R*(B) on the basis of the assumption that it is reasonable to replace the unobservable Price System B by Price System A, because the contemplated change in financial reporting regime has no consequences for the price system. But such an assumption strikes at the very roots of the whole approach: why compare the relationship between accounting and stock price data if the former have no effect on the later.

There have been a many studies that evaluate IFRS on the basis of this method of analysis. The results have been mixed (see the Appendix for a summary of these and other empirical studies). Unfortunately, the empirical studies of covariation of

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4 This is true, even from the point of view of investors. Once we include the points of view of other parties in the financial reporting system, the justification for statistical correlation weakens further to the point of disappearance. However, this broader issue is not addressed here. See, Beaver and Demski (1974), Sunder (1997).
financial reporting and stock price data are essentially irrelevant to the problem of whether companies, countries, or the whole world should choose IFRS monopoly for financial reporting.

**Promotion of IFRS by various firms and groups**

The past decade-and-a-half has seen a concerted effort to promote and market IFRS to investors, regulators, companies, teachers and the general public in many parts of the world. IASB has an obvious interest in promoting acceptance of IFRS. Four major audit firms and their international networks appear to have made a policy decision to promote a monopoly status for IFRS, and have used their considerable resources for this purpose (Harris 2008). These firms repeat verbatim the language used by the IASB (e.g., a single set of high quality principles based financial reporting standards to promote comparability across the world) without giving specific reasons why they have taken this position in the policy domain. It has been suggested that the large audit firms see international standards as a strategy to take a larger share of the audit market from small and local firms. However, there has been so little public discourse on these matters that it is difficult to know for sure.

**120 Countries can’t be wrong**

Public officials in many countries, eager to attract foreign investment capital for their development, have been led to believe that the adoption of IFRS will help them. Consequently, many have or claim to have adopted IFRS. Given the difficulties of translation, and implementation of IFRS in variable local environments, whether the claims of its adoption can be meaningfully translated into more comparable financial reports across nations and continents remains to be seen. In the meantime, following the crowd to adoption is a questionable argument often used to promote IFRS.

**How Do We Learn What is Better?**

What are our sources of learning, and means of discovering, what good financial reporting is, in the sense of making markets better or generating more wealth and prosperity for society? First, there are some a priori beliefs that we carry from our understanding of the broader world in relevant contexts and from past experience. For example, these may include truthfulness (representative faithfulness), relevance, timeliness, unbiasedness, etc. These are regarded as maintained hypotheses in most analyses because subjecting them to further questioning does not appear to be a fruitful endeavor. There is no reason to think that the a priori assumptions underlying IFRS are any better or worse than those underlying alternative standards; in any case, there is no evidence to the contrary.

A second approach to learning is systematic analysis of the problem on the basis of known first principles. For example, on the basis of known laws of physics, an engineer may be able to form a reasonable assessment of how a newly designed electrical circuit will function. On the basis of known laws of supply and demand, and estimated parameters of the problem, a businessman may form a reasonable
assessment of the product price which will yield maximum profits for him. In financial reporting, we do not seem to have identified yet such first principles on which we have broad agreement. Without such principles, our ability to form a reasonable assessment of the consequences of any changes we engineer in the system of financial reporting is severely circumscribed. I am not aware of any current work to take us in that direction. Neither IASB nor other standard-setting organizations in various parts of the world have any advantage over one another in forming better standards for better markets.

A third approach to learning is to conduct systematic experiments under controlled environments to examine the properties of alternative financial reporting regimes. In social domains where such experiments can have major unanticipated consequences for the participants, there is understandable reluctance to conduct them. For this reasons, when such experiments are undertaken, they allow voluntary participation. Since participation decision itself may differentiate the participants from non-participants in important respects, usefulness of such experiments is limited. On occasion, historical accidents may create situations that can be regarded, ex post, as experiments, and data gathered from them analyzed to gain useful insights. However, such events are too rare to serve as a reliable basis of learning about financial reporting alternatives.

These difficulties lead us to conduct small scale laboratory experiments on students or professionals, either by paying them cash or by relying on the assumption that their behavior will remain unaffected by the hypothetical nature of the experimental tasks they are asked to perform. Further, institutional interactions and their complexities in financial reporting are difficult to capture in hypothetical laboratory tasks. Understanding and choosing institutional relationships require experience and time scale much longer than what is typically available, and can be available, in experimental settings. Neither IASB nor the other regulators have relied on experimental method to learn about the potential consequences of the financial reporting interventions they contemplate.

A fourth, and the most commonly used approach to systematic learning is to analyze observations from the past about changes over time in a given place, or variations across places at a given time, or both. We may, for example, assess from past data how changes over the years in accounting for bank loans gone bad in the United States may be systematically related to the observable behavior of bankers, borrowers, and investors. Or, how the choice of financial reporting standards allowed in Switzerland might have influenced their markets as compared to most other domains where such choice was not permitted. Rooted in actual facts of the past, this approach to documented learning has obvious appeal. Unfortunately it, too, has severe limitations. The observable behavior available for analysis leaves out critical unobservable variables such as expectations and private information on which behavior of various agents is dependent. Equally important, statistical analysis of the past data allows us to establish covariation but rarely causation.
Policy making requires the latter and have little use for the former. Third, any data from the field are susceptible to self-selection and endogeneity.

What would the introduction of a world monopoly of IFRS (even if it were confined to the major economies) do to our ability to learn so we become better informed about potential improvements in financial reporting and create better markets? Of the four methods of learning mentioned above, the IFRS monopoly would have no advantage over its alternatives in the first three. With respect to the fourth approach, the monopoly will make it virtually impossible to make cross-sectional comparisons of alternative accounting regimes and of their consequences on the basis of field data because no such data would be available in such a regime.

**Standards and Alternatives**

Written standards enforced by authority are an important but not the only instrument for improving quality and coordination in society. Order in many if not most aspects of our lives is attained by shared expectations, social norms, and exchange (Sunder 2004, 2005). For example, beyond hygiene and safety, there are no written standards for food served in restaurants. Yet, these establishments create, maintain, and deliver myriads of preparations to satisfy the diverse tastes of their customers on a consistent basis. The same is true of colleges, cars, and clothing. If the arguments offered to promote IFRS monopoly are to be believed, the world would be a better place if a single body specified a uniform cuisine, cars, clothes and curriculum as well as laws and language for everyone in the world.

**Principles vs. uniformity**

Promoters of IFRS endlessly repeat “single set of principles-based standards to promote comparability.” In spite of its apparent appeal, a fundamental contradiction is hidden within. Any body of principles, being more general and less specific than rules, must also permit greater room for individual judgment in their application. Individual judgment means diversity of interpretation, and consequently less uniformity and comparability. This problem with the rhetoric used to market IFRS was pointed out early: “Common global standards, if read to mean identical, is an illusory and unobtainable goal” (Breeden, former chair of the U.S. Securities and Exchange Commission) and “a uniform classification of transactions that occur in diverse environments is logically impossible,” (Fearnley and Sunder (2006). Since no two transactions or events are identical in all respects, does uniformity mean any two transactions with *any similarity* must be treated alike, or that any two transactions with *any dissimilarity* must be treated differently (Sunder 1997)? The two answers to this question yield radically different solutions. This problem, and the foundational ambiguity of the concept of uniformity, were ignored, and has inevitably arisen in empirical studies of application of IFRS in practice (Rezaee et al. 2010).
**Language and translation**

Rhetoric of IFRS often draws on the metaphor of accounting as the language of business and the benefits of using a single accounting language across the world. The presumption is that the single precise meaning of accounting terms, specified by a central authority and enforced under the law will improve communication between reporting entities and their constituents. However,

“Consider the failed utopian vision of Esperanto. It was proposed in 1887 as an artificially constructed global language to eliminate the difficulties of communicating across the world. Languages are alive with words with their multiple and ambiguous meanings continually entering, evolving and becoming obsolete. This development is bottom-up, driven by users of language, not top-down, controlled by lexicographers. Esperanto failed because its promoters ignored the fundamental nature of language in their search for uniformity” (Fearnley and Sunder 2006).

Ambiguity of meaning is necessary for communication, and its evolution (Kitchen 1954). If the meaning of “shirt” were to cover every detail of the garment, either all shirts will have to be identical or every shirt would need a different word to describe it.

Since IFRS documents are written in English, they must be translated into various natural languages of the world. Each natural language has vocabulary and character of its own, and it is not possible to find words and phrases to create the exact translation of the English originals. Anecdotal stories of how Turkish or Japanese translations deviate from the intent of the original are heard but difficult to evaluate in the absence of unanimity behind bilingual authoritative voices. How shall one know if the financial reports putatively prepared under IFRS are indeed comparable across borders, except to rely on diverse claims of those who claim to know those languages?

