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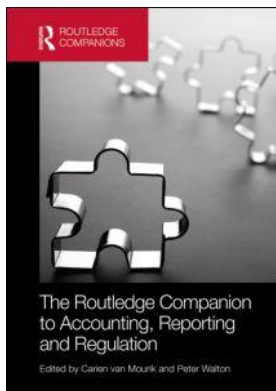


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Carien van Mourik, Peter Walton

## Socio-Economic Consequences of IFRSs

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Soledad Moya
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# Part 5

# Social and Economic Aspects of (International) Financial Reporting Regulation

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# Socio-Economic Consequences of IFRSs

*Soledad Moya*

## 1. Introduction

The objective of this chapter is to outline a map of the literature on possible social and economic consequences of the adoption and implementation of IFRSs. Although probably older, the concept of economic consequences gained prominence in the late 1970s after publications by Wyatt (1977), Rappaport (1977) and Zeff (1978). Zeff (1978: p. 56) defined economic consequences as the impact of accounting reports on the decision-making behavior of business, government, unions, investors and creditors.

In the US, the Financial Accounting Standards Board (FASB) adopted the idea that the effects of individual financial reporting standards needed to be analyzed (Rappaport, 1977). At present, however, owing to the adoption of IFRSs in the EU in 2005 and since then in many other countries worldwide,[1] we may face global socio-economic effects and, therefore, the IASB is also faced with the challenge of considering the economic consequences of individual IFRSs (Schipper, 2010) and perhaps even IFRS as a whole. Hence, the discussion on socio-economic consequences could be making a come-back. Since 2002, extant literature can be found devoted to the consequences of IFRS for the main attributes of financial information quality, that is, studies on the effects of the adoption of IFRS on the qualitative characteristics of financial information such as transparency, timeliness or comparability (e.g. Barth *et al.,* 2008; Daske *et al.,* 2008; Cascino and Gassen, 2012). Those effects could be classified as "intended" following Brüeggemann *et al.*'s (2011) classification because IFRS adoption is expected to have a positive effect on the quality of financial information.

However, there are other effects, economic or social, that require much more theoretical and empirical study, and that can be classified as unintended ones (Brüeggemann *et al.,* 2011). Some examples of these are effects on contracting, on business analysis or even on social issues beyond the numbers, such as effects on corporate social responsibility or country level effects for emerging economies. The debate about consequences of international accounting standards and the development of effects analysis is therefore relevant currently. Since IFRSs have become the key for globalization in accounting regulation, the effects derived from their implementation are a necessary issue for analysis and there is a call for research in the subject. Regulators are aware of the need for conducting effects analysis of accounting standards and are introducing, in their due

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process, additional steps that consider them. The IASB had already in 2008 included in its *Due Process Handbook* a specific section entitled Impact Analysis where it is said that, in forming its judgement on the evaluation of impact, the IASB will consider costs incurred by preparers and by users and also the benefits of better economic decision making. The European Financial Reporting Advisory Group (EFRAG), together with the Accounting Standards Board (ASB) and some national standard setters issued a discussion paper on the necessity of conducting effects analysis of accounting standards. The questions discussed are whether this effect analysis should be done, how it should be done and by whom. Some debate and responses to this Discussion Paper can be found in Haller *et al.* (2012).

Additionally, there is a general call for research on the subject as regulators recognize that, although perhaps they should be responsible for the development of these analyses, some help from academia is sure going to be very helpful. In this sense, the paper by Trombetta *et al.* (2012) shows how academic research can assist regulators and standards setters in evaluating *ex ante* and *ex post* the effects of corporate financial reporting and disclosure regulation.

Therefore the objective of this chapter is to outline a map of possible social and economic effects, many already intensively studied in the literature and others where there is still much to be done, which may help us to understand and make advances in the study of these effects. To do so, in Section 2 we go back in time and look for the moment when the so called "economic consequences" first appeared in the literature. Then, we will discuss the economic consequences of IFRSs in business, financial and capital markets (Section 3) and the social consequences (Section 4) the adoption and implementation of IFRSs may have. Finally, Section 5 looks forward to possible challenges still to come.

## 2. The origin and substance of the theory that accounting standards and regulation have social and economic consequences

### *2.1 Some conceptual issues: the definition of economic and social consequences*

Several authors identified economic consequences in the seventies, for example Rappaport (1977) or Wyatt (1977) referred to the subject in some early papers between 1975 and 1980. Rappaport, stated that, already at that moment, there was a growing recognition that the setting of financial accounting needed to be viewed more broadly than simply from a technical accounting perspective. It was not enough to be an expert accountant, it was also necessary to appreciate the environment in which accounting functions and of the impact that accounting decisions had on that environment. This expanded view of standard setting came from an increasing recognition that the legislation of accounting standards involved a potential redistribution of wealth, imposing restrictions or costs on some while conferring benefits to others.

