

# **Reflections on the 20-Year Anniversary of Worldwide IFRS Adoption**

**Stefano Cascino<sup>1</sup>, Holger Daske<sup>2</sup>, Mark DeFond<sup>3</sup>,  
Annita Florou<sup>4</sup>, Joachim Gassen<sup>5</sup>, Mingyi Hung<sup>6</sup>**

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<sup>1</sup> London School of Economics and Political Science

<sup>2</sup> University of Mannheim

<sup>3</sup> University of Southern California

<sup>4</sup> Bocconi University

<sup>5</sup> Humboldt University Berlin

<sup>6</sup> Hong Kong University of Science and Technology

# Reflections on the 20-Year Anniversary of Worldwide IFRS Adoption

## I. Introduction

The Ninth International Conference of the *Journal of International Accounting Research* (JIAR) was held, virtually, on June 24, 2022. To commemorate the 20<sup>th</sup> anniversary of the start of the worldwide adoption of International Financial Reporting Standards (IFRS) in 2002 with the EU's enactment of Regulation 1606/2002, Editor Steve Lin organized a plenary-session titled "20 Years of IFRS Research." The session consisted of five panelists (Professors Cascino, Daske, Florou, Gassen and Hung) and a moderator (DeFond), each of whom are contributors to the IFRS literature. The panel's notional charge from the Editor was to discuss the large body of research that has focused on IFRS over the past 20 years. However, the panelists were given broad latitude in choosing the specific topics they would discuss.

The panel discussion was loosely organized around two questions posed by the moderator to the panelists at the start of the session. The questions were presented to the panelists by the moderator prior to the conference, and each panelist agreed to frame their opening remarks around one of the two questions. The questions and related panelists were:

- *"There has been a great deal of IFRS research over the past 20 years. Looking back on this research, what would you say we have learned? And perhaps what do we just think we have learned?"* This question was addressed by Professors Daske and Gassen.
- *"Now that we have such a substantial body of IFRS research behind us, where do we go from here? What do we do now and what are future directions?"* This question was addressed by Professors Cascino, Florou and Hung.

The panel discussion was lively and led to many additional questions and comments both from the panelists and the audience. At the Editor's request, the panelists agreed to document their discussion in an article for the JIAR. The result is this article, which presents a short essay

from each panelist summarizing their comments, as well as related issues that were not fully explored at the conference. The five essay titles are as follows (in alphabetical order):

Essay	Panelist	Section
Time to Move from Policy-Based Evidence to Evidence-Based Policy	Stefano Cascino	II
What we have Learned, the Enforcement Puzzle, and some 21 <sup>st</sup> Century Challenges	Holger Daske	III
Implementation Challenges and the Need for Academic-Policymaker Collaboration	Annita Florou	IV
Exploring the Causal Chain and Modelling the Heterogeneity of IFRS Treatment Effects	Joachim Gassen	V
Leveraging our Body of IFRS Knowledge to Address Evolving IFRS Issues and Sustainability Reporting	Mingyi Hung	VI

A striking feature of the essays is that each panelist takes their own distinctive perspective in their interpretation of the literature and their suggestions for moving forward. Below is a very brief preview of each panelist's essay.

**Professor Cascino** argues that the adoption of IFRS, like the adoption of most financial accounting standards, suffers from a dearth of evidence that the standards are likely to achieve their stated objectives. He observes that policymakers adopted IFRS with virtually no evidence to support the claims that it would improve transparency, increase liquidity, or reduce the cost of capital. Rather, researchers were forced to look at *ex-post* evidence, creating significant barriers to drawing conclusive inferences. Professor Cascino argues that this approach has led *policy-based evidence*, rather than *evidenced-based policy*.

**Professor Daske** distills the vast IFRS literature into several concise findings. These include the observation that while the effects of IFRS are difficult to generalize across settings, the evidence generally suggests it has resulted in positive market effects. He also articulates an

important puzzle that arises from the IFRS literature: while the literature convincingly concludes that strong enforcement is necessary for effective implementation of IFRS, in practice, we do not know what “strong enforcement” of principles-based IFRS really means. Finally, Professor Daske summarizes several research opportunities for IFRS researchers going forward.

**Professor Florou** identifies a number of ongoing challenges faced by the International Accounting Standards Board (IASB) as they continue to promote IFRS globally. She argues that the IASB’s inability to impose minimum standards of enforcement, and the ambiguities inherent in partial adoption (such as in China), pose significant threats to the credibility and integrity of IFRS. She further suggests ways in which the IASB might better deal with these challenges. Finally, Professor Florou proposes several opportunities for collaboration between researchers and policymakers to address these critical issues.

**Professor Gassen** observes that while IFRS adoption is associated with positive capital market outcomes, there is limited direct evidence that stakeholders demand or use IFRS information. Rather, the observed capital market benefits may instead arise from the effects of IFRS on information flows and other processes that improve governance and management communication. He also discusses how violations of the stable unit treatment value assumption affect the generalizability of IFRS-related findings and argues that a way forward could be to formally model IFRS adoption and its spillover effects. Professor Gassen concludes by posing a number of questions on how we might also explore the causal chain to investigate sustainability reporting.

