Chapter 33
Accounting Convergence, Mandatory Adoption of IFRS, and Accounting Quality

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ABSTRACT

This chapter aims to investigate whether the mandatory adoption of international financial reporting standards (IFRS) leads to an increase in the accounting quality measured by value relevance and the role of the national institutional factors, namely development of the capital market, legal enforcement, cultural factors, legal systems, and book-tax conformity, in the change in value relevance after IFRS adoption. Towards this end, the price and financial data of listed firms from eleven EU countries for 15 years were examined by panel data methods. The results of this study indicate that mandatory adoption of IFRS leads to an increase in the value relevance of EPS however it has not a significant effect on the value relevance of BVPS. It is also found that, among the national institutional factors, legal enforcement, cultural factors, and book-tax conformity have a significant effect on the change in value relevance after IFRS adoption.

INTRODUCTION

Convergence has been defined as minimizing international differences in accounting standards by adopting a set of uniform standards globally (Whittington, 2005; Doupnik and Perera, 2011). Proponents of the convergence process claim that convergence is necessary and useful due to globalization of capital markets, simplification of valuation in foreign company acquisitions, reduction of financial reporting costs of companies listed in foreign stock exchanges, easy access to capital, reduction in capital costs, facilitation of international transfers of accounting staff, and increase in the quality of international accounting practices. On the other hand, the opponents of the convergence process argue that there are big differences between countries and the attempt to eliminate these differences would result in huge political costs, national institutions will not comply with any international authority, it is almost an im-

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possible task to develop rules that would please all the related parties all over the world, there is already a developed capital market without uniform accounting standards, requiring some companies to follow a set of standards irrelevant to them would lead "standards overload", accounting differences between countries may be necessary and appropriate due to different environmental dynamics (Doupnik and Perera, 2011). Despite the views that do not support the convergence process, International Financial Reporting Standards (IFRS) have been adopted rapidly worldwide. Such rapid adoption of IFRS is due to the general perception that IASB develops high-quality accounting standards (Ball, 2016), and using a single set of financial reporting standards throughout the world would make it easier to compare firms across countries (Holthausen, 2009). However, both the principle-based characteristics of IFRS and other financial reporting incentives of countries may invalidate this assumption. Managers may use the flexibility and discretion allowed in principle-based standards for their own benefits and manipulate their earnings by choosing an accounting method that does not reflect the basic economic event. Also, country-specific characteristics such as legal systems, tax systems, cultural factors, and so on, may eliminate the improvement in accounting quality due to IFRS.

The widespread use of IFRS throughout the world has raised the question of whether IFRS causes an increase in accounting quality as expected. There are different views and findings whether IFRS, which is expected to guide international accounting practices, can achieve global convergence in accounting practice and improve the accounting quality or not. The contradictory findings in the relevant literature cause the impact of IFRS adoption on accounting quality continues to be a current subject of academic research. In order to clarify the actual effect of IFRS on accounting quality, it is needed to investigate further by taking into account national institutional factors (also called country-specific factors) such as legal systems, tax systems, cultural values that may affect accounting quality.

This study contributes to the literature by examining the role of national institutional factors in the change in value relevance of EPS and BVPS after IFRS adoption. Value relevance is addressed as a dimension of accounting quality and cultural factors, legal systems, legal enforcement, capital market development, and book-tax conformity are examined as national institutional factors in this study. Through the extant literature, institutional factors of countries have been evaluated in terms of data obtained from academic studies performed more than 20 years ago (as La Porta et al., 1998) without considering the possibility that this data may have lost its validity. This research contributes to the extant literature by addressing various national institutional factors at once and using up-to-date data to measure these national institutional factors. The sample is composed of listed firms from 11 European Union countries including Austria, Belgium, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, and Slovenia.

The results of this study indicate that mandatory adoption of IFRS leads to an increase in the value relevance of EPS however it has not a significant effect on the value relevance of BVPS. Moreover, the national institutional factors such as legal enforcement, cultural factors, and book-tax conformity are found to have a role in the change in the value relevance after IFRS adoption.

The remainder of the chapter is organized as follows: After presenting the relevant literature in the second section, the conceptual framework and the research hypotheses are presented in the next part. Section 4 describes the sample, variables measurement, and the research design. Section 5 presents empirical results and robustness tests. Finally, Section 6 concludes the research.

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