The Analysis of the IFRS Adoption Effects on the Accounting Quality in the European Context

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Abstract

The purpose of this paper is to analyze the scientific literature dedicated to IFRS implementation process in order to recognize and understand the impact of the norms related to the quality of the information presented in financial statements. The research methodology used for this purpose is based on an analysis of 24 academic papers published between 2000 and 2015, available on international scientific databases such as: Emerald, ScienceDirect, ProQuest and SSRN. The review presents the economic consequences of the quality accounting improvement as a result of the adoption of IFRS norms. In the same time, the disclosure of the information represents a significant role in lowering the cost of equity regarding the company's economic level.

Key words: IFRS, Quality of Information, Cost of Capital, Disclosure of Information.
J.E.L. classification: M41

1. Introduction

The evolution of multinational companies influenced by the globalization factor determined the need for an uniform economic language that generates an improvement in communication between all the users of financial statements. In this context, the International Accounting Standards Board (IASB) tends to harmonize financial information, triggering the appearance of International Financial Reporting Standards. This process of IFRS implementation was based on Commission Regulation No 1606/2002. The appearance of the Commission Regulation determine that each listed entity, bank or insurance company is required to prepare its consolidated financial statements in accordance with IFRS for each financial year beginning with 1 of January 2005.

The literature review offers a lot of articles regarding the international accounting harmonization process and the evolution of accounting standards. Among the reviews that address these topics are those of Ball (2006), Jermakowicz (2004), Hail & Leuz (2006), Barth et al, (2008) and Daske et al (2008). The results obtained by the researchers show the benefits of adopting IFRS standards and illustrate the limits of the process, thus highlighting the effects of IFRS transition on result and cost of capital.

This paper presents a review of the impact that IFRS adoption has had on the quality of the information presented in the financial statements at European level. Regarding the research methodology, the attention has been focused on several academic articles available on international scientific databases. The outcome of this fundamental research involves clarifying the notion of quality on financial information and identifying the main ways of measuring the quality of information. In the same time the article provide proofs related to the IFRS adoption impact on the cost of capital.

2. The quality of financial information

The objective of the financial statements is to provide information on the financial position, performance and financial adaptability of an enterprise that is useful to a wide range of users for making economic decisions.

In order to define and understand the quality of financial information, we intend to present the definition given by the IASB Conceptual Framework for Financial Reporting in 2010. According to the definition, the quality of financial information is analyzed in relation to the types of information and it may be useful for different categories of investors, both - existing and potential, lenders and other creditors in their decisions on the reporting entity. (QC1, Conceptual Framework, 2010). The financial information must be useful, relevant and should represents exactly what the definition intend to represent. The usefulness of financial information is amplified if the documents are comparable, verifiable and understandable. " [Conceptual Framework, CQ4, 2010].

The quality of the financial information is given by their utility in the decision making process and by the way that this document illustrates the economic reality. Regarding the importance of the value of consolidated information in the context of IFRS transition, there is a series of empirical studies that have shown an increase of value added following the adoption of IFRS (Bartovt et al., 2005; Jermakowicz et al, 2007, Barth et al, 2008, Paananem and Lin, 2009). However, there are also studies that show that IFRS did not lead to an increase of value added related to the financial statements consolidation (Callao et al., 2007, Hung and Subramanyam, 2007, Gjerde et al., 2008, Paananen , 2008).

According to specialized literature, the quality of the accounting is determined by analyzing the value of the information available for different users of financial statements. Thus, Pascani (2015) illustrates a typology of values that researchers use to measure the quality of information in financial statements:

- The value relevance approach;
- The credit relevance approach;
- The extent of earnings management practices;
- Timeliness of loss recognition;
- Accounting conservatism.

The scientific papers present proofs of economic consequences related to the accounting quality improvement following the adoption of IFRS standards:

- Increasing the liquidity of Capital Markets (Bruggeman et al, 2013; Ahmen et al, 2013);
- Diminishing the Cost of Capital, (Bruggeman et al,2013; Ahmen et all, 2013);
- Increasing the efficiency of Capital Investment at the company's level (Bruggeman et al, 2013);
- Positive Consequences on the Cost of Corporate Dept, Moscariello et al. (2014).

