



University of Antwerp
Faculty of Business
and Economics

Is IFRS a “trusted” language for private firm credit decisions? An analysis of country differences in users’ perspectives

Ann Jorissen, Ronita Ram, Pedro Moraya Barros

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Why this research? What do we want to learn? (1)

. Since 2008 we witness an increased adoption of IFRS Standards for private firm reporting – to a large extent under the influence of the “Good Governance” programs of the World Bank

(1) Does IFRS adoption by private firms enhances lenders’ trust in Financial Statement numbers? (WB, ROSC, 2021)

(2) Can IFRS fulfill the role of single trusted language (Mission Statement of IFRS Foundation) in the context of private firm reporting

(3) Is lenders’ trust influenced by the institutional characteristics of the country that adopts IFRS for private firm reporting

Why this research? What do we want to learn? (2)

. Academic call for research De George et al. (2016, p945) – surveys to be conducted in countries that adopted IFRS may provide insights into the relevance of IFRS for lending decisions –

(4) is IFRS-based information used in credit/ lending decisions?

Structure of the presentation

- **Development of the research propositions**
- **Research Method**
- **Quantitative Results**
- **Qualitative Results**
- **Conclusion**
 - Trust and country influences
 - Use of financial statement information in lending decisions and country influences
 - Results related to IASB's projects
 - Results related to the World Bank "good governance programs"

Research Propositions

Based on Institutional Theory (North, 1990; Wysocki, 2011; Di Maggio and Powel, 1983) RP are developed to predict country differences related to trust in IFRS FS numbers/use of IFRS FS numbers

RP1: FinStat Info will be more trusted and used in countries with strong formal institutions

RP2: FinStat Info will be less trusted and used in countries with competing and conflicting institutions

RP3: FinStat Info will be more trusted and used in countries with a market-driven IFRS adoption

RP4: In countries characterized by weak formal institutions and conflicting informal Institutions, additional information (outside the FS) will become more important in credit-decisions

Research Propositions

Based on Institutional Theory (North, 1990; Wysocki, 2011; Di Maggio and Powell, 1983) develop RP to predict country differences related to trust/use

RP5: In countries in which both public financing through the country's stock market and private financing are present, the compliance of listed companies with IFRS can lead to mimetic pressures for private firms to comply with IFRS and this can positively influence trust and use of IFRS accounting numbers by bankers for credit decisions

RP6: when FS are audited by a high-quality auditor, Fs numbers are more trusted and used for credit decisions (also supported by signaling theory)

Research Method

- **Research Population**

Choice of Countries: theoretical sampling to choose countries that differ in terms of institutional characteristics (see also Leuz (2010))

Argentina, Brazil, Chili, Nigeria, South Africa, Zimbabwe, Fidji, Hong Kong, Malaysia and The Phippines

Bankers were approached through linked in and snowballing technique (Africa)

- **Data Collection Method**

- **Measurement of the variables – quantitative analyses**

- **Coding of the interview data – qualitative analyses**

Research Population: Profile of bankers who participated in this study

Country	No. Interviews		Role	Years of experience		No	%	
	No	%		No	%			
Argentina	10	9.3%	Credit risk analyst	44	40.7%	0-5	27	25.0%
Brazil	12	11.1%	Senior credit analyst	12	11.1%	5-10	17	15.8%
Chile	12	11.1%	Credit risk/evaluation manager	17	15.7%	10-15	25	23.1%
Fiji	10	9.3%	Credit relationship manager	6	5.6%	15+	39	36.1%
Hong Kong	9	8.3%	Head of credit/Director/VP of credit dept.	29	26.9%			
Malaysia	10	9.3%						
Nigeria	10	9.3%						
Philippines	13	12.0%						
South Africa	11	10.2%						
Zimbabwe	11	10.2%						
Total	108	100%		108	100%		108	100%

Research Method: data collection

Bankers that agreed to participate – received a questionnaire with Closed, semi-closed and open questions

Used for the quantitative analyses

- . Trust was measured using a likert – scale of 1 to 7 (closed question)
- . Use was measured on a scale of 1 to 4 (closed question)

Used for qualitative analyses

Answers to semi-open and open questions were coded and analysed with Nvivo in order to detect relationships between the constructs – through hierarchical charts

Questionnaires were pretested

Saturation point at 8 eight interviews in a country (see also Neu et al.2014)

Country adoption of IFRS (Full IFRS and IFRS for SMEs)