Wyatt (1977) affirmed that, historically, accounting standards had been based in a greater measure on technical accounting considerations that on the potential economic and social ramifications they might expect to have. In his opinion, as a result, the central issue of standard setters' considerations had often been how best to report the effects of completed transactions. However, he also affirmed that, more recently, accounting standards setters seemed to have become aware of the economic and social ramifications of the standards to be adopted.

Although both Rappaport and Wyatt did already refer to the consequences of accounting standards, one of the first definitions of the term "economic consequences" is generally attributed to Zeff. In this sense, Zeff (1978: 56) refers to them as "the impact of accounting reports on the decision-making behavior of business, government, unions, investors and

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creditors". And what would accompany this definition would be, implicitly, that accounting discussions (not yet standard setters) should take into account what kind of effects can be derived from financial reporting.

At that moment, therefore, the thought of economic consequences derived from the accounting process meant a revolution. Up to then, accounting standards had been thought to be neutral or, at least, nobody had realized that both users and preparers could be adversely affected for the accounting standard process.

### *2.2 The FASB and its role as the first accounting regulator to "care" about economic consequences*

At the moment of the first recognition of economic consequences as an issue for analysis, FASB had a key role in the development of accounting standards and, therefore, in the possible consideration of those consequences. Rappaport (1977) explains how, at that moment, FASB had three strategic options for the definition of its role in this issue:

- The "conceptual framework strategy" was based on the assumption that a well-founded framework can make a significant contribution to the development of a field of study, for it serves to organize and integrate knowledge into a systematic whole.
- The "economic impact strategy", considered that FASB should incorporate potential economic impacts into its deliberation process. This strategy would be based on the premise that while there would always be some disagreement on any proposed standard, the FASB would remain viable only if the process by which it reaches decisions was seen to be both comprehensive and equitable by the groups affected.
- The "mixed strategy" was based on a mixture of the previous two, that is, working under the conceptual framework and also considering economic impacts of accounting standards. This third strategy would mean that the FASB should not take any measurement or disclosure initiative whose consequences would be likely to be contrary to the apparent social and economic policies being pursued by the government.

FASB seems to have chosen the third one and considers both the conceptual framework and the economic consequences. To give an idea of how "impacting" that new thought was, at that moment the FASB started asking for research papers on the effects of several standards that were being discussed at the time. And perhaps it is then when the notion of economic consequences of accounting standards was born. This does not mean that before the 1970s there was no consideration of economic consequences of accounting standards; in fact, Zeff (1978) cites very interesting examples of economic consequences which occurred after the adoption of new USA standards issued by the Accounting Principles Board (APB). However, the "formal" thinking about economic consequences can be undoubtedly situated between 1975 and 1980.

One example of early studies on economic consequences would be the paper by Imhoff and Thomas (1988). In their paper, they examined capital structure changes to investigate the impact of SFAS No. 13 on lessees. This accounting standard essentially rearranged capital leases disclosures from footnotes to the balance sheet and they studied whether this mandated capitalization substantially altered key accounting ratios. Their results documented a systematic substitution from capital leases to operating leases and nonlease sources of financing. In addition, lessees appeared to reduce book leverage by increasing equity and reducing conventional debt.

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### *2.3 The implementation of IFRS in Europe: a relevant step in the "globalization" of socio-economic consequences*

We have introduced the development of the economic consequences of accounting standards concept, without referring specifically to the IFRS as those first definitions and studies were intimately related to US GAAP and FASB as the first regulator to consider those issues. The IFRS came into force in Europe on 1 January 2005. After that moment, all European quoted companies have to use IFRS in their consolidated financial reporting. For the rest, EU countries have the option to either require or permit IFRSs. Some countries, such as Spain, have already implemented new Spanish GAAP based on IFRS for all reporting entities, while other countries, such as Germany or France, are still making use of local GAAP although, in Germany, IFRS application is permitted.

Apart from the adoption in Europe, IFRS are being permitted or adopted by other jurisdictions outside Europe. We can mention here, for example, the ambitious project born in 2002 with the Norwalk Agreement signed between the FASB and the IASB. In this agreement each regulator acknowledged their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, both the FASB and IASB pleaded to use their biggest efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility was maintained.

In 2002, when the agreement was signed and the 2005 effective date of IFRS implementation for all Europe was already quite close, it seemed important to enhance a convergence process that would allow multinational companies to move easily between different countries. These movements would be much easier if a common or closer accounting regulation was agreed for financial reporting. In fact, a very relevant process took place in 2007 when the SEC eliminated its requirement for international companies to reconcile financial statements prepared under the IFRS to generally accepted accounting principles in the United States. This created an unprecedented situation of two co-existing financial reporting standards in the US. At that moment it seemed that US companies might be tempted to drop US GAAP entirely, which had been unimaginable. However, it is important to note that, recently, the convergence process seems to be at risk, In this sense experts from both regulators' bodies have stated that increasing politicization of the accounting process and tensions over sovereignty are making it harder to achieve.