**Professor Hung** argues that a fruitful direction for future research lies in leveraging what we have learned from the IFRS literature to investigate the continuing changes in IFRS and the international adoption of sustainability reporting. The current use of IFRS by tens of thousands of firms in over 100 countries presents a unique laboratory for gathering large sample evidence

on the effects of changes in accounting standards. The similarities, as well as the differences, between sustainability reporting and IFRS, and their integrated reporting, present an unprecedented opportunity for researchers to address new questions and inform policy makers.

## **II. Time to Move from Policy-Based Evidence to Evidence-Based Policy - by Stefano Cascino**

### **1. IFRS Research as *Policy-based Evidence***

Policymakers in the area of capital markets and financial reporting regulation often boast about the evidence-based nature of their policy interventions. Yet, financial reporting regulation has rarely been informed by scientific evidence emerging from ex-ante cost-benefit analyses (Buijink 2006; Schipper 2010; Leuz 2018; Cascino 2019). In contrast, until recently, proposals of new financial reporting rules and disclosure mandates have mostly been backed by unconventional analyses of implementation costs and benefits. In fact, the efforts of accounting researchers have largely focused on ex-post assessments of the economic consequences of new reporting rules (Becker et al. 2021). As such, far from informing *evidence-based policy*, one could argue that accounting research has mainly documented *policy-based evidence*.

In the late 1990s, proponents of International Financial Reporting Standards (IFRS) adoption often argued that a common set of high-quality financial reporting standards would increase accounting transparency, lead to higher market liquidity, and ultimately reduce the cost of capital for adopting firms. That said, the first empirical evidence on the link between voluntary IFRS adoption and such capital market consequences became available only much later (Buijink 2006). Similarly, the decision to mandate IFRS by the European Union and several other jurisdictions in 2005 was not informed by scientific evidence emerging from formal ex-ante economic analyses. Put differently, the rollout of the largest financial reporting policy change in history took place absent any scientific evidence providing a hint on the

treatment effects of IFRS adoption in the form of economic elasticities—that is, there were no estimates, for example, of how many percentage points would market liquidity (cost of capital) increase (decrease) as a result of the IFRS mandate (Leuz 2018).

In modern medical research, scientists typically conduct randomized control trials (RCTs)—nowadays the *gold standard* in medicine—on a sample of individuals to assess the viability of a specific drug *before* the drug itself can be offered to the wider population. In the Middle Ages, instead, medical advice would mainly follow simple hunches and guesses, rather than rigorous scientific evidence. As such, whether a drug would be safe or effective could only be discovered after its use (Banerjee and Duflo 2011).

Drawing a parallel with medical research, one could argue that financial reporting regulation is still far from modern medicine and, to some extent, still relies on informal trial-and-error evidence as was the case for “medieval medicine” (Leuz 2018). In fact, it is rare for financial market regulators to take an approach similar to that of RCTs before enacting new policies.

For instance, the U.S. Securities and Exchange Commission (SEC) conducted a formal cost-benefit analyses to inform its regulatory actions in support of the removal of short-sale constraints. With the 2005-2007 pilot program, the SEC randomly selected a subsample of the Russel 3000 firms (treated firms) and exempted them from short-sale restrictions while, at the same time, retained these restrictions for the subsample of remaining firms (control firms). Like in an RCT, this random assignment allowed the SEC to estimate the causal effect of lifting short-sale constraints before rolling out the new rules to all firms.

Initiatives to inform regulatory actions with scientific evidence produced by academic research are also gaining traction—albeit slowly—in the field of financial reporting standard setting, with major standard setters, such as the Financial Accounting Standards Board (FASB)

and the International Accounting Standards Board (IASB), now demonstrating a clear interest in supporting their policy efforts with sound cost-benefit analyses.

## **2. From *Policy-based Evidence* to *Evidence-based Policy***

Despite the obvious societal benefits of having more science-informed regulatory efforts, in practice the move towards evidence-based policy in the field of financial market regulation faces a number of obstacles (Leuz 2018).

As previously mentioned, to evaluate the effectiveness of a regulatory intervention, it is key to understand what would have happened, had a specific policy not been introduced—that is, one would want to have a sense of the *counterfactual* (Banerjee and Duflo, 2011). While experimentation has become relatively standard in medicine, practical—as well as ethical—considerations render RCTs a less feasible option for financial market regulators (Leuz, 2018).

The limitations in relying on RCTs to support financial market regulation has motivated empirical-archival researchers in accounting to gauge treatment effects of policy interventions by relying on quasi-experiments. This is because, in the field of financial reporting, natural experiments are rare, treatment measurement is complex, and relevant data are often lacking (Leuz, 2018). As a result, estimating the causal effects of potential policy interventions to back specific regulations is especially hard; and the inferences drawn from quasi-experiments are often subject to several caveats. This is the case notwithstanding the fact that recent advances in the field of econometrics have enabled researchers to deal with severe identification challenges more effectively.