(1) When countries require or permit IFRS for SMEs for private firms, they also allow Full IFRS to be applied for private firms

(2) Country adoption strategies might differ, a number of countries keep The Brand name IFRS, whereas other countries translate IFRS in its entirety or with small modifications into their “national GAAP” (IFRS-based national GAAP)

(3) Countries might have different adoption regimes according to the size of the private firms

Variable: IFRS SME Country Adoption size firm, 1= IFRS Mandatory, 0= choice

Measurement of the variables

Dependent Variables

- Trust size firm (large, medium,small) standards applied (full IFRS, IFRS SME, local GAAP)
- Use size firm (large, medium,small) standards applied (full IFRS, IFRS SME, local GAAP)
- We distinguish between audited and non-audited accounts

Independent Variables

- . Formal institutions – Protection of Creditor Legal Rights – (0 – 12) (ESG data WB)
- . Conflicting informal institutions – level of corruption – (-2,5 – 2,5) (WGI WB)
- . Market driven IFRS adoption – INCOME (high income, upper middle income, lower middle income (WB)
- . Mimetic pressures – Log (listed firms on a country's stock exchange) –
World Federation of Stock Exchanges

Statistical methods employed

Univariate Analyses

Pairwise comparison of the dependent variables trust and use according to different groups – Wilcoxon signed rank test

- Type of standard is constant but size of the firm changes
- Size of the firm is constant but the type of standard changes
- Audited versus non-audited financial statements

Multivariate Analyses – Ordered Probit Analysis

Trust/use = f(creditor legal rights, corruption, log listed, IFRS SME Country adoption, Country fixed effect)

Trust/use = f(creditor legal rights, Income, log listed, IFRS SME Country adoption, Country fixed effect)

Results: Univariate Tests

Panel A: Firm Size Different – Standards Constant

Wilcoxon signed-rank test

Null Hypothesis (H0)	Variable	Mean	Variable	Mean	Z	Prob > z	Decision
Large Firms = Medium Firms							
	Trust Large IFRS SMEs	5.833	Trust Medium IFRS SMEs	5.446	4.822	< 0.0001	Reject H0
	Use Large IFRS SMEs	3.427	Use Medium IFRS SMEs	3.305	2.264	0.0236	Reject H0
	Trust Large IFRS Full	6.25	Trust Medium IFRS Full	5.622	6.916	< 0.0001	Reject H0
	Use Large IFRS Full	3.543	Use Medium IFRS Full	3.416	2.779	0.0055	Reject H0
	Trust Large Local GAAP	5.905	Trust Medium Local GAAP	5.423	5.103	< 0.0001	Reject H0
	Use Large Local GAAP	3.227	Use Medium Local GAAP	3.055	2.534	0.0113	Reject H0
Medium Firms = Small Firms							
	Trust Medium IFRS SMEs	5.446	Trust Small IFRS SMEs	4.813	6.223	< 0.0001	Reject H0
	Use Medium IFRS SMEs	3.305	Use Small IFRS SMEs	3.053	4.203	< 0.0001	Reject H0
	Trust Medium Local GAAP	5.423	Trust Small Local GAAP	4.761	4.909	< 0.0001	Reject H0
	Use Medium Local GAAP	3.055	Use Small Local GAAP	2.847	3.638	0.0003	Reject H0
	Trust Medium IFRS Full	5.622	Trust Small IFRS Full	4.887	6.873	< 0.0001	Reject H0
	Use Medium IFRS Full	3.416	Use Small IFRS Full	3.122	4.996	< 0.0001	Reject H0
Large Firms = Small Firms							
	Trust Large IFRS SMEs	5.833	Trust Small IFRS SMEs	4.813	6.520	< 0.0001	Reject H0
	Use Large IFRS SMEs	3.427	Use Small IFRS SMEs	3.053	4.468	< 0.0001	Reject H0
	Trust Large IFRS Full	6.25	Trust Small IFRS Full	4.887	7.655	< 0.0001	Reject H0
	Use Large IFRS Full	3.543	Use Small IFRS Full	3.122	5.059	< 0.0001	Reject H0
	Trust Large Local GAAP	5.905	Trust Small Local GAAP	4.761	6.090	< 0.0001	Reject H0
	Use Large Local GAAP	3.227	Use Small Local GAAP	2.847	3.665	0.0002	Reject H0