**Discovery and evolution**

Financial reporting is a particularly complex example of a social system in which a large number of individuals and groups with their own unique interests, information, and opportunity sets act and interact dynamically. Past decades of efforts at shaping the financial reporting regime through top-down regulation suggests that our ability to design financial reporting standards for attaining a given set of outcomes, or to predict the response of this complex system when a given set of standards are promulgated is limited at best. Yet, financial reporting does require some rules. In broader socio-economic contexts, Hayek (1988) called it our fatal conceit: “Since people had been able to generate some system of rules coordinating their efforts, they must also be able to design an even better and gratifying system (p. 7).” But social systems have little to do with design, there are results of evolution through trial and error and selection. What can we do?
An alternative to the top-down design approach, which has dominated the accounting discourse of the recent decades, is to place greater reliance on bottom-up evolution of financial reporting practices. Allowing deliberate room for experimentation will facilitate experience with newer methods, and help us discover some that might work better by satisfying various constituents. This would be the social equivalent of Darwinian evolution in biology and accounting equivalent of Spenserian social evolution. A process that allows and encourages the discovery and evolution of better financial reporting in the context of experimentation in real markets will be admittedly slow, but has a better chance of improving the regime. Granting a monopoly to the IASB, or to any other corporate body, will take us in the opposite direction.

**Fit in the legal, economic and business system**

The uniformity and comparability argument in favor of IFRS ignores the interrelationships among economic, business and legal institutions of society and the corresponding regimes of financial reporting and auditing. One cannot impose an externally devised set of financial reporting standards on economies with diverse legal, corporate governance, auditing and commercial codes, and expect comparable results simply because they share a set of financial reporting standards (see Ball 1995, Sunder 2002). After years of denial by the promoters of IFRS, recent studies are beginning to reveal that the application of IFRS across national jurisdictions has not been, and is unlikely to be, uniform or to generate comparability (see, for example, E&Y 2007a, 2007b; KPMG 2006, 2007; Lang et al. 2006; and Leuz 2006, Smith 2008).

**Criteria for choice of standards**

Top-down standard-setting needs criteria for deciding which financial reporting practices are better. As mentioned earlier, representational faithfulness, neutrality, timeliness, relevance and reliability are among the characteristics that might serve as answers to this problem. However, it is rare to see either the IASB or the FASB use such criteria to defend their specific proposals over alternatives on a consistent basis. In academic literature, lowering the cost of equity capital often appears as a criterion for improving financial reporting. However, the cost of equity capital is simply a price at which capital is rented from one party to the other. In any market transaction, what is cost to one side is revenue to the other. Would the world be a better place if the price of capital, or potatoes for that matter, were lowered, *ceteris paribus*. Consumers could buy more for the same amount of money, but the farmers will get less for the same truck load of their produce. Without placing some additional conditions, how can one say that it is socially desirable to lower the price of potatoes, or capital? I have not yet seen an answer to this simple question.

Fortunately, letting the financial reporting practice evolve through experimentation and experience under a light and benign regulatory oversight does not require us to choose such criteria. Instead, the supervisor can move to a higher level criterion such as investment, growth, and gross national product as a measure of how well
the economy is doing under the regime. If, looking across the borders, the supervisor finds other economies are doing better under an alternative regime, he may nudge the locals to experiment with imitation. Indeed, the appeal during the decades of mid-twentieth century, and the recent disapproval of the U.S. system of financial reporting, appear to be linked to the performance of the U.S. economy.

**Fractal structure of reality**

In his seminal work Benoit Mandelbrot (1977) proposed fractal geometry as the label for mathematical structures that are infinitely detailed. There is no limit to how far you can zoom in and find additional features without ever seeing a repetition. He went on to apply his mathematics to physical phenomena such as the shapes of mountains, coastlines, snowflakes, trees, etc., and to stock markets. Socio-economic phenomena, too, have no natural limit in their detail. This is also applicable to financial reporting and standards written to govern them.

There is no natural limit to the amount of detail in standards and rules. It is always possible to ask for further clarification on grounds that the rule is not clear enough. Rule books get thicker over time through this process of endless demands for clarification, and not, as the promoters of IFRS might have us believe, because their writers do not believe in principles. The reason IFRS rulebook is thinner than FAS is not because one believes in principles, and the other in rules; it is simply that IASB has not been around for as long as the FASB has been. Their processes are similar, and so will be the nature of their rules.

**Role of judgment and social norms in professions**

Bicycle training wheels, spoon-feeding, unemployment benefits, and written standards of financial reporting can help one learn, develop our own ability and judgment, and become self-sufficient if they are set aside in a timely fashion. Hang on to them for too long, and they become permanent props and developmental barriers. When an auditor calls a standards board for clarification, it is rarely because of the failure of his/her judgment; it is more likely the failure of nerve to exercise that judgment in the face of pressure from the client. It is not easy for a corporate body whose sole function is to issue rules to say no to such requests, in spite of the fact that issuing clarifications and so-called guidance relieves the auditors of the opportunity—indeed obligation—to exercise his/her judgment on the way to becoming a professional cripple dependent on such guidance.

While the principles-based goal of IFRS is laudable, whether the IASB, operating as a global monopoly, can withstand the pressure to furnish professionally crippling guidance to accountants is questionable. Instead, IFRS, co-existing and competing with various national standards have a much better chance of operating in a world of social norms of financial reporting (see Sunder 2005a and b) formed by this collectivity. In this world, it would be possible for accountants, investors, and academics to compare alternative standards, and entities who choose to use them in their reports to form their own judgments about the state of the entities, and motives of their management.
Financial reporting and financial engineering:
The global financial crisis of 2007-10, especially in the financial industry, has made it clear that accountants are not the only ones who run the world of financial reporting. They share the space with a rarely acknowledged elephant in the room — the financial engineers. Accountants spend years discussing and devising their standards, and the financial engineers take a few hours or days to design new instruments, transactions, or organizations to find their way around the new standards to serve the reporting goals of their clients. No matter how complicated the rules the boards write, they cannot place effective constraints on reporting entities as long as the latter can devise new instruments and transactions.

Will an IFRS monopoly be more effective than a competitive regime of multiple standard setters in dealing with financial engineering? In a competitive regime, there will be more experimentation, and there will be a rational basis for comparing how economies or entities under alternative standards function. By adopting a monopoly regime, accountants would unilaterally discard the only tool they have for dealing with the scourge of financial engineering.

Eye-in-the-sky and camera-model Interaction
We can think about the relationship of a camera and its subject in two ways. One is an unobtrusive eye-in-the-sky which flies high above beyond the awareness of those being photographed. The second is the relationship between a model and the photographer. When the photographer points the camera, the model poses and smiles; when the photographer puts the camera down, the model relaxes, and may even frown.

We like to think that the accounting camera can operate as an eye-in-the-sky, and capture the model of the reporting entity the way it is—no posing and no distortions. But that is not possible. Both managers as well as the accountants are fully aware of each other, their intentions and actions. There is little opportunity for them to surprise each other. Financial reports are always going to posed, not candid, pictures. People who see the pictures make adjustments for their posed or candid nature. So should the readers of financial reports. Overestimating their power to enforce their intent, monopolist standard setters write rules to prevent subjects from posing. These rules fail, as is clear from the history of misstatements and restatements issued by public firms. In a competitive financial reporting world, IASB as well as its competitors and the reporting entities and their investors, decide for themselves how long they wish to be walked to school by the nanny.

Concluding Remarks
As much as we may dislike it, the fact is that, at least in the U.S., the accounting profession has had little to contribute to the most important policy decisions about accounting regime during this past decade. Perhaps the same holds true in varying degrees in other jurisdictions. Most of the decision makers—politicians and civil servants—know little about accounting and fall prey to the ideas of whoever
happens to gain access to “whispers in the ears of the princes.” There is little body of verified knowledge about accounting regimes to inform such decisions. Besides, policy science has made little progress in accounting research or profession.

The ancient tale of the pied piper has become a metaphor for a leader who entices people to follow (especially to their doom) by saliently placing the benefits up front and center, with the costs and risks hidden behind the fog of time and uncertainty. IFRS monopoly is not the first example of pied pipers in modern economic and business policy. In the 1990s, the so-called Washington Consensus on macro-economic policy had the backing of the International Monetary Fund, the World Bank, and major economic powers and thinkers in the world. There were few critics then. Today the Washington Consensus lies discredited and ignored, and has no defenders. The Euro was adopted with much fanfare in 1999 with its benefits promoted by the powerful and the knowledgeable. Today, the wisdom of that move is less clear. IFRS, if allowed to develop by choice of investors and reporting entities in a competitive environment, is a good idea. If it happens to attain universal following through such a market process, so be it. But let us think again about the damage we could inflict on our markets and economies by granting it a world-wide monopoly through edicts of national governments.

References


Ernst & Young, 2007b, Is Your Company Ready for IFRS? Ernst & Young, Website: EY.com (September 15).