First, financial reporting rules arise endogenously from, for example, prior regulatory failures. As such, selection concerns make it challenging to interpret the findings from reporting mandates (Leuz and Wysocki, 2016). Second, the introduction of financial reporting mandates often occurs at the country level—as in the case of IFRS adoption—which renders the identification of feasible control groups especially complicated. Third, reporting mandates

are often enacted at one point in time, rather than in a staggered fashion, which creates the problem that concurrent events may confound the identification of the causal effects of the newly implemented rules. Lastly, it is often hard to assess the extent to which treatment effects estimated in a particular setting—for instance, in a specific country—generalize to a broader set of countries characterized by different institutions, regulations, etc. (Glaeser and Guay 2017).

To overcome the inherent barriers in moving towards evidence-based policy that are faced by financial reporting—and, more generally, financial market regulation—, academia and policymakers should seek to cooperate more closely. A closer cooperation between academia and policymakers has the potential to unleash the production of more rigorous scientific evidence, which can ultimately inform better policy interventions and reduce the costs of ill-designed regulation.

Leuz (2018) discusses potential ways in which policymakers could help academics improve the quality of the scientific evidence they produce. For example, enhanced access to data could create the conditions for researchers to identify the causal effects of policy interventions more precisely. Moreover, accounting standard setters could collaborate with academics to design pilot programs for the introduction of new standards, or could help academics pinpoint the treatment effects of new standards by enacting new rules in a staggered fashion.

The discussion above makes it clear that, going forward, regulators cannot afford to roll out new policies—as was the case when IFRS were first introduced—without conducting a sound economic analysis of the costs and benefits that these policies are likely to entail. Similarly, the role of accounting researchers cannot be confined any further to the ex-post measurement of economic consequences from which there are only limited lessons one can learn. In contrast, it is crucial that the accounting academic community leverages the IFRS



experience to increase the awareness of these issues and thus help regulators take the guesswork out of policymaking.

### **III. What we have Learned, the Enforcement Puzzle, and some 21st Century Challenges** **- by Holger Daske**

#### **1. Introduction**

IFRS is a topic dear to my heart. I entered the EU-funded Ph.D. program “HARMONIA” around the time IFRS started to be drafted, adopted around the world, and researched. I have grown as a researcher alongside, and due to, the set of standards. I still feel privileged to have witnessed, and been able to exploit, the “most significant change in the history of accounting”. Many fundamental research questions and unique settings have emerged in response to this true “accounting revolution”. IFRS caused a leap from a fragmented and localized field to a global village of accountants, users, and researchers who all speak the same “language of business” (sometimes with dialects, but still, a considerable achievement from where we came from, i.e., the “Tower of Babel”). IFRS has opened the door for more international participation in the major accounting journals. Moreover, teaching and researching a common set of standards has fostered international cooperation, mobility, and joint understanding in our profession.

#### **2. What have we learned?**

Let me start by sharing some insights on the state of the IFRS literature. With my long-time colleague Jannis Bischof and former Ph.D. student Kirstin Becker, we recently reviewed the IFRS literature for *Foundations and Trends® in Accounting* (Becker et al., 2021). This monograph, called “IFRS: Markets, Practice, and Politics” has 200 pages of text quoting more than 600 studies. These statistics alone illustrate the sheer magnitude of the IFRS literature and its matured stage. I just repeat the core insights here (see pp. 200-202).

First, accounting research has taken up the quest of analyzing the consequences of IFRS adoption. Because the standardization of accounting regulation has different effects in different environments and for different constituents, IFRS effects are hard to generalize. Limitations of settings impede definite answers; still, collectively, research supports the notion that IFRS had positive market effects, despite confounding effects in the form of reporting incentives and simultaneous enhancements of enforcement and other elements of jurisdictions' infrastructure.

Second, with the global financial crisis of 2008-2009, IFRS had to pass its own stress-test as the awareness of the interconnection of accounting rules and financial stability increased. Accounting researchers assessed the impact of IFRS during the financial crisis. Consequently, they provided evidence that incentives for transparent risk disclosures and timely loss recognition were underdeveloped such that the disciplining power of markets could not unfold.

Third, accounting research has investigated IFRS reporting practices. Compared to the U.S., IFRS research entails high data collection costs that arise from a lack of centralized public databases (such as the SEC's EDGAR), a lack of comparability of disclosures in IFRS reports, and insufficient electronic filing requirements. There is plenty of room for improvement in the efficient transmission of IFRS data for the years to come.

Fourth, accounting research has addressed the political dimension of jurisdictions' IFRS adoption decisions, the IASB's standard-setting, and the local design of supporting institutions. Since the IASB needs to respond to an international set of constituents with diverse preferences, it operates within a more complex political economy than its national counterparts. Research shows how the governance and due process of the IASB can shield standard-setting from special interest group pressures, except in rare and extreme situations such as the financial crises.