We can reject null that the population are the same at any level below 0.05%

Univariate Results: size constant – different type of standards

Wilcoxon signed-rank test

Null Hypothesis (H0)	Variable	Mean	Variable	Mean	Z	Prob > z	Decision
IFRS for SMEs = Local GAAP	Trust Small IFRS SMEs	4.813	Trust Small Local GAAP	4.761	2.130	0.0332	Reject H0
	Use Small IFRS SMEs	3.053	Use Small Local GAAP	2.847	1.866	0.0620	Cannot Reject H0
	Trust Medium IFRS SMEs	5.446	Trust Medium Local GAAP	5.423	2.164	0.0305	Reject H0
	Use Medium IFRS SMEs	3.305	Use Medium Local GAAP	3.055	2.129	0.0333	Reject H0
	Trust Large IFRS SMEs	5.833	Trust Large Local GAAP	5.905	0.005	0.9963	Cannot Reject H0
	Use Large IFRS SMEs	3.427	Use Large Local GAAP	3.227	2.150	0.0315	Reject H0
Full IFRS = Local GAAP	Trust Small IFRS Full	4.887	Trust Small Local GAAP	4.761	3.865	0.0001	Reject H0
	Use Small IFRS Full	3.122	Use Small Local GAAP	2.847	2.999	0.0027	Reject H0
	Trust Medium IFRS Full	5.622	Trust Medium Local GAAP	5.423	3.993	0.0001	Reject H0
	Use Medium IFRS Full	3.416	Use Medium Local GAAP	3.055	3.601	0.0003	Reject H0
	Trust Large IFRS Full	6.25	Trust Large Local GAAP	5.905	3.484	0.0005	Reject H0
	Use Large IFRS Full	3.543	Use Large Local GAAP	3.227	3.507	0.0005	Reject H0

We can reject null that the population are the same at any level below 0.05% in all but 2 cases

Univariate Results: Difference between Audited and Non-audited Financial Standards

Wilcoxon signed-rank test

Null Hypothesis (H0)	Variable	Mean	Variable	Mean	Z	Prob > z	Decision
Audited = Unaudited							
	Trust Large IFRSSMEs Audited	5.833	Trust Large IFRSSMEs Unaudited	4.667	7.688	< 0.0001	Reject H0
	Trust Medium IFRSSMEs Audited	5.446	Trust Medium IFRSSMEs Unaudited	4.268	7.867	< 0.0001	Reject H0
	Trust Small IFRSSMEs Audited	4.813	Trust Small IFRSSMEs Unaudited	3.614	7.914	< 0.0001	Reject H0
	Use Large IFRS SMEs Audited	3.427	Use Large IFRS SMEs Unaudited	2.593	7.638	< 0.0001	Reject H0
	Use Medium IFRS SMEs Audited	3.305	Use Medium IFRS SMEs Unaudited	2.506	7.255	< 0.0001	Reject H0
	Use Small IFRS SMEs Audited	3.053	Use Small IFRS SMEs Unaudited	2.326	6.874	< 0.0001	Reject H0
	Trust Large Local GAAP Audited	5.905	Trust Large Local GAAP Unaudited	4.613	6.352	< 0.0001	Reject H0
	Trust Medium Local GAAP Audited	5.423	Trust Medium Local GAAP Unaudited	4.180	6.429	< 0.0001	Reject H0
	Trust Small Local GAAP Audited	4.761	Trust Small Local GAAP Unaudited	3.581	6.403	< 0.0001	Reject H0
	Use Large Local GAAP Audited	3.227	Use Large Local GAAP Unaudited	2.569	5.371	< 0.0001	Reject H0
	Use Medium Local GAAP Audited	3.055	Use Medium Local GAAP Unaudited	2.379	5.454	< 0.0001	Reject H0
	Use Small Local GAAP Audited	2.847	Use Small Local GAAP Unaudited	2.152	5.185	< 0.0001	Reject H0
	Trust Large IFRS Full Audited	6.25	Trust Large IFRS Full Unaudited	5.045	8.049	< 0.0001	Reject H0
	Trust Medium IFRS Full Audited	5.622	Trust Medium IFRS Full Unaudited	4.349	8.087	< 0.0001	Reject H0
	Trust Small IFRS Full Audited	4.887	Trust Small IFRS Full Unaudited	3.667	8.169	< 0.0001	Reject H0
	Use Large IFRS Full Audited	3.543	Use Large IFRS Full Unaudited	2.742	8.026	< 0.0001	Reject H0
	Use Medium IFRS Full Audited	3.416	Use Medium IFRS Full Unaudited	2.551	7.627	< 0.0001	Reject H0
	Use Small IFRS Full Audited	3.122	Use Small IFRS Full Unaudited	2.330	7.265	< 0.0001	Reject H0