Apart from the US, IFRS are also extending to many countries throughout the world. For example, many countries in South America and Asia have already adopted or are considering adopting IFRS.[2] Considering all that has been said so far, we can see how IFRS implementation and the consequences of accounting standards is not a local or regional issue at all but a global one where a great part of the world is, or is going to be, involved.

## 3. Economic consequences: the impact of IFRSs in business, financial and capital markets

There have been many transformations in the accounting standards setting process in the world since the first authors talked about economic consequences. However, the substance is mainly the same: if we accept that accounting standards may have an impact on the distribution of wealth, an analysis of the consequences needs to be included in the process. But what are these consequences? In recent years, and particularly since the adoption of IFRS in Europe,

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many studies have been published related to the economic consequences of IFRS adoption. In Brüeggemann *et al.* (2011) we can find a summary of those studies. These authors provide a really interesting review of most of the work done in relation to the economic consequences of IFRS and they classify economic impacts into two different categories: intended and unintended consequences. Intended consequences would be, following the authors, those derived from the IASB Conceptual Framework. That is, those related to the fundamental characteristics of accounting information. In this sense, accounting standards would try to "improve" attributes related to accounting quality such as relevance or comparability. These intended consequences are intimately related with the "informative" role of accounting information and apart from intended we consider them desirable.

The unintended ones would be relative to the contractual role of accounting. That is, accounting standards play a key role in how companies and stakeholders define their relationships and in this sense the change in an accounting rule may lead to changes in the way the different parties react and contract. This second focus runs parallel to the positive accounting theory and the effect of accounting standards on stakeholders' behavior (Holthaussen and Leftwich, 1983).

Additionally, these unintended consequences can also be desirable or non-desirable. If an accounting standard leads to lower cost of capital, this would be an unintended but desirable economic consequence. On the contrary, if a new accounting standard leads to stricter debt covenants or even to a worsening of the relative position of a company, in terms of performance or leverage, from our point of view it would be an unintended but also an undesirable economic consequence. It is interesting to note, as Brüeggeman *et al.* (2011) point out, that the two fundamental roles of financial reporting are not necessarily compatible with each other. And they provide some examples such as Gassen (2008) were the information role of accounting information is negatively related to its contracting role.

There are some other possible classifications for the effects of accounting standards. In Haller *et al.* (2012) another classification is provided based on the entities affected. They classify effects into the following categories:

- effects on the providers of capital (positive or negative);
- effects on reporting entities (positive or negative);
- other micro effects; and
- other macro effects.

There is a certain parallelism between this classification and the one we are using based in Brüeggemann *et al.* (2011), as our accounting effects would be those related to providers of capital, our business analysis, contracting effects and compliance costs could be considered as reporting entity's effects and we also consider some micro and macro effects.

### *3.1 Accounting effects: consequences relative to the main attributes of financial information according to the IASB framework*

The purpose of the IFRS implementation is based on the basic assumption that they will lead to an improvement in transparency and also in comparability so that capital will move easily among markets. The IASB Conceptual Framework issued in 2010 refers to the qualitative characteristics of financial information and cites relevance, comparability, faithful information, verifiability, timeliness and understandability as the main attributes of financial reporting. The conceptual framework declares that financial information is useful when it is relevant and represents faithfully

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what it purports to represent. It also adds that the usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable. All these characteristics would design the "informative" role of accounting mentioned before. Therefore, most empirical research has been devoted to analyze whether, effectively, this informative role of financial reporting improves with IFRS adoption. It would be considered an intended consequence following Brüeggemann *et al.* (2011).

One of the most cited studies is Barth *et al.* (2008). These authors conducted a study for more than 20 European countries and analyzed the effects of IFRS in transparency, timeliness and value relevance. They conclude that there is a positive effect of the IFRS in the quality of financial information, even though they cannot prove absolute causality due to the obvious presence of some other influencing factors such as incentives and macroeconomic issues. Another study by Morais and Curto (2009) tries to determine if the value relevance of European listed companies increased after IFRS. Their results show that the value relevance of financial information during the period companies applied mandatory IAS 7 IFRS is higher than for the period during which they applied local standards.

Another very interesting study is that conducted by Daske *et al.* (2008). In their paper they analyze the effects on market liquidity, cost of capital and Tobin's *q* of IFRS adoption for a sample of 26 countries. They find that, on average, market liquidity increases but cost of capital decreases. However, they find that the effect is not the same for all countries and depends on enforcement or incentives for transparency.

Although as we have just seen there are studies that show a positive relationship between IFRS adoption and earnings quality, we find also some studies that do not confirm that, at least not for all the desirable attributes of accounting information. In this sense we can cite the study of JeanJean and Stolowy (2008) where they analyze the effect of mandatory introduction of IFRS on earnings quality, and particularly on earnings management, in Australia, France and the UK. They find that the pervasiveness of earnings management did not decline after the IFRS implementation and that, in fact, it increased for France. They concluded that sharing rules was not a sufficient condition to create a common business language and again enforcement and incentives played an important role in the effect for financial reporting characteristics. Lambert *et al.* (2007) show how the directional impact of high quality accounting information on the cost of capital is ambiguous and in the same line we have the paper by García Osma and Pope (2009) who examined earnings management attributes across 30 countries before and after mandatory IFRS adoption. Their results indicate that reporting incentives such as the enforcement or the investor protection rules play a dominant role in the determination of earnings quality.