Table 1: A Summary of Findings on the impact of IFRS/IAS Adoptions

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Findings not for IFRS Monopoly (including insignificant results, mixed results, and substantial heterogeneity across firms/countries)</th>
<th>Findings for IFRS Monopoly (findings of benefits, &quot;benefits&quot; defined as directional findings on certain characteristics, such as lower earnings management, higher covariation with stock prices, higher conservatism, higher disclosure quality, and better information environment)</th>
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<tbody>
<tr>
<td>Earnings management</td>
<td>Goncharov et al. (2005); Van Tendeloo et al. (2005); Capkun et al. (2008); Christensen et al. (2008); Jeanjean and Stolowy (2008)</td>
<td>Barth et al. (2008); Gassen and Sellborn (2006)</td>
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<td>Information loss</td>
<td>Plumlee and Plumlee (2008)</td>
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<td>Earnings persistence</td>
<td>Atwood et al. (2011)</td>
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<td>Earnings variability/volatility</td>
<td>Hung and Subramanyam (2007)</td>
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<tr>
<td>Earnings or tax items as predictors of future cash flows</td>
<td>Atwood et al. (2011)</td>
<td>McAnally et al. (2009)</td>
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<tr>
<td>Investment-cash flow sensitivity</td>
<td></td>
<td>Schleicher et al. (2010)</td>
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<tr>
<td>Value relevance of accounting numbers (long-window tests)</td>
<td>Harris and Muller (1999)</td>
<td>Barth et al. (2008)</td>
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<tr>
<td>Information content of earnings announcements (short-window tests)</td>
<td></td>
<td>Landsman et al. (2009)</td>
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<tr>
<td>Market reaction to IFRS adoption</td>
<td>Comprix (2003); Armstrong et al. (2008); Christensen et al. (2007)</td>
<td>Karamanou and Nishiotis (2005)</td>
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<td>Disclosure quality</td>
<td></td>
<td>Daske and Gebhardt (2006)</td>
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<td>Comparability</td>
<td></td>
<td>Barth et al. (2010); Clarkson et al. (2010); DeFond et al. (2009)</td>
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<td>Valuation of equity (Tobin's Q)</td>
<td>Daske et al. (2008)</td>
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<tr>
<td><strong>Stock market liquidity</strong></td>
<td>Daske et al. (2009) (higher liquidity for serious adopters only); Platikanova (2007)</td>
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<td></td>
<td>Daske et al. (2008); Alves et al. (2008)</td>
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<tr>
<td><strong>Decrease in cost of equity capital</strong></td>
<td>Daske (2006); Daske et al. (2009) (lower cost for serious adopters only); Christensen et al. (2007); Cuijpers and Buijink (2005)</td>
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<td></td>
<td>Daske et al. (2008); Li (2008); Shi and Kim (2007)</td>
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<tr>
<td><strong>Information environment (analyst following, forecast accuracy)</strong></td>
<td>Muller et al. (2008);</td>
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<td></td>
<td>Horton et al. (2010); Wang et al. (2008); Cuijpers and Buijink (2005); Tan et al. (2009)</td>
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<tr>
<td><strong>For small and medium sized enterprises</strong></td>
<td>Daske et al. (2009)</td>
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<td><strong>Debt contracting</strong></td>
<td>Christensen et al. (2009)</td>
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<td><strong>Trade and FDI</strong></td>
<td>Marquez-Ramos (2008)</td>
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<tr>
<td><strong>Cross-border institutional investor holding</strong>&lt;sup&gt;5&lt;/sup&gt;</td>
<td>Beneish and Yohn (2008)</td>
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<td></td>
<td>Covrig et al. (2007); Yu (2009); DeFond et al. (2009)</td>
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<td><strong>Country network effect</strong></td>
<td>Ramanna and Sletten (2009)</td>
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<td><strong>Investor protection</strong></td>
<td>Hope et al. (2006)</td>
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<tr>
<td><strong>Capital structure diversity</strong></td>
<td>De Jong et al. (2006)</td>
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<tr>
<td><strong>Audit quality</strong></td>
<td>Frost et al. (2009)&lt;sup&gt;6&lt;/sup&gt;</td>
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</table>

<sup>5</sup>This line of research can also be grouped with studies on comparability or information asymmetry per se.

<sup>6</sup>Frost et al. (2009) argue that researchers fail to document any deterioration of audit quality associated with IFRS adoption, therefore such concern should not be used against IFRS.
Studies on IFRS


Tag: Market reaction- mixed.

This study examines European stock market reactions to 16 events associated with the adoption of International Financial Reporting Standards (IFRS) in Europe. European IFRS adoption represented a major milestone towards financial reporting convergence yet spurred controversy reaching the highest levels of government. We find an incrementally positive reaction for firms with lower quality pre-adoption information, which is more pronounced in banks, and with higher pre-adoption information asymmetry, consistent with investors expecting net information quality benefits from IFRS adoption. We find an incrementally negative reaction for firms domiciled in code law countries, consistent with investors’ concerns over enforcement of IFRS in those countries. Finally, we find a positive reaction to IFRS adoption events for firms with high quality pre-adoption information, consistent with investors expecting net convergence benefits from IFRS adoption.


Tag: earnings persistence- mixed.

We contribute to the debate about the relative benefits and costs of International Financial Reporting Standards (IFRS) adoption by examining whether earnings persistence and the association between current accounting earnings and future cash flows differ for firms reporting under IFRS versus firms reporting under United States Generally Accepted Accounting Principles (U.S. GAAP) and firms reporting under non-U.S. domestic accounting standards (DAS). Using samples comprised of 58,832 firm-year observations drawn from 33 countries from 2002 through 2008, we find that positive earnings reported under IFRS are no more or less persistent than earnings reported under U.S. GAAP but losses reported under IFRS are less persistent than losses reported under U.S. GAAP. Moreover, we find that earnings reported under IFRS are no more or less persistent and are no more or less associated with future cash flows than earnings reported under non-U.S. DAS. However, we find that earnings reported under U.S. GAAP are more closely associated with future cash flows than earnings reported under
IFRS. This is important if a key role of reported earnings is to help investors form expectations about future cash flows. These results should be of interest to academics and standard-setters as they debate the merits of transitioning to IFRS, and to parties who use reported earnings to form expectations about future earnings and cash flows.

Tag: commentary

What are the driving forces behind the current initiatives to globalize accounting standards? Does it make sense to have a single international accounting standard, or is it more realistic- and perhaps more desirable- for national and international standards to coexist?

Tag: commentary

Accounting in shaped by economic and political forces. It follows that increased worldwide integration of both markets and politics (driven by reductions in communications and information processing costs) makes increased integration of financial reporting standards and practice almost inevitable. But most market and political forces will remain local for the foreseeable future, so it is unclear how much convergence in actual financial reporting practice will (or should) occur. Furthermore, there is little settled theory or evidence on which to build an assessment of the advantages and disadvantages of uniform accounting rules within a country, let alone internationally. The pros and cons of IFRS therefore are somewhat conjectural, the unbridled enthusiasm of allegedly altruistic proponents notwithstanding. On the "pro" side of the ledger, I conclude that extraordinary success has been achieved in developing a comprehensive set of "high quality" IFRS standards, in persuading almost 100 countries to adopt them, and in obtaining convergence in standards with important non-adopters (notably, the U.S.). On the "con" side, I envisage problems with the current fascination of the IASB (and the FASB) with "fair value accounting." A deeper concern is that there inevitably will be substantial differences among countries in implementation of IFRS, which now risk being concealed by a veneer of uniformity. The notion that uniform standards alone will produce uniform financial reporting seems naive. In addition, I express several longer run concerns. Time will tell.


We compare measures of accounting quality for firms applying IAS with US firms to investigate whether IAS are associated with less earnings management, more timely loss recognition, and higher value relevance of accounting amounts than US GAAP. We find that IAS firms exhibit lower accounting quality relative to US firms in terms of earnings smoothing, correlation between accruals and cash flows, timely loss recognition, and the association between accounting amounts and share price. Comparisons for IAS firms before and after they adopt IAS suggest that applying IAS moves firms closer to US GAAP. Conclusions are similar when we limit our sample to more recent periods. Comparing IAS firms with US GAAP reconciled from domestic GAAP and reported by non-US firms that cross list on US markets, we find that IAS accounting amounts are of similar quality to reconciled US GAAP amounts. Our results suggest that although IAS accounting amounts may not be of higher quality than those of US GAAP applied comprehensively, they are of comparable quality to reconciled US GAAP amounts reported by cross-listed firms.


Tag: IAS-accounting quality- beneficial

We examine whether application of International Accounting Standards is associated with higher accounting quality. The application of IAS reflects the combined effects of features of the financial reporting system, including standards, their interpretation, enforcement, and litigation. We find that firms applying IAS from 21 countries generally evidence less earnings management, more timely loss recognition, and more value relevance of accounting amounts than do a matched sample of firms applying non-US domestic standards. Differences in accounting quality between the two groups of firms in the period before the IAS firms adopt IAS do not account for the post-adoption differences. We also find that firms applying IAS generally evidence an improvement in accounting quality between the pre- and post-adoption periods. Although we cannot be sure that our findings are attributable to the change in the financial reporting system rather than to changes in firms’ incentives and the economic environment, we include research design features to mitigate the effects of both.
Barth, M., W. Landsman, M. Lang, and C. Williams, 2010. Are International Accounting Standards-Based and US GAAP-Based Accounting Amounts Comparable?