Fifth, regarding the broader impact of the IFRS literature, IFRS articles were cited more often than non-IFRS articles. However, their impact has been primarily bound to the field of accounting as quotes in other disciplines are rather rare. Unsurprisingly, delivering a significant contribution has become more challenging, and the IFRS literature has moved on to studying more nuanced issues. Good examples are the targeted outreach events that the IFRS Foundation jointly hosts with rotating academic journals on specific projects on their work plan, research pipeline, or Post-Implementation Reviews (PIR) for which they are seeking academic input.<sup>1</sup>

### **3. What do we think we know?**

As for the second part of panel questions, let me pick *one* prominent puzzle: Research has persistently stressed the central role of strong enforcement for the envisioned policy goals of IFRS to materialize (e.g., Daske et al. 2008, Christensen et al., 2013, Leuz and Wysocki, 2016). However, when probing deeper, we do not really know what “strong enforcement of IFRS” actually means in practice. First, prior research, including my own, has used very crude proxies, often simple zero-one dummies (e.g., the five countries coded as “strong enforcement” in Christensen et al., 2013 that made changes in the enforcement process when adopting IFRS). Second, IFRS standards are principle-based and require substantial judgment from preparers. In fact, IFRS often explicitly call for judgment to be exercised in interpreting certain provisions or in case of a lack of guidance in individual standards (IAS 8.10). The term “judgment” appears over 700 times in the text corpus of the IFRS standards (source: IFRS Standards Blue Book). But how do we make the strong enforcement of IFRS work, in a fair fashion, when IFRS itself requires the extensive use of judgment?

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<sup>1</sup> See, e.g., the FASB/IASB joint conference with *The Accounting Review* aimed at producing insights into specific standards on revenue recognition (IFRS 15), leases (IFRS 16), and financial instruments (IFRS 9), see <https://aaahq.org/Meetings/2022/Accounting-for-an-Ever-Changing-World>. Another example is the call for papers for a special issue of *Accounting & Finance* on the application and impact of the hedge accounting requirements (IFRS 9), see <https://onlinelibrary.wiley.com/journal/1467629x>.

Two recent papers have recognized this puzzle and started addressing it from different perspectives. The study by Bissessur et al. (2021) takes a “macro-level” perspective. It covers a large cross-section of enforcement actions in Europe over time, concluding that enforcement of IFRS is a multi-dimensional concept, differentiating between enforcement “on the books” and enforcement “practices”. In contrast, Pelger and Meusburger (2021) deliver “micro-level” evidence by conducting an interview-based field study on enforcement practices. They illustrate how preparers and enforcement agents handle uncertainties in the IFRS standards, reflect on companies’ judgments, and jointly, or with the help of enforcement advisors, define possible boundaries of “appropriate” judgments. Still, there is more to be learned and done.

#### **4. Where to go from here?**

In my view, IFRS standards and financial reports have become an accepted commodity around the world. The big controversies and adoption debates have been settled (one way or another, e.g., Becker et al., 2022), and IFRS standard-setting is pretty much at a *steady state* in the *case of financial reporting* (with rare exceptions, such as IFRS 17 insurance contracts, and evergreens that re-(emerge) over time such as goodwill or intangibles). But that does not mean that future research opportunities will not emerge. To the contrary.

First, the IFRS Foundation has recently been tasked with (or accepted) the objective to end “the alphabet soup” of non-financial sustainability (or ESG) reporting frameworks that have emerged bottom-up by different initiatives around the world. With the creation of a new International Sustainability Standards Board (ISSB), the IFRS Foundation is in the *case of sustainability reporting* again at an early entrepreneurial stage. While it can harvest knowledge gained from its standard-setting experience, the expectations and political pressures are certainly not lower than those 20 years ago. After all, the sustainability standards’ (IFRS S) objective is no less than to make the world a better place. Research will closely track all developments and support this process.

Second, for all types of information disclosed, whether financial (IFRS) or sustainability (IFRS S), the digitalization of the information communicated is still at an unacceptable stage in many settings outside the United States. I perceive a dramatic imbalance between the resources spent to produce financial reports (e.g., Deutsche Bank has audit fees over 60 million EUR p.a. alone) and the form of output provided to users (a pdf-document full of unstructured data that has very low “scriptability”). Our discipline must communicate like we are in the 21<sup>st</sup> century to keep its relevance (e.g., to a “Generation Z”). Centralized registers, fully and correctly tagged reports that are audited, enforced and machine readable are a minimum requirement. Such a move will significantly lower the information processing costs, also when conducting research in the international arena.

Third, IFRS is a spiritual child of Globalization, which seemed to have been unstoppable given the mobility of people, capital, and information in the 21<sup>st</sup> century. Yet, unexpected events (such as the election of Donald Trump as President of the United States under his slogan “America First”, the Brexit from the EU, the COVID-19 pandemic with the global disruption in supply chains, and the invasion of Ukraine by Russia) have put a stop to this move, and we have seen the return to more nation-state inspired policies (e.g., the Inflation Reduction Act by the Biden Administration). To what extent these political macro developments will impact the international coordination of disclosure regulation is an open question.

Overall, these and other developments around IFRS (in their extended scope), will certainly keep our discipline, and me, busy for the next twenty years. No doubt about it.