Disclosure is also an issue to be considered as it is related to transparency, informativeness and quality of financial information. Mariusz *et al.* (2012) examine changes in segment disclosure after the introduction of IFRS 8 in Australia and document that a substantial number of firms increased the number of segments reported, although for multiple segments firms, which did not change the number of segments disclosed, they document a reduction in the amount of information disclosed.

In relation to comparability, an example can be found in Cascino and Gassen (2012) where they try to contribute to the debate whether IFRSs increase comparability or else this expectation will be dependent on the incentives of companies. Using two comparability indexes they conclude that the overall comparability effect of mandatory IFRS adoption is marginal at best. They also find that firm, region and country level incentives systematically shape accounting compliance.

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We can see then how research in the economic consequences in relation to financial information attributes seems to be inconclusive and the only qualitative characteristic in which researchers agree is value relevance as all studies seem to find a positive relationship between IFRS adoption and the increase in the value relevance of accounting information.

There are also studies revealing that having good quality standards does not necessarily mean that we will have good quality financial reporting outcomes. For example, Ball *et al.* (2003) showed how financial reporting quality was low in Hong Kong, Malaysia, Singapore and Thailand despite presumably high-quality standards because the institutional structure provided incentive to issue low-quality financial statements. In this sense, they argue that countries that want to increase financial reporting quality have to think about changes in manager and auditor incentives and other institutional features and that those may be even more important than having high quality accounting regulation.

Also in 2003, Leuz *et al.* (2003) examined the extent of earning management across three different types of economy:

1. outsider economies with large stock markets, dispersed ownership, strong investor rights and strong legal enforcement (Singapore, Hong Kong, Malaysia, UK, Norway, Canada, Australia and the US);
2. insider economies with less well-developed stock markets, concentrated ownership, weak investor rights but strong legal enforcement (Austria, Taiwan, Germany, Switzerland and Sweden); and
3. economies that are similar to the insider economies but with weak legal enforcement (Thailand, Greece, Korea, Spain and India).

They found increasing earnings management as they moved from economies in 1 to economies in 3 showing that institutional forces such as the extent of investor protection could substantially shape financial reporting outcomes.

As stated by Holthausen (2009: 459), the question is whether it is feasible to identify the most important determinants of financial disclosure quality at country level. We have seen in previous paragraphs how legal enforcement can play a key role in the quality of financial reporting outcomes so it is not only the quality of financial regulation that will lead to more quality accounting but also a set of country characteristics that take advantage of these higher quality accounting standards.

### *3.2 Business analysis effects*

Changes in accounting regulation can also modify decisions made upon business analysis. If financial reporting is based on the accounting standards, modifications on presentation or valuation rules will modify financial statements and therefore can affect business analysis.

Many examples of this effect can be found in the literature. For example, in Fitó *et al.* (2012) the authors analyze the impact of IFRS adoption in Spain. They study the effect of the IFRS introduction in accounting variables and ratios and find that the effect has been significant for most of the variables and for some or the ratios, basically those related to the company's structure. In relation to the performance ratios, they find significant differences for earnings per share. Similar studies can be found for other European countries, such as Sweden (Lantto and Sahlström, 2009) or Germany (Hung and Subramanyam, 2007). Results reported show that, in general, there is a significant impact on the analysis of financial statements due to the implementation of IFRS, although this change generally varies by country, depending on the differences between local GAAP before transition and IFRS.

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Some more specific examples can be found in recent times of proposed modifications of IFRS regulation that may affect, if issued, business analysis and therefore the process of decision making. The IASB has issued a new draft on leases which introduces significant changes in the way operating leases should be recognized and measured in the financial statements. This draft was issued in August 2010 and it is currently under discussion. Current IFRS do not require operating leases capitalization and recognizes them as an expense in the year they are accrued (IAS 17, para. 33). However, the exposure draft proposes capitalization of those operating leases in the Statement of Financial Position of companies so that users are provided with a complete and understandable picture of an entity's leasing activities.

The main advantage of this new proposal is that users of financial information will be able to know about assets controlled by the companies which, at the moment, are off balance sheet amounts. However, some disadvantages expected, basically for preparers, would be the economic effects derived from this new inclusion and the complexity added. So in this case we could be facing some economic consequences which are partly intended (the benefits for informativeness and transparency) and the costs for preparers, both from an implementation and an analysis point of view.