Tag: Enhance comparability- Benefit

This study documents the extent to which application of IFRS as applied by non-US firms results in accounting amounts that are comparable to those resulting from application of US GAAP by US firms. We operationalize comparability by assessing accounting system comparability and value relevance comparability. Accounting system comparability metrics are based on the difference between predicted stock prices (stock returns) resulting from applying US GAAP and IFRS pricing multiples to each firm’s earnings and equity book value (earnings and change in earnings). Value relevance comparability metrics are based on differences in value relevance of these accounting amounts between US and IFRS firms. IFRS firms have higher accounting system and value relevance comparability with US firms when IFRS firms apply IFRS than when they applied non-US domestic standards. In addition, comparability is higher for IFRS firms that adopted IFRS mandatorily, for firm-year observations after 2005, and for IFRS firms domiciled in countries with common law legal origin. Additional findings indicate US firms generally have higher value relevance of accounting amounts than IFRS firms. However, value relevance is not significantly higher for US firms than for IFRS firms that adopt IFRS mandatorily and those domiciled in common law countries, which indicates value relevance comparability for these firms. Overall, the findings suggest widespread application of IFRS by non-US firms has enhanced financial reporting comparability with US firms, but differences remain for some firms.


Tag: Earnings Management and Value Relevance- benefit

This paper analyzes a sample of 1,722 European firms during their mandatory transition from local country accounting rules (Local GAAP) to International Financial Reporting Standards (IFRS) in 2004 and 2005 using the same set of firm-year observations. We use this unique transition period to examine the impact of a change in accounting standards on the quality of firms' financial statements. The transition to IFRS appears to have a small but significant impact on firms' reported total assets and book equity, as well as on their reported goodwill, intangible assets, property plant and equipment, long term debt and current assets and liabilities. For the same reporting period, Return on Assets (ROA) is significantly higher under IFRS than under Local GAAP with the greater increase
occurring in those firms with lower levels of ROA under Local GAAP. This transition earnings management is present in all countries, but its level is highest in those countries with weaker legal institutions and higher levels of pre-transition earnings management. These results are consistent with managers using the transition to improve their reported earnings and ROA. IFRS earnings reconciliation disclosures are value relevant even with the noted transition earnings management. The value relevance of the book value of equity is limited to the Local GAAP reports. Both, partial and full IFRS earnings reconciliations are associated with market value and returns.


Tag: Neutral- endogeneity argument

We examine the impact of incentives on accounting quality changes around IFRS adoption. In particular, we examine earnings management and timely loss recognition, constructs often used to assess accounting standards quality. While existing literature documents accounting quality improvements following IFRS adoption, we find that improvements are confined to firms with incentives to adopt. Further, we find that firms that resist IFRS have closer connections with banks and inside shareholders, which could explain these firms' lack of incentives to adopt IFRS. The overall results indicate that incentives dominate accounting standards in determining accounting quality.

http://www.sciencedirect.com/science?_ob=ArticleURL&_udi=B6W4P-4R05BX8-1&_user=483702&_coverDate=12%2F31%2F2007&_rdoc=1&_fmt=high&_orig=search&_origin=search&_sort=d&_docanchor=&view=c&rerunOrigin=scholar.google&acct=C000022720&_version=1&_userid=483702&md5=9313c5591c2fafbf2dacb459a7ef7544&searchtype=a

Tag: economic consequences- mixed

This study examines the economic consequences for UK firms of the European Union's decision to impose mandatory IFRS. We hypothesize that the impact varies across firms and is conditional on the perceived benefit. We estimate a counter-factual proxy for a UK firm's willingness to adopt IFRS from the prior GAAP choices of German firms. We show that this proxy predicts cross-sectional variations in both the short-run market reactions and the long-run changes in cost of equity that are associated with the decision.
This implies that mandatory IFRS adoption does not benefit all firms in a uniform way but results in relative winners and losers.


Tag: New perspective- debt contracting

We examine whether earnings reconciliation from U.K. generally accepted accounting principles (GAAP) to International Financial Reporting Standards (IFRS) convey information. As a result of debt contracting, mandatory accounting changes are expected to affect the likelihood of violating existing covenants based on rolling GAAP, leading to a redistribution of wealth between shareholders and lenders. Consistent with this prediction, we find significant market reactions to IFRS reconciliation announcements. These market reactions are more pronounced among firms that face a greater likelihood and costs of covenant violation and early announcements. While the association between later announcements and weaker market reactions is consistent with contractual implications of technical changes to earnings, which investors quickly learn to predict, it is inconsistent with IFRS forcing all firms in the sample to reveal firm-specific information through accruals. Thus, by showing that mandatory IFRS also affects debt contracting, we expand on existing IFRS research that focuses on how accounting quality and cost of capital are impacted.


Tag: fair value accounting (less relevant)

We examine whether and why companies prefer fair value to historical cost when they can choose between the two valuation methods. With the exception of investment property owned by real estate companies, historical cost by far dominates fair value in practice. Indeed, fair value accounting is not used for plant, equipment, and intangible assets. We find that companies using fair value accounting rely more on debt financing than companies that use historical cost. This evidence is consistent with companies using fair value to signal asset liquidation values to their creditors, and is not consistent with equity investors demanding fair value accounting for non-financial assets. Our evidence broadly speaks to the importance of
accounting for contracting.

P Clarkson, JD Hanna, GD Richardson, R Thompson. 2010. The Impact of IFRS Adoption on the Value Relevance of Book Value and Earnings


Tag: value relevance- comparability- benefit

In this study, we investigate the impact of IFRS adoption in Europe and Australia on the relevance of book value and earnings for equity valuation. Using a sample of 3,488 firms that initially adopted International Financial Reporting Standards (IFRS) in 2005, we are able to compare the numbers originally reported for the 2004 fiscal years to the IFRS numbers that were provided in 2005 as the 2004 IFRS comparative numbers. Traditional linear pricing models suggest that earnings per share (EPS) and book value per share (BVPS) numbers measured consistently with IFRS have similar explanatory power for firm stock price as do EPS and BVPS measured according to the original Local GAAP requirements. When the firms are partitioned into Common Law and Code Law origin groups, these same linear pricing models suggest a decrease in price relevance for firms in Common Law countries and an increase in price relevance for Code Law countries.

As part of the inquiry, we introduce a cross-product term, equal to the product EPS and BVPS, into the traditional linear pricing models which allows the pricing model to reflect nonlinearities in the relationship between EPS, BVPS and prices. When this new cross-product variable is included in the pricing model, the estimated coefficient on this variable is statistically significant and negative, as theory suggests in the presence of important nonlinearities. Our evidence reveals that there is increased nonlinearity in the data subsequent to IFRS adoption, with this increase being most pronounced for firms in Common Law countries. With nonlinear effects controlled for, there is no observed change in price relevance for firms in either Code Law or Common Law countries, contradicting the results from the linear pricing models. Further, if one interprets the heteroscedasticity of measurement errors as one dimension of financial reporting quality, the results also suggest that the distribution of measurement errors becomes more similar across Code Law and Common Law countries after the adoption of IFRS, removing one difference between these groups. Thus, IFRS enhances comparability - an inference that would not be possible had we confined the analysis only to linear pricing models.


http://www.informaworld.com/smpp/content~db=all~content=a723788918

Tag: analyst following- CoC- mixed
This study examines the determinants and consequences of voluntary adoption of non-local accounting principles (non-local GAAP) by firms listed and domiciled in the European Union (EU). We restrict ourselves to the two predominant internationally accepted sets of accounting standards: International Accounting Standards (IAS) and United States generally accepted accounting principles (US GAAP). We have used various sources to identify EU firms that use non-local GAAP. We examine the 1999 annual reports of all these firms, because accounting standard choices in more recent years may be affected by the announcement of the proposal by the European Commission in February 2001 to mandate IAS usage from 2005 on. The maintained hypothesis is that firms that voluntarily adopt IAS or US GAAP expect to experience net benefits from adoption. The finding that 133 non-financial firms in the EU voluntarily used non-local GAAP in 1999 suggests that the majority of listed EU firms does not expect to benefit from non-local GAAP adoption. By studying the characteristics of non-local GAAP adopters this study provides insight into the determinants of non-local GAAP adoption. We find that firms voluntarily using non-local GAAP are more likely to be listed on a US exchange, the EASDAQ exchange in Brussels, and have more geographically dispersed operations. Furthermore, they are more likely to be domiciled in a country with lower quality financial reporting and where IAS is explicitly allowed as an alternative to local GAAP. We also study whether non-local GAAP adopters have lower levels of information asymmetry, a much cited benefit of using more transparent financial reporting, than non-adopters. We examine three proxies for information asymmetry: analyst following, cost of equity capital, and uncertainty among analysts and investors (forecast dispersion and stock return volatility). We document a positive effect of non-local GAAP adoption on analyst following, but fail to find evidence of a lower cost of capital for non-local GAAP adopters. Contrary to expectations, uncertainty among analysts and investors appears to be higher for firms using IAS or US GAAP than for firms using local GAAP. However, by comparing 'early' and 'late' adopters, we find some evidence that suggests that benefits take some time to fully materialise.