#### **IV. Implementation Challenges and the Need for Academic-Policymaker Collaboration** **- by Annita Florou**

##### **1. Introduction**

In this essay, I attempt to discuss some of the most important challenges faced by the International Accounting Standards Board (IASB) in promoting the use of International Financial Reporting Standards (IFRS) globally. Then I provide some suggestions as to how future IFRS research might help us better understand these challenges. I conclude by highlighting the need for further collaboration between academics and regulators as a way to achieve more insightful and impactful research.

##### **2. The Challenge of Enforcement**

Over the last two decades, the role of the IASB in enforcing IFRS has been widely debated. Historically, standard-setting has developed within domestic jurisdictions, with national standard-setters exercising enforcement authority. Conversely, the IASB issues international standards without having any equivalent statutory power or global enforcement mechanism. As a result, IFRS are applied locally to different degrees, as the IASB continues to rely on national regulators (and other similar domestic bodies) to ensure the appropriate implementation of its standards. This situation may lead to a lack of harmonization in IFRS enforcement: that is, a lack of uniformity in the application of international standards, thus creating comparability issues and the possible misuse of IFRS.

Indeed, the inability to impose minimum standards of enforcement across countries is, probably, the greatest failure of IASB as an organization and potentially poses a serious risk to the integrity and credibility of IFRS. Recently, some progress has been made to solve this problem. For example, in May 2016, the IASB enhanced its collaboration with the International Organization of Securities Commissions (IOSCO), which promotes transparency in capital markets globally. In doing so, the IASB and IOSCO agreed to several interactions, including

discussions about IFRS implementation (including diversity issues) that the IOSCO members identified; and the periodical exchange of information about progress in the use of IFRS. Similarly, the Securities Exchange Commission (SEC) has started to cooperate with European regulators in an attempt to address differences in IFRS application. However, these actions have not been sufficient to create a global enforcement mechanism, which is why additional effort is needed.

In pursuing the enforcement agenda, the following actions could be helpful:

- a. The IASB could play a broader role in IFRS enforcement by evolving into a quasi-international enforcement body. However, this implies that IFRS-adoption jurisdictions will have to give up some of their national sovereignty.
- b. Regional enforcement entities could be created, with the aim of ensuring homogeneous application of IFRS at the European, Australian/Asian, or Latin American level. Since some types of regional bodies have already been established to provide the IASB with advice and feedback, one solution might be to attribute them enforcement power as well. Such bodies include the European Financial Reporting Advisory Group (EFRAG), Asia-Oceania Standard-Setters Group (AOSSG), Group of Latin American Standard-Setters (GLASS) and Pan African Federation of Accountants (PAFA).

Of course, the aforementioned enforcement initiatives would not be politically costless: countries, especially those having little incentives for transparent financial reporting, may be aggressively opposed to such programs. For this reason, the IASB members should decide in advance how much capital they would be willing to expend on the enforcement challenge.

### **3. Convergence vs. Full Adoption: The Case of China**

As mentioned, countries' commitments to IFRS varies widely across the world. Some countries, such as Australia and EU countries, adopted IFRS in its entirety ("full adoption"); others, such as the emerging economy of China, opted for an ambiguous process, called

“convergence”. When converging, jurisdictions maintain their own national standards and selectively apply specific IFRS or parts of IFRS, depending on what they believe is “appropriate” for their economy. Because of this process, China, among all countries, represents the most challenging case.

China committed to converge with IFRS in 2007. Nevertheless, its national standards still differ from IFRS regarding certain important issues, such as fair value accounting and related-party transactions (RPTs). Specifically, China stood out for limiting fair value accounting to only the most prominent companies, justifying the choice by the backwardness of Chinese capital markets and financial institutions. Similarly, China opted to exempt its State-Owned Enterprises (SOEs) from various RPTs disclosures required by IFRS. While the fair value exception can be considered meaningful in the context of Chinese institutions, the RPTs disclosure exemption was essentially a strategic self-serving choice: that is, given the dominant role of state ownership and control in Chinese companies, the government tried to “protect” them from detailed information about their RPTs. However, RPTs disclosures are critical to an entity’s integrity, and therefore such exemptions potentially impair financial reporting quality and transparency.

In this context, the IASB should play an active role in monitoring the convergence process to preserve the long run cohesion and integrity of IFRS from the innumerable local variances that are mostly self-serving in nature.

#### **4. Future Research Directions: Some Suggestions**

The global use of IFRS gave rise to a voluminous literature investigating a plethora of research questions. Some of the findings of this literature point to several IFRS-related benefits (e.g., enhanced comparability, lower cost of debt financing, increased institutional investments) as well as some costs (e.g., higher audit fees).

Future IFRS research might yield useful insights that could enable the IASB and its constituencies to better understand the potential “threats” of heterogeneous enforcement and



the convergence option. So far, the vast majority of studies have involved many countries around the world. Thus, a new direction could be to “go back to basics” and focus on individual countries, since the approach to IFRS by many different jurisdictions has been a very diverse undertaking. This direction would enable researchers to dig into the details of IFRS implementation within a specific country or a small cluster. In this regard, future research could focus on a limited set of low-enforcement countries or a potentially important “convergence” country, such as China, and employ textual analysis tools to investigate thoroughly the level of compliance with certain financial reporting choices and disclosures of specific IFRS. Further analysis could then examine the consequences of such choices and disclosures. Research projects of this nature can generate new findings that are impactful as they are closely linked to the agenda of the IASB and they have the potential to generate useful insights related to the on-going “Disclosures Initiative” project of the IASB.