The IASB proposal for operating leases has received nearly 1,000 comment letters (290 answers after the consulting process in 2009 and 760 after the 2010 draft) from individuals, auditors, private companies and other institutions, some supporting and some complaining about the project. It is interesting to note that approximately half of the letter writers supported the project based on the increasing quality of the information argument. Amongst the complaints, the issues most mentioned are the ballooning effect in the balance sheets (so that issue is seen as an advantage by some and as an inconvenience for others), economic effects such as leverage, and compliance costs and complexity derived from implementation.

Prior literature on the impact of new accounting standards shows how the potential magnitude of the effect can be measured by means of the analysis of key ratios. Beattie *et al.* (1998) and Fülbier *et al.* (2008) demonstrate that the capitalization of operating leases can have a significant impact on financial ratios which, at the same time, may lead to relevant economic consequences related to the financial structure, financial contracts and performance of companies affected. For Spain, Fitó *et al.* (2011) have conducted an *ex ante* research study trying to predict, using the capitalization method, the effect on financial ratios of operating leases capitalization in Spanish companies. The results indicate a significant increase in their leverage positions and this may affect their capital structure, debt covenants and their relative position in the market. They also find significant effects for both Return on Equity and Return on Assets, which means that the proposal does not only affect the presentation of items in the balance sheet and static measures such as gearing, but also the "real" performance of the company (ROA) and the return for shareholders (ROE).

### *3.3 Contracting effects*

We can read in the IASB Conceptual Framework that the general purpose of financial reporting is to provide financial information about the reporting entity that is useful in making decisions and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided (IASB, 2010: para. 1). So the second fundamental role of financial reporting is to make management accountable for the company's resources.

This second role brings into the economic consequences literature the stewardship theory where managers are administrators of the company's wealth and act in the best way they can to protect it. This theory opposes the agency theory which considers the conflict of interests

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between managers and shareholders and regards accounting information as a control for managers to ensure that their own interests do not prevail among those of the shareholders. The stewardship theory supports exactly the opposite. Managers are not destroyers of the company and what they really try to do is to manage the company as honestly and efficiently as possible in order to benefit shareholders. If these assumptions are correct, accounting standards should allow them to do a better job, making management easier and facilitating the decision-making process.

Consistent with this stewardship role of accounting, contracts between the firm and its stakeholders are frequently based on financial accounting numbers (Brüeggemann *et al.,* 2011). Some examples of contracting would be related to lending agreements or management compensation contracts. These economic consequences that can be considered as unintended have not been as much studied in the literature. However, some examples can be found, for example in Wu and Zang (2009). These authors find that IFRS adoption is associated with the firm's internal performance evaluation and, in particular, with increases in the sensitivities of CEO turnover and employee layoffs to accounting earnings. However, it is interesting to note that those authors base their assumption on the improvement of those informational benefits of IFRS adoption but we have seen so far how there seems to be consensus only for market relevance while evidence for transparency, comparability or disclosure seems to be inconclusive.

IFRS could also induce economic consequences through adjustments in debt conditions. In fact, and in relation to the business analysis section, if companies see their leverage ratios altered due to a change in an accounting standard, it is fairly possible that debt contracting is more restricted or even that firms may have to renegotiate part of the debt. There are, however, scarce studies that have worked on this subject, for example Christensen *et al.* (2009), where they provide indirect evidence of a relationship between IFRS adoption and wealth transfers between lenders and shareholders by means of the impact on debt covenants.

An additional effect could be derived from the previous one related to the capital structure of the reporting entities. As Imhoff showed already in 1983 for US GAAP and financial leases capitalization, changes in the recognition of leases (in that study he was referring to capital leases) modified in some cases firms' capital structure as many of them moved from capital leases to operating leases in order not to include them in their balance sheets. With the proposal of operating leases capitalization, it could happen again that firms switched to another source of financing trying to avoid the recognition, as a liability, of their future operating leases payments.

There are some other contracts that can be affected by the IFRS adoption. Some examples could be dividends payout, management compensation contracts or even tax agreements. Literature on the subject is scarce still but sure that, in the future, there will be a development of this research area as regulators must know about all the effects that can be derived from the issuing of new standards.

### *3.4 Compliance costs*

The incorporation of new standards may have an important effect on the costs of compliance for preparers. With the 2005 IFRS adoption, jurisdictions adopting IFRS had to move to a different conceptual framework and new standards that meant a lot of training and need of expertise for companies. In Spain, for example, an extraordinary call for accounting and the new regulation courses came from small and medium-sized companies at the time of understanding and therefore being able to adapt to the new Spanish Accounting Standards based on IFRS. Big companies often rely on their auditors for the compliance with new standards and regulations.

But not only when adopting IFRS as their general regulatory body do the reporting entities have compliance costs. Also, when a new standard is issued, if presentation of financial statements,

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measurement or disclosure is substantially affected, they will face important costs of adaptation. In this sense and as we have said in the previous section it is interesting to note how the Exposure Draft issued by the IASB in relation to the Operating Leases received more than 1,000 comment letters from individuals, auditors and firms, many of which complained about the costs of compliance. This last issue, about complexity, seems to be a very recurrent one, often related with the imprecision that users find in the definitions and contents of the exposed draft.