Tag: Expected CoC- Bad

The question of whether the adoption of International Financial Reporting Standards (IFRS) results in measurable economic benefits is of special interest, particularly in light of the European Union's adoption of IFRS for listed companies. In this paper, I investigate the common conjecture that internationally recognised financial reporting standards (IAS/IFRS or US-GAAP) reduce the cost of capital for adopting firms. Building on Leuz and Verrecchia (2000), I use a set of German firms that have adopted such standards and investigate the potential economic benefits of this
reporting strategy by analysing their cost of equity capital through the use and customisation of available implied estimation methods. Evidence from the 1993–2002 period fails to document lower expected cost of equity capital for firms applying IAS/IFRS or US-GAAP. During the transition period I analyse, the expected cost of equity capital in fact appear to have rather increased under non-local accounting standards.

Tag: financial report quality- benefit

From 2005, over 7,000 listed firms in the European Union and many more around the world are required to adopt International Financial Reporting Standards (IFRS). The introduction of a uniform accounting regime is expected to ensure greater comparability and transparency of financial reporting around the world. However, recent research has questioned the quality of financial statements prepared under IFRS standards, particularly in the presence of weak enforcement mechanisms and adverse reporting incentives (Ball *et al.*, 2003). In this paper, we assess the quality of the financial statements of Austrian, German and Swiss firms which have already adopted internationally recognized standards (IFRS or U.S. GAAP). The study makes use of available disclosure quality scores extracted from detailed analyses of annual reports by reputed accounting scholars (‘experts’). This work complements other contemporary research on the quality of IFRS financial statements where the properties of earnings are used as an evaluation metric (Barth *et al.*, 2005). Our evidence shows that disclosure quality has increased significantly under IFRS in the three European countries we analyse. This result holds not only for firms which have voluntarily adopted IFRS or U.S. GAAP, but also for firms which mandatorily adopted such standards in response to the requirements of specific stock market segments. Although we cannot establish direct causality due to the inherent self-selection issues for most of our sample firms, the evidence shows that the quality of financial reports has increased significantly with the adoption of IFRS.

This paper examines market liquidity and cost of capital effects associated with voluntary IFRS adoptions around the world. In contrast to prior work, we focus on the heterogeneity in the economic consequences, recognizing that firms have considerable discretion in how they implement IFRS. Some firms may simply adopt the label, while for others IFRS adoption may be part of a strategy to increase their commitment to transparency. To illustrate these differences, we classify firms into ‘label’ and ‘serious’ adopters using changes in firms’ underlying reporting incentives and actual reporting behavior, and then analyze whether capital markets respond differently around IFRS adoptions. We find that, on average, voluntary IFRS adoptions are not associated with capital market benefits, especially when compared to other forms of commitment such as cross-listing in the U.S. Consistent with our predictions, we find an increase in market liquidity and a decline in the cost of capital for ‘serious’ adopters. These benefits are likely attributable to broader changes in firms’ commitment to transparency, and not just IFRS.


This paper examines the economic consequences of mandatory International Financial Reporting Standards (IFRS) reporting around the world. We analyze the effects on market liquidity, cost of capital, and Tobin's q in 26 countries using a large sample of firms that are mandated to adopt IFRS. We find that, on average, market liquidity increases around the time of the introduction of IFRS. We also document a decrease in firms' cost of capital and an increase in equity valuations, but only if we account for the possibility that the effects occur prior to the official adoption date. Partitioning our sample, we find that the capital-market benefits occur only in countries where firms have incentives to be transparent and where legal enforcement is strong, underscoring the central importance of firms' reporting incentives and countries' enforcement regimes for the quality of financial reporting. Comparing mandatory and voluntary adopters, we find that the capital market effects are most pronounced for firms that voluntarily switch to IFRS, both in the year when they switch and again later, when IFRS become mandatory. While the former result is likely due to self-selection, the latter result cautions us to attribute the capital-market effects for mandatory adopters solely or even primarily to the IFRS mandate. Many adopting countries make concurrent efforts to improve enforcement and governance regimes, which likely play into our findings. Consistent with this interpretation, the estimated liquidity improvements are smaller in magnitude when we analyze them on a monthly basis, which is more likely to isolate IFRS reporting effects.
Proponents of International Financial Reporting Standards (IFRS) claim that mandatory adoption results in improved financial statement comparability that in turn leads to increased cross-border investment. We test this assertion by examining US mutual fund investment in IFRS users following the mandatory adoption of IFRS in the European Union (EU) in 2005. Our analysis consists of comparing the change in US mutual fund ownership in 14 EU countries with a benchmark group of firms in nine non-IFRS adopting countries. We separately analyze “mandatory” adopters in the EU (who adopt IFRS after it becomes mandatory in 2005), and “voluntary” adopters in the EU (who adopt IFRS prior to 2005). We argue that if mandatory IFRS adoption improves comparability, the improvement is likely to vary across firms. We find that when IFRS adoption results in a large improvement in comparability, US mutual fund ownership increases among all voluntary adopters, but only among mandatory adopters in countries where implementation is likely to be more credible. Further, when IFRS adoption results in a small improvement in comparability, US mutual fund ownership decreases among mandatory adopters in countries where implementation is likely to be less credible. These findings suggest that when mandatory IFRS adoption results in a large improvement in comparability, firms benefit in countries where implementation is likely to be more credible; but when mandatory IFRS adoption results in only a small improvement in comparability, mandatory adopters incur costs in countries where implementation is likely to be less credible, where costs and benefits are measured in terms of mutual fund ownership.


http://www.informaworld.com/smpp/content~db=all~content=a769606418

Tag: use of financial instruments, cost structure
The consequences of international accounting standards are likely to reach beyond the impact on financial statements. This paper demonstrates one of the economic implications of international standards. We focus on the impact of the International Financial Reporting Standards (IFRS) regulation on preference shares (IAS 32) in the Netherlands. IAS 32 causes most preference shares to lose their classification as equity and these shares will hence be classified as liabilities. We document that for Dutch firms with preferred stock outstanding, the reclassification will on average increase the reported debt ratio by 35%. We find that 71% of the firms that are affected by IAS 32 buy back their preference shares or alter the specifications of the preference shares in such a way that the classification as equity can be maintained. The main determinant of the decision whether to give these consequences to IAS 32 is the magnitude of the impact of IAS 32 on a firm's debt ratio. We conclude that IFRS does not only lead to a decrease in the use of financial instruments that otherwise would have added to the capital structure diversity, but also changes firms' real capital structure.


… So, how can company leaders—especially in finance—begin to plan properly for tomorrow’s IFRS world? Company leaders need to get familiar with “big picture” issues to fully understand the impact a move to IFRS will have on their organizations. Gaining this perspective will help determine an approach that coordinates key constituents, considers the organization’s current state of readiness, and identifies priorities to inform the development of an eventual IFRS implementation strategy. This pre-work is the initial stage for leaders to get a better sense of the type of change the organization can expect when it’s time to implement IFRS.

Whether a company ultimately decides to address IFRS from a perspective of minimizing differences with U.S. GAAP or resolves to take a “fresh start” route (preparing to apply IFRS as if it had always used the standards), companies will need to go through initial planning.

Understanding the impact of IFRS on various aspects of a company is important to preparing a successful implementation. The planning process typically includes assessing technical accounting, tax, internal processes and statutory reporting, technology
infrastructure and organizational issues. This publication presents an overview for each of
these areas followed by practical steps to help executives engage in the planning process
today.

Deloitte, 2008, IFRS and US GAAP – A Pocket Comparison, Deloitte
Development LLC.


Dye, R., and S. Sunder, 2001, Why Not Allow FASB and IASB Standards to
Compete in the U.S.?,
Accounting Horizons 15, 257–272.

http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.22.6368&rep=rep1&type=
pdf

This paper discusses arguments for and against introducing competition into the
accounting standard-setting process in the U.S. by allowing individual corporations to
issue financial reports prepared in accordance with either FASB or IASB rules. The paper
examines several arguments supporting the status quo, including (1) the FASB's
experience and world leadership in making accounting rules, (2) the increased risk of a
"race to the bottom" under regulatory competition, (3) the inability of most users of
financial reports to understand the complex technical issues underlying accounting
standards, (4) the possibility that IASB’s standards will be diluted to gain international
acceptance, allowing additional opportunities for earnings management, (5) the risks of
the IASB being deadlocked or captured by interests hostile to business, (6) the costs of
experimentation in standard-setting, and (7) economies from network externalities.
Arguments examined on the other side include how competition will (1) help meet the
needs of globalized businesses, (2) increase the likelihood that the accounting standards
will be efficient, (3) help protect standard-setters from undue pressure from interest
groups, (4) allow different standards to develop for different corporate clienteles, (5)
allow corporations to send more informative signals by their choice of accounting
standards, (6) protect corporations against capture of regulatory body by narrow interests,
and (7) not affect network externalities at national or global scales.