Moreover, future research can contribute to areas where the current findings on IFRS adoption are controversial. In doing so, one way forward could be a better investigation of the institutional details of the transition to IFRS. For example, when IFRS adoption became mandatory in the EU, its Member States had the option of deferring the use of IFRS by certain companies, such as those listed on unregulated markets. Notably, the UK mandated the switch to IFRS for companies listed on the Alternative Investment Market (AIM) in 2007, two years later than the mandatory adoption of IFRS by companies listed on the Main London Stock Exchange. In this regard, single-country studies can help researchers better understand the important institutional details with the aim of exploiting them in the research design. In doing so, researchers may also address well-developed questions related to the issues of enforcement and convergence.

Recently, in an effort to stimulate academic research, the IASB has produced podcasts providing a summary of key issues/questions related to specific IFRS, such as IFRS 9 on

financial instruments, IFRS 15 on revenue recognition, IFRS 16 on leases and IFRS 17 on insurance contracts. Researchers may find these podcasts informative and useful in developing new research projects.

## **5. Academics and Regulators: The Need for Collaboration**

So, what is the way forward? It is widely argued that accounting research might assist standard-setters by providing useful insights. Yet, still today, one of the biggest problems of research seems to be the lack of collaboration between academics and regulators.

The present situation, in fact, represents a gap between the two that is both “necessary” and “difficult” to bridge. It is “necessary” because the development of financial reporting strongly depends on academic research as high-quality research outputs can lead to better policies and regulations. It is “difficult” because a great deal of long-term effort is required from both researchers and policymakers; indeed, it takes “two to tango” since each group has responsibility for the gap. On one hand, academics are criticized for using very technical and complex language (the communication gap) and for investigating issues that are distant from regulators’ concerns (the substantive gap). On the other hand, regulators are criticized for not engaging enough with the academic community, and in particular, for not sharing proprietary data with researchers, even with confidentiality agreements.

Thus, in an attempt to capture regulators’ attention, academics should try to communicate their research in a more “user-friendly” way as well as investigate topics closely linked to the regulators’ agenda. Similarly, regulators should make a greater effort by being more open-minded and flexible in their interactions with researchers. In fact, if policymakers provided access to their data, perhaps academics could address more policy-relevant questions.

## **V. Exploring the Causal Chain and Modeling the Heterogeneity of IFRS Treatment Effects**

**- by Joachim Gassen**

### **1. Exploring the Causal Chain**

The IFRS literature has provided mounting evidence for market effects of IFRS adoption (Becker et al., 2021). Relative to this rich body of literature, there seem to be relative few studies that provide clear and direct evidence for the actual demand for and use of IFRS information by investment professionals or other stakeholders (Cascino et al., 2014). For example, while it is undisputed that financial analysts and institutional investors rely on financial accounting information for their decision making (Brown et al., 2015), I am not aware of a significant literature that documents financial analysts praising the informational advantages of IFRS over national accounting regimes or the discussion of specific IFRS disclosures in analyst reports (see Bischof et al., 2014, for a rare example looking at fair value disclosures by international banks). The limited existing evidence seems to be more in line with investment professionals being challenged by the complexity of financial reporting standards and therefore focusing on the ‘big picture’ presented by accounting information to understand and assess the business models of reporting firms (Cascino et al., 2021). Given that financial analysts seem to make only limited use of detailed financial reporting information, it appears even less likely that algorithmic trading, the media or retail investors impound substantial amounts of IFRS information into markets.

An alternative mechanism that could explain some of the market effects of IFRS adoption could be that the adoption of IFRS has led to improvements of internal information flows and processes within firms, resulting in better informed management, more efficient governance, clearer managerial communication with the investment community and, ultimately, market outcomes like lower risk and cost of capital. While some indirect evidence for learning effects

of IFRS adoption exists (e.g., Ozkan et al. 2011; Wu and Zhang, 2019), one wonders how influential this channel could be to trigger the documented market effects.

These perceived shortcomings of the prior literature seem relevant as understanding the causal chain of IFRS market effects is crucial for generalizing the insights of IFRS adoption to other regulatory settings. Work that collects data on these issues could be mostly descriptive and exploratory in nature including case studies, interviews, and survey-based evidence. It also seems to be a fruitful area for qualitative work. This evidence could then inform theory work to model the causal chains in more detail and trigger subsequent empirical studies to support or refute these predictions.

## **2. Treatment Effect Heterogeneity and SUTVA**

Most quantitative studies assessing IFRS adoption effects use quasi-experimental approaches to assess counterfactual outcomes. Among these studies, difference-in differences designs are arguably the most common.