## 4. Social consequences as the impact of IFRSs implementation beyond business: the impact for individuals and other stakeholders

There is scarce literature on social impacts and we have not yet found a definition. From our point of view, social consequences are those that cannot be quantified and that affect social aspects of business, both at a micro- and at a macroeconomic level. From a micro perspective, changes in accounting regulation may determine disclosures about social issues and corporate social responsibility. An example can be found in the actual move towards the development of the integrated reporting, meaning that annual accounts have to incorporate not only economic but social information. Also from a micro perspective, we can refer to the lobbying process generated by accounting standards.

From a macroeconomic point of view, if there are effects at country level that cannot be quantified specifically we could refer to macro social effects. As stated by Biondi (2011) our socio-economies are a figurative construct that is deeply embedded in accounting. He adds that accounting, as a straightforward routine, may have greater significance than is usually acknowledged, under which the main stakeholders (such as financees and financed in the global financial markets) and the other stakeholders such as employees, labor unions, environmentalists and developing countries may also be affected in different ways, either positively or negatively.

Traditionally, quite a lot of attention has been paid to the socio-political analysis of economic statistics but that is not the case with accounting. Biondi suggests several reasons for this fact:

- Accounting appears more neutral, mechanical, procedural and objective than economic statistics which makes it appear as less manipulative and more apolitical than statistics.
- Accounting appears lifeless and plain boring and has traditionally been considered as unintellectual and trivial in human life.
- Despite this monotonousness, accounting requires some degree of technical knowledge if one wants to make use of it and be able to discuss it.

All these factors may have led to non-consideration of socio-political issues of accounting standards. However, accounting is a social and a political issue from the moment that it affects business and people.

### *4.1 Impact on corporate social responsibility*

When we talk about impact of accounting standards on corporate social responsibility we are referring to what in the literature is described as green accounting, which can be defined as that part of accounting that tries to account for environment issues reflecting not only economic but also social impacts of regulation.

In recent times we have seen an increase in the awareness on the part of corporate entities that they should give something back to society. An entity that fails to make a positive contribution to society will be perceived as being socially irresponsible. The corporate social reports which have now become an annual report in addition to the traditional financial report, are

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one of the instruments used to demonstrate that entities care about social information. In this sense, Idowu and Towler (2004) look at corporate social responsibility (CRS) reports of different companies across different industries in the UK. They show how there are two distinct practices adopted when reporting on CSR matters. Some companies issue separate reports for their CSR activities whilst others devote a section in their annual reports for providing information on these activities. The study also notes that all companies in the survey recognize the enormous benefits that can emanate from making known their CSR policies and activities.

Accounting regulation can, therefore, contribute a lot to the provision and disclosure of social information. The new trend toward the integrated reporting, defined as a new corporate report where both financial and social information are disclosed and related to each other, is an example of the impact that accounting standards may have in the development of green accounting.

### *4.2 The lobbying process of accounting standards*

Sutton (1984) affirms that an accounting standard setting process is a political lobbying one and, as such, it offers potential participants several opportunities and means by which they can influence its outcomes. Both FASB and IASB have often gone through a lobbying process when an accounting standard is released for discussion. As an example, it can be said that both the project on operating leases cited in previous sections and the one on revenue recognition that both regulators are working on in a joint manner, have received around 1,000 comment letters each, which can give us an idea of the impacts expected from these changes of regulation, if finally issued.

The lobbying process is often related to the economic consequences of the standards, as mentioned in previous paragraphs, but we consider the lobbying process itself a social consequence of standards, as it makes individuals, preparers and users react and opine themselves about proposals that are going to make a change in their personal or business lives. In this sense, we definitely do not consider accounting to be boring or non-political when it has the capability of provoking so much response.

### *4.3 Impacts at a macroeconomic level: country-level studies*

The globalization process is not only affecting Europe (and US eventually due to the homogenization process in progress). Many countries outside Europe have been or will be impacted by this new world of accounting homogenization. There is some literature about how this globalization process is viewed from emerging countries.

A very interesting study is that of Gallhofer *et al.* (2011), where they interview Syrian accountants, exploring how they perceive globalization's actual and potential impacts. They show how Syrian professionals perceive globalization as Anglo-American and imperialistic in character. They point out some challenges facing the Syrian profession, including competition in accountancy from international firms that threatens to impact upon local jobs, the need to adopt and enforce international standards of accounting in Syria and related changes required in training to achieve integration in the global order. However, they also see globalization as having positive dimensions that may improve their lives and the profession.

Another interesting reference would be that of China, where the globalization process is presented as an occasion of growth. In this sense, Suzuki *et al.* (2007) state that since 2000, international accounting, as a common language on business and a mode of governance, has

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become widely disseminated in China and has become an indispensable infrastructure of its socio-economy. Our main conclusion here is that more research is needed for potential impacts at country level and about the relationship between jurisdictions. Surveys and personal interviews are bound to be particularly useful if we want to know about the feelings and reactions towards the globalization of financial reporting.