We can reject null that the population are the same at a significance level below 0.05%

Multivariate Results: IFRS for SMEs

Dependent Variable	Trust Large (N = 90) (1)	Trust Medium (N = 92) (2)	Trust Small (N = 91) (3)	Use Large (N = 96) (4)	Use Medium (N = 95) (5)	Use Small (N = 95) (6)
IFRS SME Country Adoption Large F	-1.074 (0.648)			-0.013 (0.643)		
IFRS SME Country Adoption Medium F		0.180 (0.270)			0.115 (0.290)	
IFRS SME Country Adoption Small F			0.716* (0.286)			0.266 (0.293)
Legal Rights	-0.123* (0.050)	-0.080 (0.052)	-0.094* (0.048)	-0.106* (0.049)	-0.071 (0.054)	-0.124* (0.048)
Corruption	0.226 (0.167)	0.134 (0.163)	-0.158 (0.174)	0.292 (0.179)	0.312 (0.174)	0.185 (0.184)
Log Listed	0.017 (0.101)	0.055 (0.098)	0.255* (0.117)	-0.204 (0.117)	-0.319** (0.116)	-0.165 (0.130)
Country Effects	0.124* (0.055)	0.052 (0.049)	0.011 (0.049)	-0.011 (0.059)	0.030 (0.053)	-0.021 (0.052)
Constant	-3.252*** (0.831)	-2.062** (0.787)	-0.837 (0.707)	-4.228*** (0.877)	-4.048*** (0.818)	-3.432*** (0.778)
LR chi2	10.362	4.797	8.825	12.633	13.918	15.916
Prob>chi2	0.066	0.441	0.116	0.027	0.016	0.007
Log likelihood	-116.055	-128.936	-147.780	-86.725	-91.960	-106.815

Ordinal Probit Regressions. Asymptotic z-statistics are in parentheses. *** significant at 1%; two-tailed tests ** significant at 5%; two-tailed tests * significant at 10%; two-tailed tests

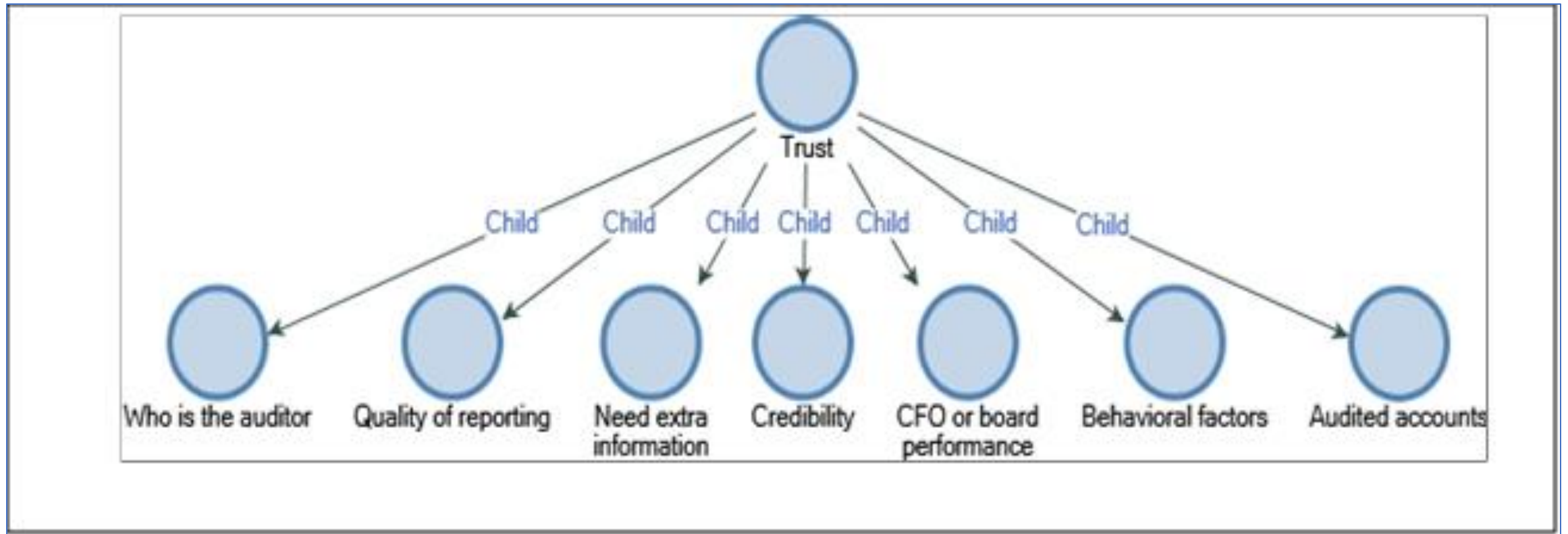
Dependent variables:

- (1) Trust Large: Levels of trust in financial statements prepared by large companies using IFRS SMEs - audited.
- (2) Trust Medium: Levels of trust in financial statements prepared by medium-sized companies using IFRS SMEs - audited.
- (3) Trust Small: Levels of trust in financial statements prepared by small companies using IFRS SMEs - audited.
- (4) Use Large: Usefulness of the information embedded in the financial statements of large companies using IFRS for SMEs (audited) in your decision-making (e.g. loans, determination of collateral, investment in equity capital)..
- (5) Use Medium: Usefulness of the information embedded in the financial statements of medium-sized companies using IFRS for SMEs (audited) in your decision-making (e.g. loans, determination of collateral, investment in equity capital)..
- (6) Use Small: Usefulness of the information embedded in the financial statements of small companies using IFRS for SMEs (audited) in your decision-making (e.g. loans, determination of collateral, investment in equity capital)..

Multivariate results: Local GAAP

Dependent Variable	Trust Medium (N = 71) (1)	Trust Small (N = 71) (2)	Use Medium (N = 73) (3)	Use Small (N = 72) (4)
IFRS SME Country Adoption Medium F	0.955**		0.704*	
	(0.321)		(0.329)	
IFRS SME Country Adoption Small F		0.941**		0.599
		(0.321)		(0.323)
Legal Rights	-0.056	-0.099	-0.094	-0.186**
	(0.065)	(0.057)	(0.064)	(0.058)
Corruption	0.458*	-0.062	0.410	-0.208
	(0.222)	(0.239)	(0.237)	(0.248)
Log Listed	-0.202	0.091	-0.143	0.326
	(0.188)	(0.204)	(0.197)	(0.212)
Country Effects	0.116	0.053	-0.042	-0.072
	(0.060)	(0.059)	(0.062)	(0.062)
Constant	-2.788**	-1.180	-2.771**	-0.831
	(1.073)	(1.075)	(1.052)	(1.094)
LR chi2	19.074	11.537	19.192	14.614
Prob>chi2	0.002	0.042	0.002	0.012
Log likelihood	-96.533	-116.994	-77.808	-84.005

Figure 1: When do bankers trust financial statement information



Qualitative results support the quantitative results and confirm all research propositions, except RP 5

▪ Informal conflicting institutions and economic conditions influence trust and use (RP2)

- . Informal economy (black market)
- . Hyper inflation

. Additional Information (RP4)

- . Information on directors' and managers' behavior, management business plans, Company visits, back up plans, director's and manager's financial knowledge
- . Credible third party information: National Bank, credit agencies, tax information if the tax authority is considered efficient and reliable (link to strong formal institutions)

Qualitative results support the quantitative results and confirm all research propositions, except RP 5