The Stable Unit Treatment Value Assumption (SUTVA) is a core micro-econometrical assumption required to identify consistent average treatment effects (Rubin, 1977). It requires the treatment effects of units to be unaffected by the treatment status of other units and is also required for difference-in-differences designs (Lechner, 2011). In the IFRS setting, it implies that the IFRS adoption effect for an individual firm should not depend on whether other firms adopt IFRS. As Leuz and Wysocki (2016) argue, accounting standards can be characterized as network goods that create externalities and spillovers, suggesting that this assumption is very likely violated. To see this, consider for example whether the information asymmetry effect of a global firm domiciled in the U.K. adopting IFRS would be affected by whether its main competitors in the U.S. also adopt IFRS. If we assume that cross-sectional comparability matters for the information asymmetry effects of IFRS adoption or that familiarizing oneself with IFRS regulations requires a non-trivial investment, the effect of IFRS adoption for the

U.K. firm should be affected by whether its U.S. competitors also adopt IFRS. First, this would make the financial accounting information of the U.S. peers more comparable to the U.K. firm, easing the uncovering of new information. Second, receivers of financial accounting information like U.S. financial analysts would be more likely to invest in familiarizing themselves with IFRS when they can use this knowledge on more firms.

What this entails is that we cannot estimate generalizable IFRS treatment effects. Instead, we can only learn about treatment effects for a certain treatment uptake. Explained more practically: we will never know how large the IFRS adoption effect would have been if also the U.S. would have adopted IFRS. This also implies that deriving naïve policy advice from IFRS effect studies on whether any given jurisdiction should follow suit and adopt IFRS is potentially misguided.

A way around this issue is not easy as Manski's reflection issue lurks as soon as one is trying to model the network effects of IFRS adoption directly (Manski, 1993; Rysman, 2019). The reflection problem implies that absent additional exogenous variation it is not feasible to differentiate whether an observed treatment effect results from the direct treatment effect or a group spillover. However, if one has clear theoretical grounds on which to predict the magnitude of spillovers and ideally suitable instruments for their determinants, it seems promising to study the network effects of IFRS adoption by exploring the heterogeneity of IFRS treatment effects at the firm level. This would also help to separate the fixed cost argument from the information co-variance argument as spillover determinants. The fixed cost argument predicts potentially regional positive spillovers that flatten out as more firms from the respective region adopt IFRS. The comparability effect predicts positive spillovers for firms whose information likely covary with other firms. In addition, network spillovers can be expected to be larger for firms with global reach while they should be more limited for firms with a very regional network. Modeling and analyzing IFRS adoption spillover effects can also

inform researchers and policymakers about treatment effect sizes for hypothetical treatment uptakes in other settings.

### **3. The Way Forward**

While the IFRS literature is a relatively mature field, work along the lines outlined above might still be informative to the literature. An important aspect for evaluating future work will likely be whether we can expect the findings to generalize to other settings. In that regard, we are currently observing great interest in the international adoption of mandatory and voluntary sustainability reporting. While this clearly is a different research topic, its underlying econometrics and theoretical foundations are similar. This implies that we should strive to understand the causal chain in detail before jumping to conclusions based on effect studies that rely on a reduced form approach. Relevant questions in that regard include: Who demands and who uses sustainability information? Why do jurisdictions introduce a mandate? What is the role of the various standardization agencies? How do firms produce sustainability reporting information and sustainable reports? Does the information production itself have side-effects? Can we observe how sustainability reporting affects decision-making at the individual level? What decisions by which users does it affect? Does it crowd out private information production? How long is it capable to inform recipients? Answering these questions should result in a clearer picture of how sustainability information affects the behavior of market participants and ultimately economic outcomes. In addition, studying the network spillovers related to sustainability reporting helps us to assess its macro effects and to hypothesize about treatment effects for those jurisdictions that have not yet adopted a reporting mandate.

## **VI. Leveraging our Body of IFRS Knowledge to Address Evolving IFRS Issues and Sustainability Reporting**

**- by Mingyi Hung**

### **1. Introduction**

This essay discusses my view on where we go from here, given the substantial body of IFRS research. I suggest two main directions to capitalize on our collective knowledge from the IFRS literature: 1) assess the impact of ongoing changes in IFRS, 2) leverage what we have learned from the IFRS to study the adoption of sustainability accounting standards in global markets. I elaborate my observations and suggest research opportunities for each direction below.

### **2. Ongoing changes in IFRS**

The 2005 worldwide adoption of IFRS is of great interest among researchers because it provides a unique opportunity to test new research questions and gain insights on fundamental characteristics of accounting that users find valuable (DeFond 2019), such as the impact of improved financial statement comparability across different institutions (DeFond, Hu, Hung, and Li 2011; Yip and Young 2012). Since first-time IFRS adopters are required to restate their prior year's financial statements from local GAAP to IFRS, this setting also allows researchers to identify specific changes in the accounting standards that affect the usefulness of accounting numbers in valuation and contracting (Hung and Subramanyam 2007).

Given the large body of literature on the effect of mandatory IFRS adoption (DeGorge, Li, and Shivakumar 2016), the incremental contribution from research exploring alternative methodologies or additional economic outcomes using the same setting is limited. However, investigating the impact of ongoing changes in IFRS is a relatively fruitful direction for future research. While there continues to be debate on whether the impact of mandatory IFRS adoption is driven by concurrent changes (e.g., reporting enforcement), future research can

bear this in mind to assess the extent to which the effects reflect changes in accounting standards or complementary shifts in other institutional factors.