Ernst & Young, 2007b, IFRS – An Option for U.S. Issuers?, Hot Topic, Professional
Practice Group, Ernst & Young LLP.
http://www.securitization.net/pdf/EY/IFRS_June07.pdf


**Tag: audit concentration- reject previous concerns**

This paper is a response to the U.S. Securities and Exchange Commission’s request for comments on its proposed rule concerning a “Roadmap” for the use of financial statements prepared in accordance with International Financial Reporting Standards (IFRS) by U.S. issuers. The paper addresses only a few of the 70 multipart questions contained in the Roadmap. We find that while there are widely divergent opinions, little empirical evidence directly bears on the question of whether U.S. issuers should be required or permitted to adopt IFRS. We conclude that further analysis of the costs and benefits of a mandated transition to IFRS should be done. Notwithstanding the need for further analysis, we question whether it is justified to withhold from U.S. issuers the option to use IFRS for financial reports based on industry membership or size, when all non-U.S. issuers have the option to do so. While IFRS might marginally increase the concentration among audit firms, research suggests that concentration of audit services may be driven primarily by the litigious environment in the U.S. This suggests that concentration would be relatively unaffected by a change in accounting standards.


**Tag: comparable quality- neutral**

We compare accounting-based and market-based earnings attributes under IFRS and US GAAP for a sample of US-listed, IFRS reporting firms in fiscal 2004 through 2006. Our sample and research design provide a powerful setting to compare IFRS and US GAAP. For each
earnings attribute, we calculate two separate cross-sectional analyses, one for US GAAP and another for IFRS. As each firm appears twice, once in each cross-sectional analysis, our analysis can therefore be thought of as if it were a comparison of matched pairs where the firm is used as its own control. As US-listed, the accounting and reporting of these firms was subject to similar US regulatory scrutiny, which provides a more controlled setting to examine differences in reporting under IFRS and US GAAP. Our evidence suggests that earnings under US GAAP and IFRS are of comparable quality. Nonetheless, US GAAP-reconciled earnings is incrementally relevant and informative in this period, suggesting that discontinuing reconciliation of IFRS to US GAAP result in less useful financial statements for valuation. When we extend our comparison to examine the relationships between home country incentives and the two sets of accounting standards, we find differences between reporting under IFRS and US GAAP are mainly found in a few specific earnings attributes in code law countries, where auditors are strong, analysts following is high, and investor protection low.


Tag: Comprehensive review.

Drawing on the academic literature in accounting, finance and economics, we analyze economic and policy factors related to the potential adoption of International Financial Reporting Standards (IFRS) in the U.S. We highlight the unique institutional features of U.S. markets to assess the potential impact of IFRS adoption on the quality and comparability of U.S. reporting practices, the ensuing capital market effects, and the potential costs of switching from U.S. GAAP to IFRS. We discuss the compatibility of IFRS with the current U.S. regulatory and legal environment as well as the possible effects of IFRS adoption on the U.S. economy as a whole. We also consider how a switch to IFRS may affect worldwide competition among accounting standards and standard setters, and discuss the political ramifications of such a decision on the standard setting process and on the governance structure of the International Accounting Standards Board. Our analysis shows that the decision to adopt IFRS mainly involves a cost-benefit
tradeoff between (1) recurring, albeit modest, comparability benefits for investors, (2) recurring future cost savings that will largely accrue to multinational companies, and (3) one-time transition costs borne by all firms and the U.S. economy as a whole, including those from adjustments to U.S. institutions. We conclude by outlining several possible scenarios for the future of U.S. accounting standards, ranging from maintaining U.S. GAAP, letting firms decide whether and when to adopt IFRS, to the creation of a competing U.S. GAAP-based set of global accounting standards that could serve as an alternative to IFRS.


**Tag: value relevance- mixed**

We investigate the market valuation of earnings and book value amounts prepared under IAS and US-GAAP to provide evidence for the debate between the US SEC and NYSE on whether foreign firms should be allowed to list in the US using IAS. We find that the US-GAAP earnings reconciliation adjustment is value-relevant and that US-GAAP amounts are valued differently for market value and return models, but not a price-per-share model. We also find that IAS amounts are more highly associated with price-per-share than US-GAAP amounts, and that US-GAAP amounts are more highly associated with security returns than IAS amounts.


**Tag: improve investor protection and make capital markets more accessible- benefit**

International Financial Reporting Standards (IFRS) have recently been adopted in a number of jurisdictions, including the European Union. Despite the importance of IFRS in the context of global accounting standards harmonization, little is known regarding what institutional factors influence countries' decisions to voluntarily adopt IFRS. This issue is relevant to standard setters because a better understanding of the motivations for adoption will enable them to promote IFRS more effectively to countries that currently do not employ IFRS. Consistent with bonding theory, we find that countries with weaker investor protection mechanisms are more likely to adopt IFRS. Our evidence also shows
that jurisdictions that are perceived to provide better access to their domestic capital markets are more likely to adopt IFRS. Taken together, our results are consistent with the view that IFRS represent a vehicle through which countries can improve investor protection and make their capital markets more accessible to foreign investors.


http://www.springerlink.com/content/91647u2175267563/

Tag: investor beliefs

We investigate the market reaction to, and the value-relevance of, information contained in the mandatory transitional documents required by International Financial Reporting Standards (2005). We find significant negative abnormal returns for firms reporting negative earnings reconciliation. Although the informational content of the positive earnings adjustments is value-relevant before disclosure, for negative earnings adjustments it is value-relevant only after disclosure. This finding is consistent with managers delaying the communication of bad news until IFRS compliance. A finer model shows that adjustments attributed to impairment of goodwill, share-based payments, and deferred taxes are incrementally value-relevant but that only the impairment of goodwill and deferred taxes reveal new information. Our results indicate that mandatory IFRS adoption alters investors’ beliefs about stock prices.


Tag: information environment (forecast error)- benefit

We examine the effect of mandatory International Financial Reporting Standards (IFRS') adoption on firms' information environment. We find that after mandatory IFRS adoption consensus forecast errors decrease for firms that mandatorily adopt IFRS relative to forecast errors of other firms. We also find decreasing forecast errors for voluntary adopters, but this effect is smaller and not robust. Moreover, we show that the magnitude of the forecast errors decrease is associated with the firm-specific differences between local GAAP and IFRS. Exploiting individual analyst level data and isolating settings where investors would benefit more from either increased comparability or higher quality information, we document that the improvement in the information environment is driven both by information and comparability effects. These results are robust to variations in the measurement of information environment quality, forecast horizon, sample composition and tests of earnings management.

http://www.springerlink.com/content/6183272780417756/

Tag: fair-value (income smoothing) orientation of IAS

Using a sample of German firms, we investigate the financial statement effects of adopting International Accounting Standards (IAS) during 1998 through 2002. We find that total assets and book value of equity, as well as variability of book value and income, are significantly higher under IAS than under German GAAP (HGB). In addition, book value and income are no more value relevant under IAS than under HGB, and HGB (IAS) income is highly persistent (transitory). Finally, we find weak evidence that IAS income exhibits greater conditional conservatism than HGB income. Our results are consistent with the fair-value (income smoothing) orientation of IAS (HGB).


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The Securities and Exchange Commission (hereafter, SEC) issued a call for comment on a proposal to adopt a roadmap for potential use of international financial reporting standards (hereafter, IFRS) by U.S. companies. We comment on five key issues raised by the SEC proposal. First, we propose that the need for a global regulator is overstated. A global regulator is unlikely to help achieve the stated goals of comparability and consistency of financial reporting on a global basis. We favor allowing U.S. companies to choose use of U.S. GAAP or IFRS rather than mandating one global monopoly set of standards. Second, we agree that the focus on auditing is a very relevant issue that deserves more attention from standard setters. Gains from adopting principles-based accounting standards such as IFRS are likely to be realized only if auditors are also principles-based. Third, while we have serious concerns about governance and financing mechanisms of the International Accounting Standards Board (hereafter, IASB), we recommend that all regulatory actions cannot be held to a standstill while structural changes are made to the IASB. Fourth, we are not in favor of requiring reconciliation schedules from U.S. companies using IFRS. We view such reconciliations as being costly and unnecessary. Fifth, we recommend that the SEC pay more explicit attention to the educational and professional judgment consequences of its proposals.

In this paper, we analyze the effect of the mandatory introduction of IFRS standards on earnings quality, and more precisely on earnings management. We concentrate on three IFRS first-time adopter countries, namely Australia, France, and the UK. We find that the pervasiveness of earnings management did not decline after the introduction of IFRS, and in fact increased in France. Our findings confirm that sharing rules is not a sufficient condition to create a common business language, and that management incentives and national institutional factors play an important role in framing financial reporting characteristics. We suggest that the IASB, the SEC and the European Commission should now devote their efforts to harmonizing incentives and institutional factors rather than harmonizing accounting standards.

http://www.kpmg.sk/dbfetch/52616e646f6d4956aff42bfa91e4e4fc9c34347444eadb4e938871a42eceae07/application_of_ifrs_choices_in_practice_2006.pdf

KPMG, 2008a, IFRS Compared with US GAAP, KPMG LLP.