If no trustworthy additional information is found, then

credit is granted with collateral

credit is denied - this hinders a firm's growth or growth potential

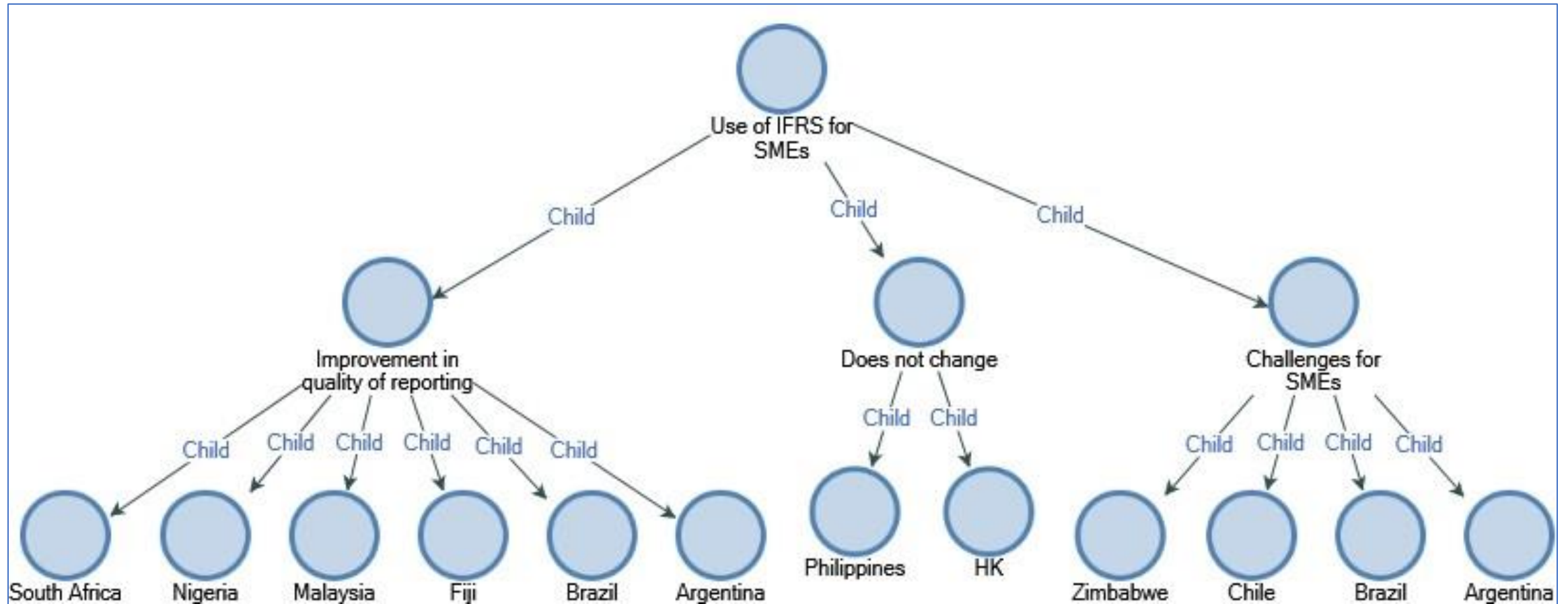
High quality auditing matters (RP6)

- Bankers keep lists of high and low quality auditors in their country

Very often small companies choose low quality auditors – as a result they are deprived from credit

. Bankers do only use financial statement information of small companies in their decision-making if it is audited by a high quality auditor

Figure 2: Influence of the adoption of IFRS for SMEs



Conclusion with respect to “trust”

- **Is IFRS-based financial information more “trusted” than local-GAAP based information (non-IFRS inspired) for private firm reporting?**

Yes it is

- . Univariate statistics provide evidence
- . Multivariate statistics – significance of the IFRS SME country adoption variable
- . Multivariate statistics – significance of the variable creditor legal rights: in countries with weak legal creditor protection – IFRS based financial statement information is more trusted, it substitutes for weak creditor protection
- . **Do country characteristics influence this trust?**
 - . Yes when corruption levels are higher and hyper inflation is present, trust is lower

Conclusion with respect to “use”

- **Is IFRS-based financial information more used than local-GAAP based information (non-IFRS inspired) for credit decisions with respect to private firms?**

The level of use decreases with the size of the company. For small firms financial Statement information is used if it is audited by a high quality auditor

- . **Do country characteristics influence this use?**

IFRS based information is more used in countries with weak creditor legal rights

IFRS based information is more used in countries with higher income levels, so more market driven IFRS adoption

Conclusion with respect to the adoption of IFRS for SME

- **Does country adoption of IFRS for SMEs increase the quality of private firm reporting? Do country characteristics matter**
 - . Yes especially in those countries where the difference between the prior local (non-IFRS Inspired GAAP) is large
 - . Weak formal institutions are an obstacle to the realization of possible benefits of IFRS SME adoption
 - . Appreciation by bankers of the more extended disclosures provided under IFRS for SME In comparison to local (non-IFRS based) GAAP

Conclusion – policy relevant findings

IASB's Standard Setting

- . IFRS for SME, disclosures are appreciated by the bankers
- . Importance of hyperinflation in a country – has an impact on both trust and use of IFRS information (IAS 29 – Financial Reporting in Hyperinflation economies)

“Good Governance Programs” of the World Bank

- . Importance of financial education
- . Importance of high quality auditing
- . Importance of efficient and reliable tax authorities for contributing to the Provision of reliable company information