## 5. Challenges in gauging the socio-economic impact that IFRSs do seem to have: how to define and measure benefits and costs?

Two regulators are playing a key role in this globalization process. The first and most important one is IASB, the body which issues IFRS and is therefore responsible for the development of a body of high quality standards. The other is EFRAG, the European body in charge of assisting the European Commission in the endorsement of IFRS, and the IASB by providing advice on the technical quality of IFRS.

### *5.1 The incorporation of "economic consequences" into the IASB due process: the effects analysis*

Regulators are aware of the need for conducting effects analysis of accounting standards and are introducing, in their due process, additional steps that take into consideration the effects derived from the new standards.

For the IASB, a relevant step was taken in 2008 when the *Due Process Handbook* for IASB was issued by the International Accounting Standards Committee Foundation (IASCF). This document includes a specific reference to the effects analysis process. It states that, after publication of IFRS, the IASB will prepare an analysis of the likely effects and this information will be provided to jurisdictions that adopt IFRSs. The analysis will attempt to assess the likely effects of the new IFRS (para. 50) on: the financial statements of preparers, compliance costs for users, cost of analysis for users, comparability costs and quality and usefulness effects.

This paragraph refers basically to the intended consequences related to usefulness and quality of information and also consequences for users as those derived from the business analysis and implementation costs. The IASB does not go beyond those effects and therefore does not include other unintended consequences than those related to the contracting role of accounting.

An example of the work that IASB has been doing would be the publication of the IFRS 11 Effects Analysis in July 2011. In the document, we can find two sections dedicated to effects analysis, one with the financial statements effects and the other with the cost–benefit analysis (CBA). This cost–benefit analysis is a qualitative one, where IASB separates costs and benefits for users and for preparers. There are only some quantitative references related to concrete examples of reporting entities.

### *5.2 The role of EFRAG in the effects analysis process*

EFRAG, the Accounting Standards Board (ASB) and some national standard setters have issued a discussion paper on the necessity of conducting effects analysis of accounting standards[3]. The questions discussed are whether this effect analysis should be done, how it should be done and who should do it.

The Discussion Paper was quite a preliminary one and several comment letters were received in response. The European Accounting Association's Financial Reporting Standards Committee (FRSC) responded to the document and their conclusions can be found in Haller *et al.* (2012).

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The EFRAG document does not contain guidance for the implementation of an effects analysis procedure and is still defining what an effect analysis is, what effects should be considered and who should perform this analysis. In this sense, the paper by Trombetta *et al.* (2012) as an additional part of the response of FRSC to EFRAG's Discussion Paper, shows how academic research can assist regulators and standards setters in evaluating *ex ante* and *ex post* the effects of corporate financial reporting and disclosure regulation.

### *5.3 Future prospects for the consideration of socio economic consequences of accounting standards*

The impact analysis of accounting standards has definitely come onto the agenda of regulators. Both IASB and EFRAG know that jurisdictions which have already incorporated IFRSs into their legal framework, or which are about to do so, may require some impact assessment before a new IFRS is brought into law and probably also afterwards, so they are making efforts for the recognition and consideration of those effects.

There are, therefore, some questions open for debate. One would be in relation to the responsibility of the effect analysis. The IASB is, probably, in the first term responsible for it but engaged with other regulators, the academia and the reporting entities. That is, IASB would be responsible for the consideration of those effect studies, but is IASB responsible for their contents? Or would it be better if an independent party was in charge? In recent times IASB has made some open calls for research into subjects related to the adoption or implementation of new standards. Following these calls, academia or the reporting entities could be very helpful in the development of these studies and providing conclusions that may be useful for jurisdictions that are future adopters.

Another question is whether EFRAG is also responsible for the performing of effect analysis. We understand that they are from the moment that they have a regulatory commitment, and that IFRS as adopted in Europe can have differences with the original IFRS. However, and following from what has been said for IASB, EFRAG should be accompanied by other regulators.

What about the effects that should be considered? In this paper we have mapped the main social and economic consequences derived from IFRS implementation. Of course, there may be others that have not yet been considered but the question is whether they should all be considered by regulators. Or should they only focus on those that are strictly related to their objectives, basically to the benefits (or not) of economic decision making resulting from improved financial reporting? From our point of view regulators should consider as many effects as possible, as long as it is reasonable and assumable. That is, apart from the effects on the attributes on financial information and therefore in the information quality, taking into consideration other effects such as those in the business analysis, in the contracting relations and in compliance costs, can help jurisdictions and reporting entities to be aware of the changes that they may be compelled to face.

Another open question is what type of effect analysis should be carried out? Should it be a cost–benefit analysis? Should it be quantitative in nature or else qualitative? We believe that the answer will depend on the nature of the standard to be brought to law. We will be able to carry out quantitative analysis for the predicted impact, on leverage or return, of the capitalization of operating leases, but, for the revenue recognition project (IASB, 2011a) probably only qualitative analysis will be possible as the impact cannot be accounted for in terms of change in accounting variables or ratios. We believe that, if it is possible to carry out a quantitative analysis of the predicted or the *ex post* impact, it would be desirable. However, a qualitative cost–benefit analysis would also be very useful, as we can see for example in the IFRS 11 effects analysis carried out by IFRS.