KPMG, 2008b, IFRS in the U.S.: Benefits and Challenges of the Coming Change, KPMG LLP.
https://www.in.kpmg.com/securedata/ifrs_Institute/Files/IFRSinTheUS.pdf


Objectives
To solicit views from respondents in academia on the incorporation of IFRS into the Accounting Curriculum

To understand the status of IFRS integration in accounting curricula

Methodology
Web-based survey conducted among accounting educators at US colleges/universities.
Survey duration: July 28 – August 20, 2009
Total respondents: 500

**Executive Summary**

Speedy adoption and incorporation of IFRS is advocated based on concerns around disadvantages to the U.S. economy and students.

Incorporation of and teaching IFRS should be a significant part of the school curriculum by 2011.

Intermediate accounting is the course of choice to include significant components of IFRS.

Public accounting firms and state societies sponsor most webcasts and IFRS sessions at conferences.

A majority say up to one-quarter of their faculty have more than a superficial knowledge of IFRS.

Low sense of urgency exists among regulators to adopt IFRS by a “date certain”.

There is expectation that the U.S. will follow a convergence of U.S. GAAP and IFRS with substantial equivalence by 2015 or later.

Making room for IFRS in the curriculum, now the biggest challenge for the academic community vs. curriculum development in 2008.

Critical thinking skills, accounting concepts and principles along with ethics continue to be important for accounting students.

Most say ethics, fair value (mark-to-market) accounting and IFRS are/ will be part of schools’ accounting curriculum.

Schools are providing limited financial support or course release time to faculty members to prepare for any of the relevant courses.

External parties can best facilitate faculty IFRS efforts through problems and case studies comparing IFRS and U.S. GAAP.

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**Landsman, W., E. Maydew and J. Thornock. 2009. The Information Content of Annual Earnings Announcements and Mandatory Adoption of IFRS. Working Paper.**


**Tag: information content increases- benefit**

This study examines whether the information content of earnings announcements increases in countries following mandatory IFRS adoption. We examine two measures of information content from Beaver (1968), abnormal return volatility and abnormal trading volume, across 16 countries before and after they mandated adoption of IFRS, relative to 11 countries that retained domestic accounting standards. The evidence suggests that information content, as measured by abnormal
return volatility and abnormal trading volume at earnings announcements, increased in countries that mandated adoption of IFRS relative to those that maintained domestic accounting standards.

Li, S., 2008, Does Mandatory Adoption of International Accounting Standards Reduce the Cost of Equity Capital?, Working paper, University of Southern California.

http://www.business.illinois.edu/accountancy/events/forum/papers/07-08/Li.pdf

Tag: CoC- benefit

This paper examines whether the mandatory adoption of International Accounting Standards (IAS) in the European Union (EU) in 2005 reduces the cost of equity capital. Using a sample of 6,456 firm-year observations of 1,084 EU firms during the period of 1995 to 2006, I find evidence that mandatory introduction of IAS, on average, significantly reduces the cost of equity for mandatory adopters by 48 basis points. I also find that this reduction is present only in countries with strong legal enforcement and that both increased disclosure and enhanced information comparability help explain why IAS reduces the cost of equity. Taken together, these findings suggest that mandatory IAS adoption benefits shareholders, but that the benefits depend on the strength of the countries’ legal enforcement.


Tag: IFRS improves the relevance and quality- benefit

The potential conversion of accounting standards from U.S. GAAP to International Financial Reporting Standards (IFRS) raises the issue of unknown financial reporting consequences. We consider one important accounting issue, namely equity-based compensation, and study how IFRS conversion will affect financial statements and the quality of reported numbers. The difference between the two standards is that IFRS reports tax benefits from equity-based compensation at their intrinsic value each period. This amounts to quasi fair-value accounting under IFRS compared to historic-cost accounting under GAAP. We develop and compare pro forma GAAP and IFRS accounting reports for a broad cross section of US firms. We find that IFRS conversion will significantly increase deferred tax assets and recognized tax benefits for about one-third of our sample firms. Moreover, reported tax items are more volatile under IFRS. Importantly, we find that IFRS tax items are better able to predict future cash flows. One conclusion is that IFRS improves the relevance, and thereby, the quality, of at least some reported numbers.
Márquez-Ramos, L., 2008, The Effect of IFRS Adoption on Trade and Foreign Direct Investments,
Working paper, University Jaume I.

http://services.bepress.com/itfa/18th/art19/

Tag: FDI- benefit
This paper focuses on the importance of accounting harmonisation on foreign activities from a macroeconomic perspective. International Financing Reporting Standards (IFRS) adoption is considered to reduce information costs among countries and is, therefore, an important way to encourage international trade flows and investments. Moreover, heterogeneity in trade and FDI determinants among different European countries (well-established capitalist countries in the “West” and post-communist countries in the “East”) is analysed since transition economies present a lower development of market institutions and, therefore, of financial systems. The effect of IFRS adoption is analysed from a gravity framework. The fixed-effects vector decomposition (FEVD) procedure, recently proposed by Plumper and Troeger (2007), is used to estimate panel data characterised by the presence of time invariant variables, or variables which vary rarely in time. The results provide evidence that benefits exist in terms of trade and FDI when IFRS are adopted. Furthermore, the positive effect of adopting uniform accounting standards on foreign activities in Europe is higher in transition economies. Finally, this effect also differs in countries because of behavioural factors such as unfamiliarity aversion.

Tag: information environment- mixed

We examine the causes and consequences of European real estate firms’ decisions to provide investment property fair values prior to the required disclosure of this information under International Financial Reporting Standards (IFRS). We find evidence that investor demand for fair value information—reflected in more dispersed ownership—and a firm’s commitment to transparency increase the likelihood of providing fair values prior to their required provision under International Accounting Standard 40 – Investment Property. We also find that firms not providing these fair values face higher information asymmetry. However, we fail to find that the relatively higher information asymmetry was reduced following mandatory adoption of IFRS. Rather, we find that differences in information asymmetry largely remain. Taken together, this evidence suggests that common adoption of fair value accounting due to the mandatory adoption of IFRS does not necessarily level the informational playing field.
The compulsory use of IFRS for the consolidated statements of listed companies in the EU and elsewhere, and the convergence of IFRS with US GAAP, might imply the end of 'international accounting' as an important field of study. However, there are motives and opportunities for international differences of practice to exist within IFRS usage. Some of the original motives for international accounting differences may still be effective in an IFRS context, though in different ways. The opportunities for different IFRS practices are divided into eight types. Hypotheses relating to each of these are proposed, and some ways of testing them are suggested. Some implications of the existence of different national versions of IFRS are noted.

The degree to which, and the purposes for which, International Financial Reporting Standards (IFRS) have been adopted vary internationally. This paper uses classification techniques in order to investigate the reaction of countries, or companies within them, to IFRS. In addition, this paper investigates five aspects of this; for example, whether European countries mandate IFRS for unconsolidated financial reports. Previous classifications in accounting are used to help to predict and explain this.

The introduction of IFRS was intended to improve accounting quality and ensure greater comparability and transparency of financial reporting around the world. This study examines market liquidity costs and concludes on the heterogeneous IFRS effect across adopting countries in Europe. Using reported accounting differences, the study relates liquidity costs with restated accounts under IFRS (i.e., IFRS effect on financial statements) in four legal origin groups (France, Germany, United Kingdom and Sweden). Findings confirm that liquidity costs of UK companies are strongly affected by IFRS restatements; for French companies this effect is present but weaker. Restatements of equity and net income under IFRS are associated with an increase in liquidity costs (significant for French and UK companies). Empirical results suggest that investors anticipate the IFRS effect but in several cases adjust liquidity costs over several reporting periods.
In December 2007 the SEC issued a formal rule release that allows foreign-private issuers that employ the IFRS to file their financial statements without providing a reconciliation to U.S. GAAP. While the rule change was made after the SEC received and analyzed comments from various constituents on the proposing release, the rule change has not been without controversy and many have argued that the decision was ‘premature’, based at least partially on evidence of the usefulness of the reconciliations to investors and others.

The purpose of our study is to provide a more complete picture of the information that will be lost to investors due to the rule change. Our analysis focuses on the quantitative values included in the reconciliation, a measure of the information formerly required by the SEC. We identify 100 FPIs that filed 20-Fs during 2006 using IFRS. We collect and classify the line-by-line amounts into 22 categories and, using this classification, examine the frequency, magnitude, and sign of the reconciling items. We also sort the FPIs based on market cap (size) and industry and provide the same statistics within those groups. In our analyses we document that there are a few categories where a large proportion of FPIs have reported reconciling items while there are several categories where reconciling items are relatively infrequent. In addition, we observe that size does seem to matter; the frequency, magnitude, and sign of the reconciling items differ across size groups. We also observe differences across industry groups.

http://www.sdn.sap.com/irj/scn/go/portal/prtroot/docs/library/uuid/70d7a259-b8f5-2b10-0aa7-96b908965b79?QuickLink=index&overridelayout=true

Situation
Recognizing the value of high-quality, global accounting standards, the SEC is considering measures that could lead to retiring US GAAP and adopting International Financial Reporting Standards (IFRS) in the US. This would be a dramatic change that deserves executives’ attention now, as the debate begins.
Our perspective
Although there will be significant challenges along the way, the transition to IFRS will bring considerable benefits to US business.