Examples of major changes in IFRS in recent years include IFRS 9 (Financial instruments), IFRS 15 (Revenue from contracts with customers), and IFRS 16 (Leases).<sup>2</sup> By examining the first-order, intended outcomes of these changes in accounting standards, we can help advance the literature and provide policy implications. Since tens of thousands of firms in over 100 countries currently report under IFRS or IFRS-based local standards, these changes also allow researchers to explore how alternative accounting treatments affect firms' financial reporting quality and operations across different institutional environments. For example, using the mandatory shift to expected credit loss (ECL) provisioning following the adoption of IFRS 9, recent studies find that the mandatory shift on average improves the timeliness of loan loss recognition, and the effect varies across banks with different risk exposures and ownership structures (Kim, Ng, Wang, and Wu 2021; López-Espinosa, Ormazabal, and Sakasai 2021; Hung, Ru, She, and Wang 2022). Studies also find that banks reduce lending to risky borrowers (Ertan 2019), and increase information production (Kim, Kim, Kleymenova, and Li 2022). These findings help improve our understanding on how a major change in bank accounting, i.e., a shift to forward-looking ECL provisioning, shapes banks' reporting practices and risk taking.

### **3. Adoption of sustainability accounting standards**

Another fruitful venue for future research is to apply what we have learned from mandatory IFRS adoption to the widespread adoption of sustainability accounting standards in global capital markets. The global convergence of sustainability reporting is gaining momentum in recent years. For example, the IFRS Foundation established the International Sustainability

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<sup>2</sup> For studies on these issues, see <https://aaahq.org/Meetings/2022/Accounting-for-an-Ever-Changing-World/Program>



Standards Board (ISSB) in 2021. Unlike financial reporting under IFRS, however, sustainability reporting is yet to have a set of globally accepted standards. The proliferation of multiple sustainability reporting frameworks and the lack of consistent disclosure requirements are the subject of much criticism and confusion (EC 2013). These challenges offer opportunities for researchers to explore alternative reporting requirements, which should inform regulators.

An underexplored area for sustainability disclosure research is to assess the impact of alternative reporting requirements on users' decisions. Similar to financial disclosures, an important goal of sustainability disclosures is to provide useful information to help stakeholders' decision-making. As noted by Andreas Barckow, Chairman of the IASB, "a message that we are also hearing very consistently from jurisdictions is you should not really separate the two domains, as they go hand in hand. It could very well mean we're tackling standards together from an ISSB and an IASB perspective (Maurer 2021)." However, as sustainability disclosure regulations are commonly used as a tool to curb negative externalities on society and the environment, most studies focus on how they alter firm behavior (Chen, Hung, and Wang 2018; Fiechter, Hitz, and Lehmann 2022). We know relatively little about how information disclosures under different sustainability reporting requirements affect investors or other stakeholders' decisions.

For example, the EU adopted the Non-Financial Reporting Directive (NFRD) in 2017. The directive offers several options, such as disclosure venue and assurance requirements. Some countries, such as France and the U.K. require affected firms to report the NFRD disclosures in the annual or management report while other countries allow a separate report. While the regulation only requires outside auditors to verify the presence of the non-financial statements, France, Italy, and Spain further require audited assurance on the content of the disclosures. These variations allow researchers to examine the implications of alternative reporting venues

or assurance requirements on users' decisions. Such inquiries could benefit from what we learn from the mandatory IFRS adoption to establish causal inferences and explore institutional differences. The evidence would be timely and relevant to the ongoing development of sustainability disclosure regulations, such as the recent SEC proposal on enhancement and standardization of climate-related disclosures.

Comparison of alternative regulatory requirements could also help shed light on the effectiveness of specific environmental or social disclosure regulations in altering firm behavior. Take diversity disclosures as an example. Canada's 2014 mandatory gender diversity disclosure requires firms to disclose, in the proxy circular for the annual meeting, a core set of information such as director term limits, written boardroom diversity policies, and targets of representation of women on the board and in executive officer positions. Importantly, a firm must disclose whether it has adopted the relevant policy or practice, and, if not, disclose why not. This approach contrasts with the 2019 SEC amended Regulation S-K. While the SEC requires firms to disclose information regarding consideration of diversity in director nominations and to describe how the diversity policy is implemented if they adopt a policy, it does not define "diversity," nor does it require a firm to disclose the non-adoption of a diversity policy. Recent studies suggest that while the U.S. disclosure regulation has little impact on board diversity, the Canadian regulation facilitates shareholder oversight and motivates firms to make stronger diversity commitments that lead to improved boardroom gender diversity (Hu, Hung, and Li 2022).

In summary, the mandatory adoption of IFRS presents an "exogenous shock" to financial disclosures and provides rich opportunities to explore the relevance of key accounting properties. Moving forward, the continuous changes in IFRS, the development of sustainability disclosure regulations, and the integration between financial and non-financial disclosures

represent fruitful venues for researchers to further leverage the IFRS adoption to provide evidence that answers new questions and informs policy makers.

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