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## 6. Conclusions

The debate about consequences of international accounting standards and the development of effects analysis is ongoing. Since IFRS have become the key for globalization in accounting regulation, the effects derived from their implementation are a necessary issue for analysis. Regulators are aware of the need for conducting effects analysis of accounting standards and are introducing, in their due process, additional steps that take into consideration the effects derived from the new standards. Additionally, there is a general call for research on the subject as regulators recognize that, although they should, perhaps, be responsible for the development of these analyses, some help from academia would be helpful.

In this paper we have tried to outline a map of possible effects, both social and economic, due to IFRS adoption, which may help us to understand and to advance in the study of these effects. Some have already been quite intensively studied in the literature while others still have a lot to be done.

The economic consequences of IFRS adoption relate basically to the effect on the main attributes of financial information as stated by the IASB Conceptual Framework, the impact on business analysis and in contracting relationships. We have seen how there is abundant literature on the subject, although mainly focused in the category devoted to financial information quality. IFRS has generated an intended and desirable effect in the value relevance of accounting information. However, attributes as transparency or comparability do not seem to improve in a clear and straightforward way as research is inconclusive about it and it looks as if enforcement and reporting incentives should play a determinant role in the success of the IFRS adoption in terms of incrementing information quality. In this sense we advocate that wider studies should be conducted to try and test the improvement or not of qualitative characteristics of financial reporting as it is one of the expected effects of regulators.

For the business analysis, empirical research both *ex ante* or *ex post* shows how, in a general way, IFRS adoption has incorporated significant effects both for leverage and liquidity positions and for performance analysis. Those economic consequences can be intended or not and also desirable or not depending on the direction of the effects provoked.

There are also some effects derived from the contracting role of accounting. Again we get unintended consequences that may be desirable or not. If IFRS adoption leads to easier or better lending agreements or improvements in the design of performance incentives, this will be an unintended but desirable consequence. However, if the new standards lead to stricter conditions for reporting entities, changes in their financial structure or worsening of their relative positions, then those would be unintended but also undesirable consequences. There are many other examples of contracts that can be affected by the IFRS adoption, such as dividends payout, management compensation contracts or even tax agreements. Literature on the subject is scarce so there is much work to do in this area.

We have also considered the social consequences of IFRS adoption. Literature here too is scarce and is not generally to be found in accounting journals but rather in social sciences literature. When we relate to social consequences we consider issues such as green accounting and corporate social responsibility, the lobbying process or, more at a macroeconomic level, country-level impacts. We have seen how new standards generate at times huge amounts of responses both in support of or against the proposal. We definitely do not consider accounting to be boring or non political when it has the capability of provoking so much response. In our opinion, there is a need for studies on those social consequences in order to determine how individuals, businesses or countries are affected beyond the numbers. Also more research is needed for the potential impacts at country level and about the relationship between jurisdictions. Surveys and personal interviews are bound to be particularly useful if we want to know about feelings and reactions towards the globalization of financial reporting.

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Regulators have included the effects analysis in their agenda and we have seen how both IASB and EFRAG are incorporating this issue in their future projects. However, several questions remain related to who should be responsible for the effect analysis studies, what effects should be considered and what kind of analysis should be carried forward. In this sense, we believe that regulators are responsible for the incorporation of this step as a compulsory one in the process of standard setting, but they should not do this alone and should count on academic expertise and knowledge and the opinions of reporting entities affected by the changes. Studies should cover as many of the effects as possible. Apart from the effects on the attributes of financial information and therefore on the quality of financial information, considering other effects, such as those in the business analysis, in the contracting relations and in compliance costs, can help jurisdictions and reporting entities to be aware of the changes that they may be compelled to face. As for the type of analysis, we believe that both qualitative and quantitative studies can be very useful for making jurisdictions aware of the impact of IFRSs.

Some 35 years ago, Zeff (1978) asserted that the economic consequences of accounting standards were going to be the most challenging accounting issues of the 1970s, for the US and FASB. Now, in the new era of globalized international accounting standards, it is time for a reconsideration. The incorporation of IFRSs in Europe in 2005 and the expansion to a major part of the world has brought significant changes to the accounting standard processes. New consequences, both social and economic, are affecting financial information stakeholders, from the reporting entities as preparers, to users such as investors or creditors, but also to social accounting and country relationships. It is time therefore to reconsider those issues if we want the process of international accounting standards globalization to be a success.

## Notes

1 See www.iasplus.com for detail of IFRS implementation by country.
2 Updated information about the process of IFRS adoption worldwide is available at www.iasplus.com.
3 EFRAG (2011) "Considering the Effects of Accounting Standards". Discussion Paper.

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