Implications
Companies need to begin preparing without delay to be ready to take advantage of the benefits of IFRS when they become available. While the initial IFRS conversion will come at a cost, it will be outweighed by the benefits gained.

PwC, 2008, IFRS and US GAAP: Similarities and Differences, PricewaterhouseCoopers LLP.
http://bigpicture.typepad.com/comments/files/SandD_07.pdf

Ramanna, Karthik, and Ewa Sletten. 2009. Network Effects in Countries’ Adoption of IFRS.

Tag: country network benefit
If a country’s accounting standards represent a political-economic equilibrium, why is that equilibrium for some countries shifting over time in favor of IFRS? We develop and test the hypothesis that perceived network benefits from the extant worldwide adoption of IFRS influences a country’s shift away from local accounting standards. That is, as more jurisdictions with economic ties to a given country adopt IFRS, perceived benefits from lowering transactions costs to foreign financial-statement users come to outweigh institutional differences (e.g., auditing technology) that make IFRS adoption costly. We find that perceived network benefits increase the degree of IFRS harmonization among countries, although larger countries and countries less dependent on foreign trade have a differentially lower response to these perceived benefits.

http://faculty.msb.edu/kr268/Papers/one_size.pdf

Tag: theory paper- ambiguous prediction on uniform standard
I build a model of neoclassical production to examine the capital market and welfare effects of a uniform accounting standard (like IFRS). Firms vary in their cost of compliance to the standard, and investors vary in their cost of learning diverse standards for capital allocation. I show that a uniform accounting standard increases the quantity of capital in the economy and lowers the cost of capital. However, uniform standards force
diverse firms onto the same standard, which reduces welfare. A regulator selects the optimal number and type of standard to balance these competing effects. Uniform accounting standards are better than diverse accounting standards when firm productivity and variation between investors is large, but worse when the cost of investment and variation between firms is large. I draw implications for IFRS/GAAP convergence, and the incentives versus standards debate.


Tag: CoC- benefit- cross-section

We construct a large sample of 21,608 firm-years with International Financial Reporting Standards (IFRS) adopters and non-adopters from 34 countries over the 1998-2004 period, and evaluate differences in the implied cost of capital between the IFRS adopters and the non-adopters. We also investigate whether and how the cost-of-capital effect of IFRS adoptions is differentially influenced by the efficacy of institutional infrastructures determining a country's corporate governance and enforcement mechanisms. Our results reveal the following. First, we find that the cost of equity capital is significantly lower for the full IFRS adopters than for the non-adopters, suggesting that the IFRS adopters benefit from greater and better disclosures via IFRS by having a lower cost of raising capital from equity markets. Moreover this result holds, irrespective of a country's institutional infrastructure. Second, we find that the cost of capital decreases with the efficacy of institutional infrastructure. Finally and more importantly, we find that the cost of capital-reducing effect of IFRS adoption is greater when the IFRS adopters are from countries with weak institutional infrastructures than when they are from countries with strong infrastructures. The above results are overall robust to the use of alternative measures of the expected cost of capital and a battery of sensitivity checks.

http://www.informaworld.com/smpp/content~db=all~content=a788718502

Tag: accounting quality- review of literature
In 2002, the European Union (EU) Parliament passed a regulation that requires consolidated and simple accounts for all companies listed in the EU to use International Financial Reporting Standards (IFRS) for fiscal years starting after 1 January 2005. This change in accounting systems will have a large impact on the information environment for EU companies. This paper provides a review of the literature on adoption of different Generally Accepted Accounting Principles (GAAP). We thus provide background and guidance for researchers studying the change in accounting quality following widespread IFRS adoption in the EU. We argue that cross-country differences in accounting quality are likely to remain following IFRS adoption because accounting quality is a function of the firm's overall institutional setting, including the legal and political system of the country in which the firm resides.

http://scitation.aip.org/getabs/servlet/GetabsServlet?prog=normal&id=ACHXXX0002300001000101000001&idtype=cvips&gifs=yes&ref=no

A broad consensus in accounting favors principles over rules to guide creation of a uniform high-quality set of standards for use everywhere, and granting monopoly power to a single body for this purpose. If implemented into policy, this consensus will discourage discovery of and evolution toward better methods of financial reporting, make it difficult to conduct comparative studies of the consequences of using alternative methods of accounting, promote substitution of analysis and thinking by rote learning in accounting classes, help discourage talented youth from collegiate programs in accounting, and probably endanger the place of accounting discipline in university curricula. Because the presumed benefits in the form of increased comparability of financial reports internationally or stateside are unlikely to be realized, the wisdom of undertaking these burdens remains questionable. The paper calls for a re-examination of the accounting consensus.

This study investigates how accounting harmonization affects one particular group of financial statement users - foreign financial analysts - through enhanced usefulness of accounting data across countries. We utilize a unique database that identifies analysts’ locations to assemble a sample of 2,059 distinct foreign analysts from 36 countries covering a total of 2,748 firms that have adopted International Financial Reporting Standard (IFRS) during 2001-2007. We find that mandatory IFRS adoption attracts foreign analysts, particularly those who are located in countries that are simultaneously adopting IFRS along with the covered firm’s country. We also find that mandatory IFRS adoption improves foreign analysts’ forecast accuracy. Multivariate regressions show an increase of 26% in the foreign analyst following from all sample countries, 37% for foreign analysts from simultaneously adopting countries, and 46% for foreign analysts from simultaneously adopting countries who have prior experience following firms using IFRS. There is an improvement of around 15% in forecast accuracy from the pre- to the post-IFRS period across all three of these analyst groups. Further analysis shows that the gains in analyst following are greater for firms located in countries that had local GAAP that was more different from IFRS prior to IFRS adoption, and that the change in foreign analyst following is increasing in the extent to which IFRS adoption eliminates GAAP differences between the firm’s home country and the analyst’s home country. These measures of the extent to which IFRS adoption eliminates GAAP differences are unrelated to increases in foreign analysts’ forecast accuracy. These results suggest that accounting harmonization in the form of widespread IFRS adoption facilitates cross-border comparisons of financial data and therefore lowers the costs for financial analysts to follow firms from other countries.


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Tag: improved function of capital markets- benefit
We examine the economic consequences of the mandatory adoption of IFRS in EU countries by showing which types of economies have the largest reduction in investment-cash flow sensitivity post-IFRS. We also examine whether the reduction in investment-cash flow sensitivity depends on firm size as well as economy type. We find that the investment-cash flow sensitivity of insider economies is higher than that of outsider economies pre-IFRS and that IFRS reduces the investment-cash flow sensitivity of insider economies more than that of outsider economies. Also, we find that small firms in insider economies have the highest sensitivity of investment to lagged cash flow pre-IFRS, and that they are no longer sensitive to lagged cash flow post-IFRS. Overall, our results suggest that IFRS adoption might have improved the functioning of capital markets in relation to small firms in insider economies.


Tag: internal consistency of standard matters

A cross-firm consistent application of accounting standards is sought in all major accounting regimes. Since many transactions and events are only vaguely or not explicitly addressed in the standards managers must often use judgment when applying accounting standards to particular transactions or events. This analysis concludes that a consistent application of accounting standards can only be ensured if the accounting standards themselves are internally consistent. By contrast, inconsistent standards—in the absence of clear guidance—permit managers to (more or less arbitrarily) choose between different accounting methods. Moreover, it is found that a consistent application presupposes the existence of specific guidance (‘rules’) in order to frame management's judgment. It is argued that the reliance on principles only—as requested by many in the accounting literature—fails to ensure a consistent application because it allows management to exert judgment differently in identical cases. The assessment includes arguments and propositions from the international discussion in the accounting literature and also refers to other related fields of research, such as legal theory.


Tag: “harmonization” reduces information asymmetry- benefit
Prior literature shows that investors under-invest in foreign firms due to information asymmetry problems. I posit that differences in local accounting standards are a source of the information asymmetry among investors. Using security-level holdings of international mutual funds, I find that harmonizing accounting standards (adoption of IFRS) increases foreign mutual fund holdings. Harmonizing accounting standards increases cross-border holdings 1) directly by reducing the information processing cost of foreign investors by facilitating comparability of financial information and 2) indirectly by lowering the effect of other barriers on cross-border investments such as geographic distance. Further analysis suggests that harmonization across regimes is a more effective means to attract foreign capital than a unilateral improvement in the country’s reporting regime.