The scope of increasing the quality of accounting information is to facilitate transparency by reducing accounting asymmetry. Martinez-Ferrero (2014) sustains that in the companies where exist a better quality of accounting information, a higher future performance will be achieved because these companies are positively assessed on the market due to the quality information they have make available to users.

3. The information disclosure and the cost of capital

The Capital Cost is an important indicator that expresses the state of the financial market at a certain moment and has a particular impact on company's managers. A report from American Professional Body (AICPA) states mentions that by reducing cost of equity it's a creation of increased information.

In one of Ly St Kosal's papers (2010) this phenomenon is explained using three theories:

- The first theory is related to the risk of investor's estimations regarding the returns they expect in relation with the security return, the risk being greater for firms that provide for investors a relatively small number of information compared to firms that reveal a high level of information. With other words, the disclosure of information reduces the cost of capital by reducing risk in investor estimates;
- The second theory presents the ratio between transaction costs and liquidation. Asymmetry of accounting information implies an increase in transaction costs and a decrease in market liquidity, by generating reductions to investors in order to maintain their existing stock portfolio;
- The third theory suggests that information disclosure contributes to increased transaction intermediation, and decrease the cost of capital.

The consequence of capital cost reductions was also tested by several authors. For example, Prather-Kinsey et al,(2008) concludes on the basis of an analysis using a sample of 157 European firms that investors perceived net benefits following the adoption of IFRS, which involved a significant decrease in the cost of equity. Botosan and Plumlee (2000) examine the association between the cost of capital and the various types of disclosures in a financial exercise (annual reports, quarterly reports, and other types of reports that capture the relationship with investors).

From the authors' researches, the annual reports lead to a decrease in capital cost by confirming the theory. Surprisingly, the other types of reporting have a positive relationship with the cost of capital, being the premises of increasing its value due to the increase in stock price volatility.

The type of funding that companies want to achieve has also led to studies. Francis et al (2005) present the level of disclosure, and how these concepts affect or not the cost of capital. On a sample of companies from 34 countries, they found that sectors with high financial needs had a high and voluntary level of disclosure. This effect put in place a decrease of the cost of debt and the cost of equity. Their results also indicated that, although there are transnational differences in legal and financial systems that affect disclosure levels, when they want to access external funding , the country factors operate independently of disclosure levels.

The welfare of investors was analyzed by Gao (2010), which launched the hypothesis that an improvement in disclosure of information also leads to an increase in investor welfare. According to the results of the study, the hypothesis is confirmed only in certain situations (production economy, perfect competition,). This model demonstrates three important elements:

- There are certain situations that may negatively affect investor welfare;
- The increase of capital cost can occur with the quality of disclosure when new investments are not elastic.
- The cost of capital may vary in an opposite direction to investor welfare, when the quality of the disclosure informations changes.

Christensen et al (2010) tracked changes in equity after disclosures. The results of the research have revealed that the reduction in the cost of ex-disclosure is balance by an increase equal to the cost of the capital since the information would be release.

Daske et al. (2008) analyzed the globally economic consequences of IFRS adopting on a sample of firms in 26 countries between pre and post adoption years (2001-2005). Research results show that market liquidity increased during the IFRS adoption and the cost of capital declined, with capital market effects being more evident in voluntary adoption compared to mandatory adoption. Other researchers (Elbakry et al., 2017) analyzed changes in the value of accounting information before and after the mandatory adoption of IFRS in Germany and the UK by using three valuation models (the Ohlson, modified and expanded base model) of equity. The results of these models indicated that although the values of equity information have decreased, growth has been related to income information in both Germany and the UK,

4. Conclusions

The purpose of this paper has been to present a synthesis of the IFRS effects on the accounting quality. Starting from the definition of the accounting quality, the review is measuring accounting quality along with the presentation of the economic consequences resulting from the IFRS adoption.

The paper has brought to attention important scientific papers which present information about the cost of capital, its role, and also present different ways about his reduction.

An important aspect present in the paper is related to the process disclosure of financial information. In the same time, An important point is represented by the mode of application considered. Most studies show a decrease in the cost of capital, especially for companies that have voluntarily adopted IFRSs, compared to those that have been force to adopt IFRS.

5. References

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