Mandatory adoption of IFRS and timely loss recognition across Europe: The effect of corporate finance incentives

Ann L.-C. Chan, Audrey W.-H. Hsu, Edward Lee

1. Introduction

Recent literature on the mandatory adoption of International Financial Reporting Standards (IFRS) across the European Union focuses extensively on the economic consequences of this new accounting regime for the capital markets. These studies generally reveal that mandatory IFRS adoption has a beneficial impact on the capital market, although mainly among countries with better legal enforcement. However, capital market economic consequences are only indirect effects of the change in accounting standards and therefore merely provide indirect evidence of the impact of IFRS. The direct effect of IFRS should be changes in the quality of accounting disclosure, which in turn would provide more direct evidence of the influence of the new accounting standards. Despite this, studies of the mandatory IFRS adoption have so far paid relatively less attention to its effect on accounting disclosure quality and those that do yield mixed findings regarding its benefits.

We examine the impact of mandatory IFRS adoption across Europe on accounting disclosure quality by focusing on timely loss recognition. The inverse relationship between timely loss recognition and costs of debt is well established in the literature (e.g., Ahmed, Billings, Morton, & Stanford-Harris, 2002; Ball, Robin, & Sadka, 2008; Ball & Shivakumar, 2005; Watts, 2003a,b; Zhang, 2008). Timely recognition of loss benefits lenders since it enhances debt contracting efficiency by causing poorly performing borrowers to breach debt covenants in a timely fashion. We further examine the relationship between timely loss recognition and costs of debt across European countries. Our results are robust to controls for firm characteristics such as interest coverage, return on assets, earnings volatility, loss, accrual quality, beta, and growth.
contracting efficiency and could therefore reduce the costs of debt capital. Although Florou and Kosi (2013) show that the costs of public debt is indeed lower after the mandatory adoption of IFRS, Ahmed, Neel, and Wang (2013) and Chen, Tang, Jiang, and Lin (2010) both find that timely loss recognition instead declines among mandatory IFRS adopters. In other words, it appears that the direction of the new accounting standards’ direct effect (i.e., the decrease in the timeliness of loss recognition) cannot substantiate the direction of its indirect effect (i.e., the decrease in the costs of debt). Therefore, empirical evidence of the decline in both loss recognition timeliness and costs of debt capital, following mandatory IFRS adoption, is difficult to reconcile.³

We argue that firms with higher costs of debt are more likely to increase their timely loss recognition following mandatory adoption of IFRS. Our argument is based on three grounds. First, the mandatory adoption of IFRS could render the capital market more sensitive to accounting disclosures than under previous domestic standards. By applying a more consistent set of accounting standards across a large set of countries, IFRS facilitates cross-border financial statement comparability (Ball, 2006). Second, the increased use of financial reports by investors after mandatory adoption of IFRS may lead firms to recognize losses more timely. Prior studies indicate that timely loss recognition is more pronounced when public financial disclosure is a more likely solution for the information asymmetry problem (e.g., Ball, Kothari, & Robin, 2000; Ball, Robin, & Wu, 2003). Thus, we would expect companies to recognize economic losses in a more timely fashion, especially when they face greater agency conflicts with debtholders. Third, we expect companies incurring higher costs of debts may exhibit greater in-

³ Florou and Kosi (2013) sampled 21 countries and Ahmed et al. (2013) sampled 19 studies. The samples of these two studies overlapped by 18 countries. Therefore, it is unlikely that the differences in their results are driven by differences in the countries sampled.

total interest-bearing debt, following existing studies such as Pittman and Fortin (2004) and Francis, La Fond, Olsson, and Schipper (2005).⁴ Our analyses also control for firm characteristics that may determine firms’ incentives to recognize losses on a timely basis as well as both industry and country effects. Finally, we determine the pervasiveness of private debt and bank-based financing among our sampled countries, following the approach of Bushman and Piotroski (2006).

Our findings are as follows. First, using a difference-in-differences research design, we observe that mandatory adopters (treatment sample) with higher costs of debt are associated with incrementally higher C-scores relative to voluntary adopters (control sample) after 2005, when IFRS was enacted. Second, the aforementioned observations exist only among mandatory IFRS adopters domiciled in countries with a lower pervasiveness of private debt or bank-based financing. The results imply that the increase in timely loss recognition that can be attributed to mandatory IFRS adoption depends on firms’ corporate finance incentives to reduce the cost of borrowing and on whether the firm is domiciled in countries where public debt is more prevalent.

We contribute to the growing literature on IFRS in three ways. First, we are one of the first studies that argue that accounting conservatism is the means by which the benefit of mandatory IFRS adoption is realized. While many studies have shown that IFRS adoption is associated with lower costs of debt capital (e.g., Florou & Kosi, 2013; Wu & Zhang, 2009), there is little evidence on whether firms charge a higher premium to compensate (Diamond & Verrecchia, 1991). Accounting information is used in debt covenants and therefore charge a higher premium to compensate (Diamond & Verrecchia, 1991). Accounting information is used in debt covenants or covenants that firms can employ to address debtholder–shareholder agency conflicts in the post-IFRS period, which is consistent with the prediction by Ball (2006, p. 12). Second, we show that corporate finance incentives play an influential role in determining whether firms commit to higher accounting disclosure quality after their mandatory IFRS adoption, which is consistent with the theory of Leuz (2010, pp. 248–250). While the existing literature provides mixed findings of the impact of mandatory IFRS adoption on timely loss recognition (e.g., Ahmed et al., 2013; Dimitropoulos, Asteriou, Kousenidis, & Leventis, 2013), our study highlights the need to consider the conditioning effect of corporate finance incentives. Finally, we also reconcile the inconsistency in the existing literature, between the expected and the observed impact of mandatory IFRS adoption on timely loss recognition (Ahmed et al., 2013; Ball, 2006; Chen et al., 2010). We show that the decrease in the timeliness of loss recognition after IFRS, documented by concurrent studies (e.g., Ahmed et al., 2013; Chen et al., 2010), is caused by a background trend and not mandatory IFRS adoption.

Our paper is organized as follows. Section 2 reviews the relevant literature and develops the hypotheses. Section 3 describes the methodology, sample, and data. Section 4 presents the empirical findings. Section 5 concludes.

2. Literature review and hypothesis development

2.1. Timely loss recognition and the costs of debt

Higher accounting disclosure quality decreases information asymmetry, which in turn lowers lenders’ perceived risk and reduces adverse selection problems (Verrecchia, 2001). When lending money to firms, investors need to assess the default risk of borrowers, based on all available information. Capital suppliers are likely to perceive firms that withhold information and have greater information uncertainty as riskier and therefore charge a higher premium to compensate (Diamond & Verrecchia, 1991). Accounting information is used in debt covenants

⁴ We use this measure because it enables us to cover a much larger sample size than other measures such as yield spread from bond issues or syndicated loans would allow. These alternative measures are often limited by data availability and could also incur sample selection bias. For instance, Dealscan has a greater coverage of syndicated loans for the US than for European firms.
دریافت فوری متن کامل مقاله

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات