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The Impact Of International Financial Reporting Standards (IFRS) On Conditional Conservatism In The Financial Statements Of Non-Financial Industry Sectors In The United Arab Emirates

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Abstract

The research objective of this study is to shed light on the impact of adoption the International Financial Reporting Standards (IFRS) on accounting conservatism in the financial statements of all non-financial industry sector companies listed on the stock exchange in the United Arab Emirates during the period from 2010 to 2019. The study investigates the change in the level of conservatism before and after the mandatory adoption of IFRS and its impact on financial statements, in order to identify the results of implementing IFRS. Basu's (1997) scale was used to measure accounting conservatism in the financial statements. The results of the study indicate an impact of implementing IFRS on accounting conservatism, where there was a decrease in the level of accounting conservatism after the adoption of IFRS in the financial statements of non-financial industry sector companies in the United Arab Emirates.

Keywords: IFRS, IASB, UAE, accounting conservatism, conditional accounting conservatism, Basu Model.

1. Introduction

Historically, countries developed their own accounting standards, which were shaped by local institutions and regulations, and integrated into national economies and cultures. These standards were called Generally Accepted Accounting Principles (GAAP) and often differed in their objectives from country to country. Additionally, some countries adopted standards developed by other countries, such as the United Arab Emirates, which adopted US GAAP. For various reasons, such as the globalization of the economy and the growth of international trade, the creation of a unified financial market in Europe (the European Union), and the increasing power and influence of multinational corporations, as well as the collapse of several global companies, there was a need for a common set of financial accounting standards to create a common global language for financial reporting in order to provide suitable financial information that helps current and potential investors in making investment decisions (such as buying, holding, and selling stocks) and current and potential creditors in making credit decisions, which leads to directing economic resources in the right directions, and helps the international community avoid global financial crises.

The International Accounting Standards Board (IASB) seeks to provide a common basis adopted by different entities in measurement and reporting processes. This is manifested through its purpose of developing a high-quality, conceptually sound, globally accepted, and implementable set of financial reporting standards for the public good, based on clearly defined principles.

The history of International Financial Reporting Standards (IFRS) extends over more than 50 years. The International Accounting Standards Committee (IASC), which was established in the 1970s, was responsible for developing International Accounting Standards (IAS), which formulated 41 standards, many of which were amended and canceled by the International Accounting Standards Board (IASB), which was established in 2001 to replace the IASC and has issued 17 standards so far.

Numerous studies have examined the impact of IFRS on accounting conservatism, covering many aspects and using different proxies and measures. Some of these studies have found a decrease in the level of conservatism in financial reports after the adoption of IFRS (Lu & Trabelsi, 2013). Conversely, some studies have shown an increase in earnings smoothing after adoption of IFRS (Capkun & Collins, 2016). On the contrary, a recent study has shown an increase in the level of conservatism in financial reports after the adoption of IFRS (Abdullaha & Marzuki, 2021). The results of applying IFRS standards appear to be inconclusive.

Based on the above, this study aims to investigate the impact of IFRS on conditional conservatism in non-financial industry sector companies in the United Arab Emirates. The selection of the research topic stems from its variables, with the adoption of IFRS being the main variable of interest. The importance of the adopted variable, accounting conservatism, is historically associated with the non-use of conservatism applications as one of the main reasons behind global financial crises, such as the collapse of the US stock market in 1929 and the announcement of financial fraud cases in the early 21st century, such as the collapse of Enron, the fourth-largest US energy company, followed by the collapse of WorldCom, and finally the financial crisis of 2008. All of these were due to the non-application of accounting conservatism policies.

The study includes a main hypothesis that states that the mandatory application of IFRS may affect conditional conservatism in financial reports.

The Basu model (1997) was used to measure conditional conservatism, which relates to the asymmetric timing of earnings between good and bad news.

2. Literature Review

2.1. Research problem

The adoption of International Financial Reporting Standards (IFRS) has led to changes in the recognition, measurement, and presentation of financial statement items. This has provided researchers with an opportunity to investigate the impact of IFRS on financial reporting, with particular attention given to the concept of conservatism. Numerous studies have examined the effect of mandatory adoption of IFRS on accounting conservatism, yielding varying results in terms of the degree of impact on conservatism in financial statements. Some studies have found a decrease in conservatism after the adoption of IFRS (Piot et al., 2011; Ahmed et al., 2013; Andre et al., 2015), while others report no impact (Zhuang & Young, 2014). Recent studies, however, suggest an increase in conservatism levels after the adoption of IFRS (Abdullaha & Marzuki, 2021; Mal-Alain et al., 2021).

The author Wong argues that it is important to investigate whether IFRS, which originated in Anglo-American contexts, can achieve its objectives in the Middle East and North Africa region (Wong, 2018). Similarly, Linnenluecke suggests that a significant number of studies in Asia and the Pacific have shown that "less developed and newer markets with different institutional and regulatory characteristics, different stock market backgrounds, and different investment behaviors offer many opportunities for further research across all markets" (Linnenluecke et al., 2017a). Many authors recommend that future researchers conduct similar analyses in other countries or groups of countries that have adopted IFRS. This may be particularly relevant for emerging markets and other European countries not covered in their studies (Zeghal & Lahmar, 2016).

Based on the above, the researcher believes that the impact of mandatory adoption of IFRS on accounting practices requires further investigation. Similarly, we believe that conservatism as a fundamental concept in accounting requires further study, especially after the adoption of IFRS. The research problem is therefore focused on studying the impact of IFRS on conditional conservatism. The research question can be summarized as follows: How does the adoption of IFRS affect conditional conservatism?

2.2. Importance of the study

The importance of studying accounting can be divided into two aspects: the first is derived from the independent variable (IFRS), while the second is derived from the dependent variable (accounting conservatism). Regarding the importance of IFRS, scholars have shown interest in the decision to adopt or not adopt IFRS, as evidenced by the study conducted by Ramanna and Sletten (2009) on a sample of 102 countries outside the European Union. Some practitioners have criticized the IASB approach, claiming that it introduced a significant amount of risk to the concepts of objectivity and comparability (De George & Shivakumar, 2016). Additionally, some researchers argue that there is a trend among regulators to move away from historical cost accounting, with conservatism being one of its applications, and towards fair value accounting (LaFond & Watts, 2008). This trend is reflected in IFRS 7, which focuses on disclosing the fair value of financial instruments, IFRS 13, which addresses the measurement of fair value, and IAS 38, which applies to intangible assets (paragraph 8). However, fair value estimates lack verifiability, which can lead to additional distortions (Nasev, 2009). On the other hand, Hoogervorst, the Chairman of the International Accounting Standards Board, has defended IFRS, stating that it includes various mechanisms to ensure caution in financial reporting (Hoogervorst, 2012). Andre et al. (2015) agrees with Hoogervorst, claiming that IFRS is conceptually conservative, but inappropriate application of conditional conservatism principles is likely to prevent financial reports from reaching the level of conservatism targeted by the International Accounting Standards Board.

Regarding the importance of accounting conservatism, historically, the failure to use conservative applications has been a significant factor behind global financial crises, such as the collapse of the US stock market in 1929, the disclosure of financial fraud cases in the early 21st century, the collapse of Enron, the fourth-largest US energy company, and later, the collapse of WorldCom, and the 2008 financial crisis, which affected the information environment and resulted in companies using lower levels of conservatism in 2008 and higher levels after the crisis (Lu & Trabelsi, 2016). Research suggests that standard-setters continue to place increasing importance on the concept of conservatism. Conservatism has been a dimension of reliability, which is the fourth qualitative characteristic of accounting information, in the framework of the Financial Accounting Standards Board (FASB). Still, the IASB removed the prudence concept from its conceptual framework in 2010. The second section of the qualitative characteristics of financial information was devoid of prudence, and "faithful representation" was introduced as a fundamental qualitative characteristic of financial information, emphasizing completeness, neutrality, and freedom from error (IASB, 2010). The removal of prudence from the conceptual framework was based on the concept's conflict with neutrality, which includes greater use of fair values under International Financial Reporting Standards, testing for impairment instead of write-off, including the possibility of reversing previous impairment losses on finite-lived assets, and stricter rules on how and when provisions are recognized. However, due to the intense criticism leveled at the IASB, conservatism was reintroduced to the conceptual framework in 2018.

2.3. Objective of the study

The primary research objective of this study is to shed light on the impact of implementing IFRS on accounting conservatism in the financial statements of all non-financial industry sectors registered in the Abu Dhabi and Dubai stock markets from 2010 to 2019. The investigation will focus on the change in the level of conservatism after the mandatory application of international financial reporting standards and their impact on financial statements to determine the outcomes of adopting IFRS.

2.4. Study contribution

The study contributes to expanding the research field on the impact of IFRS on accounting conservatism in non-financial industry sectors. Empirical studies in these sectors are very limited. In addition, the application of IFRS in the Middle East region is a recent phenomenon compared to the adoption of IFRS in Europe in 2005. The UAE was chosen as a case study, as it adopted IFRS in 2015, providing a 10-year period from 2010 to 2019, five years before and after the adoption. Moreover, identifying the outcomes of IFRS adoption in the UAE will serve as a guide for other countries in the region that have not yet adopted or partially adopted IFRS. Therefore, the findings of this study will be beneficial for these countries in making informed decisions regarding the mandatory adoption of IFRS.

2.5. Developing Study Hypotheses

The mandatory adoption of IFRS by a large number of European listed companies in 2005 led to significant accounting changes, as generally accepted accounting principles (GAAP) were replaced by a single set of international financial reporting standards (Andre, 2015). One of the main purposes of adopting IFRS was to enhance financial reporting through a set of "high-quality standards" to maintain business community confidence in financial statements. Some argue that accounting conservatism increases if investors expect the accounting numbers to be less verifiable and turn to other sources of information. In order to maintain user confidence in financial statements as a source of information, companies tend to increase the level of conservatism, thus increasing the credibility of financial statements (Lu & Trabelsi, 2013).

Under the assumption that accounting conservatism is affected by accounting standards, this change from GAAP to IFRS could have a significant impact on accounting conservatism (Fullana et al., 2018). Fullana et al. argue that this fact justifies the importance of empirical studies that analyze the effects of this standardization change for practitioners, academics, and policymakers.

This study will examine whether the mandatory adoption of IFRS has affected the level of accounting conservatism in the financial statements of the United Arab Emirates. Therefore, the research is based on the following main hypothesis:

The mandatory application of International financial reporting standards (IFRS) may affect accounting conservatism.

3. Accounting Conservatism and the Application of IFRS

3.1. Accounting Conservatism

The concept of conservatism is one of the oldest accounting principles that has been studied by the accounting profession since the early 20th century. Initially, research in those days was limited to describing conservatism as a phenomenon. Bliss described it as "the well-known rule, which states that no anticipated profits should be taken into account, while all anticipated losses should be considered" (Bliss, 1924). Sterling considered it one of the most influential determinants in the preparation of financial statements (Sterling, 1970).

Conservatism was also described as a mental state that manifests when the accountant is uncertain about estimating a specific event or item. In such cases, the accountant must choose the methods and procedures that lead to the lowest net profit or net asset value (FASB, 1980). Sanders and his colleagues mentioned the negative use of conservatism, as it was used as a way to hide profits by creating allocations and reserves or reducing inventory at the end of the period to reduce profits for tax evasion purposes (Sanders et al., 1938).

In the 1960s, the definition of conservatism evolved, as Moonitz considered it a reaction to the uncertainty phenomenon. He stated that conservatism represents a gem of cautionary advice, and its distinctive role in accounting is to ensure that cases of uncertainty and risks associated with any activity are given sufficient consideration and importance (Moonitz, 1961). Sterling described conservatism as the fundamental and most important principle that, if conflicting with any other accounting principle, prevails over it (Sterling, 1967).

To explain this, the author presents the cost or market rule, whichever is lower (which is recognized by the majority of accounting professional organizations and is followed by accountants) as an example of the situation in which conservatism prevails over other assumptions and principles. If the market price is used as the basis for valuing inventory, it will conflict with the historical cost principle and the going concern assumption. Adopting market prices means the intention to liquidate, and it also conflicts with the matching principle, as it carries the current year with a decrease in market prices compared to historical costs while increasing the profits of the next year with the same amount.

In the 1990s, Basu provided an explanation for conservatism through its relationship with the capital market. He interpreted the tendency for conservatism as the accountants' inclination to seek a higher verification threshold to recognize good news as profits, which leads to hesitancy in recognizing bad news as losses. Conservatism also plays an effective and excellent role between the contracting parties in the entity. If accounting is not regular, the contracting parties will voluntarily agree that the accounting numbers used to divide cash flows between them should be determined conservatively (Basu, 1997). Conservatism appears to be a tool for organizing contractual relationships.

At the beginning of the new millennium, the author Watts presented justifications or explanations for accounting conservatism. Watts argues that "conservatism is an important feature of financial reporting preparation to ensure effective contracting between shareholders, bondholders, and managers by reducing managerial bias and the risk of opportunistic payments (such as compensation and profits). It also contributes to reducing litigation risks and reducing the present value of taxes, as well as reducing the political costs of corporate organizers who overestimate net assets" (Watts, 2003a). The author further states that "most previous studies focused on contractual motives in debt contracts and management compensation contracts because conservatism appears as an effective contracting tool, requiring more stringent recognition standards for profits than for losses, and this is the first explanation that Watts agrees with Basu above." The second justification or driver for conservatism is legal liability or exposure to litigation, which prompts management to report reserved values for profits and net assets to avoid legal accountability. Because taxable income depends on accounting income, the tax amount becomes a driver for management to adjust accounting income by not recognizing a portion of this income in this period and transferring it to a later period to reduce the present value of the tax, which is the third justification. Fourth, political explanations, where Watts argues "that companies may use accounting conservatism to reduce political costs that may arise as a result of the numbers presented in the financial statements, as the level of political costs that the company may bear may increase based on some accounting numbers. For example, profits can send messages to politicians and regulatory authorities about the company's interest and focus on these companies" (Watts, 2003a).

Ryan & Beaver provided a definition of conservatism from the perspective of public budgeting, which is the continuous decrease in book value compared to market value of equity over successive periods (Ryan & Beaver, 2000).

Hayn & Givoly defined conservatism from the perspective of the income statement as the choice between alternatives and accounting policies resulting in a continuous decrease in net profit from period to period by accelerating the recognition of expenses and deferring the recognition of revenues (Hayn & Givoly, 2000).

The concept of conservatism has been criticized by Ball & Shivakumar "since it gives biased and unfair results when it defers the recognition of current revenues to the future period, while accelerating the recognition of expenses in the future period and recognizing them in the current period" (Ball & Shivakumar, 2005).

It is worth noting that since Basu in 1997, studies have emphasized the importance of conservatism as an important measure of accounting quality within an international framework (Ball et al. 2000, Watts 2003a and b, Ball et al. 2003, Barth et al. 2008, and Ball et al. 2008).

3.1.1. Types of Accounting Conservatism

The theoretical and applied studies that have addressed the concept of conservatism have witnessed various forms of conservatism. These classifications were based on the perspectives of the authors and their areas of interest. The researcher focuses on the classification that has gained acceptance and consensus in accounting research due to its relevance to policies, economic events, and issues. These classifications are conditional conservatism and unconditional conservatism. Both types serve many purposes, including attracting investors, reducing litigation, taxes, and regulatory costs for companies, and enabling accounting and industry regulators to reduce economic instability and avoid crises (Beaver & Ryan, 2005).

Literature related to conditional conservatism focuses more on improving contracting efficiency by considering managers' incentives to report upward-biased accounting. Meanwhile, literature related to unconditional conservatism focuses more on evaluating specific types of economic assets and liabilities and determining their effects on future income.

3.1.1.1. Conditional Conservatism

When the economic value of assets (stocks) increases until that increase is realized, the book values of the assets are reduced, and income is decreased in anticipation of future (unfavorable) events that are not sufficiently appropriate. This form of prudence, based on news, ensures that potential economic losses are reported in earnings in a timely manner, while potential economic gains are deferred. It is called conditional because recognition is conditional on receiving news and timeliness is conditioned by the sign (good, bad) of the news received.

Conditional conservatism is also known for using greater aggressiveness in recognizing bad news compared to recognizing good news, which is considered a key qualitative characteristic of financial reporting (Watts, 2003a; Francis et al., 2004; Ecker et al., 2006; Ball et al., 2008; Dechow et al., 2010; and Kothari et al., 2010).

Some examples of conditional conservatism include:

- Applying the lower of cost or market (LCM) rule.

- Recognizing impairment write-downs for long-term assets and intangible assets, which are done once a year.
- Creating allowances for doubtful accounts.
- Reversing previously recognized gains when they are no longer probable.
- Delaying recognition of potential future gains until they are realized, while recognizing potential future losses.

  This form of conservatism is also known as ex-post conservatism, where conservatism is reflected in the income statement and in recognizing profits. It means not recording expected future profits until they are realized and recognizing expected future losses.

3.1.1.2. Unconditional Conservatism

Unconditional conservatism is an accounting practice that proactively records expenses before the company's value decreases due to expected economic losses. It is also known as ex-ante conservatism or independent conservatism from news. Unconditional conservatism can be defined as systematic understatement of the book value of net assets relative to their economic value, regardless of any news. (Pope & Walker, 2003; Beaver & Ryan, 2005). This type of conservatism does not rely on market news or future events, but rather results from the choice of accounting methods and policies used to measure and record assets at book values that are lower than their market values over their assumed life, leading to unrecorded (internal) reputation. Therefore, unconditional conservatism is a major source of unrecorded reputation, which also represents the present value of expected economic profits. Fullana et al. argue that unconditional conservatism leads to a gap between market value and book value (Fullana et al., 2018). Examples of **unconditional conservatism include:**

1. Treating research and development expenses as expenses incurred on the income statement as soon as they occur.
2. Using the accelerated depreciation method for long-lived assets.
3. Recording assets at historical cost.
4. Choosing the completed-contract method to recognize revenue from construction contracts.
5. Charging most of the costs related to internally developed intangible assets to expense.

Ball and Shivakumar criticize the tendency of unconditional conservatism, "because bias in unconditional conservatism to an unknown extent will lead to randomness in decisions and reduce contracting efficiency, whereas conditional conservatism (recognizing losses in a timely manner) can improve contracting efficiency" (Ball and Shivakumar, 2005). There is general acceptance among standard-setters that unconditional conservatism, as an intentional reduction in asset and profit values, is a form of "bad" prudence (Efrag et al., 2013), while conditional conservatism has been recognized as a characteristic of financial reporting standards at national or supranational levels by standard-setters in Europe (Efrag et al., 2013). Ball and Shivakumar see unconditional conservatism as preceding conditional conservatism, and they conclude that the two types of conservatism, despite their conceptual differences, are interrelated in practice.

3.2. Reviewing

The adoption of International Financial Reporting Standards (IFRS) has provided researchers from various parts of the world with an unprecedented opportunity to study the consequences of applying accounting standards and how these results differ across institutional and legal systems. Accounting research in general has concluded that the introduction of IFRS was widely beneficial (Ball, et al. 2015; Brüggemann, et al. 2013). However, some argue that IFRS allows for discretion, as some elements of receivables include an element of estimation that is largely within management's discretion, making receivables managed and decided by managers a playground for earnings management (Mangala & Singla, 2021; Sanders, et al. 1938). The exercise of discretion by managers may reduce the value of the information provided, due to managers' misuse of the opportunities available in the accounting system to manage their earnings (Toumeh & Yahya, 2017 & Al-Tamimi, S. A., & Al Anssari, M. A. 2022). IFRS introduced fair value accounting as another accounting measurement system, but it has been subjected to numerous criticisms as it undermines the concept of objectivity, which is one of the components of historical cost accounting and which is a manifestation of accounting conservatism.

Piot and colleagues investigated the effects of IFRS adoption in the European Union on accounting conservatism, which is a characteristic of earnings quality and contracting efficiency, and the way in which the Big Four auditing firms adjust for these effects. The study used a large database comprising more than 5,000 entities adopting IFRS from 22 EU countries, observed during the period 2001-2008. The main results are as follows: 1) conditional conservatism, which is the lack of symmetry in timing between bad news and good news, decreased under IFRS for entities that adopted it mandatorily; 2) the size of the IFRS effect was positively related to the distance between the pre-existing generally accepted accounting principles and the international financial reporting standards; 3) the Big Four auditors exhibit more aggressive earnings conservatism under IFRS, with an increase (decrease) in the timing of good (bad) news; 4) unconditional conservatism is higher under IFRS in the presence of the Big Four auditing firms; and 5) mandatory IFRS adoption provides a weak contribution to the comparability of accounting earnings if observed from a timing perspective. Taken together, these findings indicate that mandatory IFRS adoption in the EU has hampered accounting quality (Piot, et al. 2011 & Tamim, S. A., Mahmood, F. A., & Anssari, M. A. A. 2023).

The study conducted by Lu & Trabelsi (2013) indicates that there are both positive and negative effects on different stakeholders in the accounting system when adopting International Financial Reporting Standards (IFRS). It is important for practitioners and regulators in accounting, auditing, investment, and finance to understand these effects and deal with them appropriately.

The research suggests that the level of accounting conservatism decreases after the adoption of mandatory IFRS standards, which may indicate an improvement in financial disclosure quality and transparency. However, caution should be exercised as this decrease may increase the likelihood of earnings manipulation in some cases. Additionally, the study suggests that accounting conservatism is related to the information environment and is useful in providing relatively reliable information.

The study introduced the impact of audit firms on accounting conservatism, as the Big Four auditing firms have market-based incentives to enhance accounting conservatism, either to reduce their exposure to litigation risk and/or to maintain their reputation as higher quality auditors (Basu, 2005). Therefore, they may use the flexibility of IFRS-based accounting to accept or impose increasing levels of unconditional conservatism. As for investors, they argue that published accounting profits have become more aggressive (i.e., more conservative) under IFRS, with less sensitivity to negative stock market performance and, in some contexts, more sensitivity to positive stock market performance. Other lenders and creditors may find that higher aggressiveness in profits has positive effects on timely commitment initiation.

Lu & Trabelsi's (2013) research on changes in accounting conservatism after the mandatory adoption of IFRS resulted in three main findings: first, the level of accounting conservatism decreases after mandatory adoption of IFRS; second, the adoption weakens the relationship between information asymmetry and accounting conservatism; and third, the change in accounting conservatism under IFRS is related to changes in the information environment. The result shows that accounting conservatism is related to the information environment, supporting the idea that conservative accounting is useful in providing relatively reliable information.

The study explained the first finding of the decrease in accounting conservatism after mandatory adoption of IFRS based on the perspectives of parties closely related to reported accounting numbers (management) and investors and bondholders. Accounting conservatism will decrease if investors expect higher quality financial reporting preparation after mandatory adoption of IFRS, more financial report transparency, and less information asymmetry. Accounting conservatism will increase if investors expect accounting numbers to be less verifiable and rely more on other sources of information. Therefore, when informed investors know the flexibility provided by standards that allowed fair value accounting as a basis for measurement in financial statements represented by changes in reputation, research and development expenses, and asset revaluation, these accounting numbers are less reliable due to the recognition of more unverifiable gains. In addition, more opportunistic earnings management is expected to be carried out by management.

The creditors (bondholders) are expected to perceive the accounting numbers as less reliable after the mandatory adoption of International Financial Reporting Standards (IFRS), as long as fair value options are available. Therefore, company management may choose measurement accounting that gives them more leeway in profit management. As a result, creditors may impose more stringent requirements in credit contracts, such as higher net asset requirements, to compensate for the loss of accounting credibility and higher interest rates. Here, the positions of the parties concerned regarding the accounting numbers presented in the financial statements have changed due to the flexibility provided by the standards, and therefore, the requirements for conservatism have changed. Thus, the non-conformity of information between management and creditors increases, leading to another specific case of conservatism.

This study shows that the inconsistency of information is positively related to accounting conservatism and is consistent with LaFond & Watts (2008). The adoption of IFRS may weaken this relationship. People may turn to other sources of information after the adoption of international standards for financial reporting, which is claimed to be a principle-based accounting standard. This may be because IFRS reduces the level of conservatism in accounting, thereby reducing accounting credibility, threatening the role of accounting as a source of information. Therefore, it is better to maintain accounting conservatism to some extent rather than blindly reduce it (Basu & Waymire, 2006; Watts, 2003a; Ball, 2010).

Regarding how changes in accounting conservatism under IFRS are related to changes in the information environment, the empirical results of this study show that the level of accounting conservatism decreases after mandatory adoption of IFRS, reaching its lowest level before the 2008 financial crisis. It then increased sharply in the same year after the financial crisis. This supports the idea that enhancing conservatism in accounting is an effective mechanism for increasing information credibility. Therefore, conservative accounting is useful for the information environment, providing reliable information. Conservative accounting can benefit the information environment (company financial statements) and investors by providing reliable information on current company performance. By applying high earnings verification standards and low loss verification standards to reduce managers' tendency to exaggerate unverifiable gains and reduce losses, gains and losses displayed in financial data become credible. Therefore, conservative accounting can facilitate information flow and lead to a better information environment.

Researchers (Andre et al., 2015) studied the impact of mandatory adoption of International Financial Reporting Standards (IFRS) in Europe in 2005 on conditional conservatism. To measure conditional conservatism, a modified version of the Khan and Watts (2009) scale was used, which is derived from the Basu (1997) scale also known as the C-Score. This scale includes controls for the effects of unconditional conservatism and the cost of capital after adopting IFRS. In addition, the Brown et al. (2014) index was used to measure audit quality and accounting enforcement strength. The level of conditional conservatism was examined for a sample of European companies that adopted IFRS in 2005, both pre- and post-adoption, consisting of 13,711 financial report notes from 16 countries (Austria, Belgium, Denmark, Germany, Finland, France, UK, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, and Switzerland) from 2000 to 2010.

The study evaluated the role of impairment testing in the change in conditional conservatism in Europe, as impairment tests are a key mechanism for ensuring conditional conservatism under international financial reporting standards. Therefore, companies were divided into two groups: those that apply impairment tests and those that do not. The analysis focused not only on any decrease in the value of tangible assets but also on the separate decrease in the values of intangible assets and goodwill, as the standards require regular impairment testing of goodwill and other indefinite-lived intangible assets. The research showed that impairment testing of goodwill represents the largest portion of manipulated intangible assets (Roychowdhury and Martin, 2013).

The results of the study showed that conditional conservatism tendency decreased after adopting IFRS in Europe throughout the study period. Therefore, the decrease in conditional conservatism after adopting international financial reporting standards is related to recognizing and avoiding impairment. Thus, companies in the first group that recognize impairment show a slight decrease in the level of conditional conservatism compared to companies in the second group that do not recognize impairment, hence showing a greater decrease in conditional conservatism. It can also be said that companies that do not record impairment when evidence indicates a potential need to do so (i.e., have low-value assets) experience a more pronounced decrease in conditional conservatism.

In addition, using the audit and enforcement index (Brown et al., 2014), the results showed that the decrease in conditional conservatism was less pronounced for countries with high-quality audit environments and strong enforcement of accounting compliance. (Zeghal and Lahmar, 2016) conducted their study on a sample of 15 European countries observed from 2000 to 2010. The purpose was to analyze the mandatory impact of IFRS adoption on both conditional and unconditional conservatism, which were measured by identifying bad news in a timely manner compared to recognizing good news and estimates.

The results of the study confirmed a significant reduction in accounting conservatism during the period of IFRS adoption in Europe. Moreover, the decrease in the level of conservatism is more significant for countries with local standards that differ significantly from IFRS. However, there was no significant reduction in the level of unconditional conservatism for continental and Anglo-American models. Furthermore, we were able to observe a decrease in the conditional conservatism gap between countries operating under the continental model and those operating under the Anglo-American model. This important observation allows us to conclude that the International Accounting Standards Board achieves its goal by coordinating international accounting practices. However, the gap was not significantly reduced for unconditional conservatism, which can be explained by other factors affecting accounting practices in the European Union.

The results of this study were consistent with (Piot et al., 2011) and (Andre et al., 2015), but differed from previous studies in several important aspects. Firstly, a longer period was used, especially after adopting IFRS (five years), which is likely to allow for better analysis of the results of these standards. Secondly, previous studies that compared different contexts were not able to distinguish between the effects of adopting IFRS and the effects of other specific events. As a remedy for the differences in the results, thirdly, two different measures of conservatism were considered to control for biases and take the forms of conservatism into account. One of the important recommendations of this study is that future researchers can conduct similar analyses in other country contexts or groups of countries that adopt IFRS. This may be particularly relevant for emerging countries and other European countries not covered by this study.

The authors Krishnan and Zhang (2022) provided a response to proponents of regulatory push towards International Financial Reporting Standards (IFRS) in the United States and elsewhere. The authors addressed those who believe that principle-based standards are more beneficial to capital market participants compared to rules-based standards (GAAP).

The aim of the study was to inform the Financial Accounting Standards Board (FASB), the Securities and Exchange Commission (SEC), and others by providing empirical evidence on the relationship between IFRS and conditional conservatism, which is the accounting conservatism based on bad news being timely recognized and losses being recognized while gains are postponed. The authors began their article by stating that they do not know how IFRS affects accounting conservatism for US companies. Therefore, their study used three measures previously used in research: the C-SCORE by Khan and Watts (2009), the asymmetric timing measure by Basu (1997), and the measure developed by Ball and Shivakumar (2005, 2006, 2008).

The study empirically examined the relationship between conditional conservatism and the adoption of IFRS for US companies using a measure of a firm's reliance on principle-based versus rules-based standards. The results showed that conditional conservatism is lower for firms that rely more on IFRS, and this relationship is more pronounced for firms with greater earnings management incentives. This means that IFRS reporting standards are less conservative and more earnings-managed, as they allow managers to exercise professional judgment in obtaining the desired company performance. This was confirmed by the SEC (2003) on the importance of effective implementation to ensure that managers do not abuse the flexibility of principle-based standards. Similarly, auditors and audit committee members need to exercise caution in restricting managers' tendency to abuse principle-based standards.
However, the inverse relationship between conditional conservatism and the adoption of IFRS is mitigated when there are concerns related to contracting or litigation because regulators try to use conservatism to protect themselves. Additional analysis shows that reliance on IFRS also reduces unconditional conservatism in accounting (systematic reduction of book values of net assets).

The authors argue that their evidence informs the Financial Accounting Standards Board (FASB), the Securities and Exchange Commission (SEC), and others that the adoption of International Financial Reporting Standards (IFRS) comes at a potential cost to bondholders due to decreased accounting conservatism. This has implications for regulators, auditors, analysts, investors, and others.
The researchers manually collected data from financial reports of non-financial sector companies listed on the Argaam website. Stock prices were also collected from the Mubasher website for Abu Dhabi and Dubai stock markets in the United Arab Emirates (UAE).

- **The UAE was selected for several reasons:**

1. Abu Dhabi and Dubai stock markets are emerging markets, and there is a scarcity of studies that have examined the effects of adopting IFRS on the quality of accounting numbers, particularly accounting conservatism.
2. The UAE economy is a fast-growing emerging economy, with a market capitalization of 1.84 trillion AED in the UAE stock market.
3. The UAE is one of the major oil-exporting countries and is a member of OPEC.

4. The UAE reflects different cultural and institutional environments, providing a unique setting for studying the effect of IFRS adoption on the quality of financial reporting and conservatism.
5. The recent adoption of IFRS in the UAE also provides an opportunity to study the economic consequences of IFRS application, given neighboring countries' plans to converge with the IFRS, such as the Arab Republic of Egypt.

   The researcher followed the Basu (1997) model to measure the level of conditional conservatism, as many rigorous studies rely on this model, such as Piot et al. (2011), Andre et al. (2015), and Krishnan and Zhang (2022).

To apply this model, we present the following equation:

EPS= β_0 + $\beta 1DR_{it}$ + $\beta 2R_{it}$ + $\beta 3DR_{it}$*Rit + ε_{it} --------0)

Table 1 Definitions of the equation's variables

Variable	**Definition**
EPS	Earnings per share
Return	Annual stock return of company i in year t, measured three months after the end of the fiscal year
β0	The regression model constant represents the profits that are recognized within the revenues of the current period and that were treated in a previous period (or periods) as unrealized gains, and since these gains are not associated with the news of the current period, it is expected that the value of this coefficient positive value (Basu, 1997)
β1	Bad news response coefficient
B2	Profits regression coefficient on market returns, which measures the degree to which Earing respond to good news (Basu 1997).
β3	Difference in response between good and bad news, measuring the level of conservatism in financial reporting. A positive and high value indicates high conservatism, while a value of zero means the financial reports are not conservative
D	Dummy variable that takes the value 1 if the return is negative (indicating that the company reports losses) and high conservatism, and 0 if the return is positive and low conservatism
ε_{it}	Error term in the regression model for company i at the end of period t

• (First Model) The impact of adopting IFRS on conditional conservatism:
EPS= β0 + β1DRit + β2Rit + β3DRit*Rit + β4 IFRS + β5 IFRS*D + β6 IFRSit*Rit + B7 IFRSit*D*Rit + εit ----- 1)

Where:

IFRS is the key variable representing the adoption of International Financial Reporting Standards.

Essentially, Basu regresses earnings per share (EPS/P) on stock returns(R) separately for "good news" and "bad news" years to observe the company's conservatism during the year. A company's year is considered a "good news" year if its market return is positive or zero, i.e., R_{it} >0. Conversely, a company's year is considered a "bad news" year if its stock return is negative, i.e., R_{it} <0. The estimated slope measures the timing of recognizing news embedded in earnings with the sign of stock return. The stock price at the beginning of the year was adopted at the end of the third month of the following year, as the 12-month return ends three months after the close of the fiscal year. (Badia et al., 2027; Brockman & Ye, 2015).

Technically, the Basu regression model uses a dummy variable, DR, to distinguish between "good news" and "bad news" and thus allows for different regression coefficients and intercepts between these two groups. Under "good news" ($R_{it} \geq 0$), DR is equal to 0 and the timing coefficient is β0. Under "bad news" (R_{it} <0), DR is equal to 1 and the bad timing coefficient is β0 + β1. Clearly, 1 is the asymmetric timing coefficient, which is the primary indicator of accounting conservatism in the Basu model. The larger 1 is, the higher the degree of conservatism.

4. Applied Study

4.1. Introduction

The applied study aims to test the study's main hypothesis, which is to analyze the relationship between the adoption of International Financial Reporting Standards (IFRS) on the one hand, and the level of conditional accounting conservatism on the other hand, and to find practical evidence whether the adoption of (IFRS) standards in the United Arab Emirates it affects the level of conditioned accounting conservatism on the financial statements of industrial companies in the post- adoption period compared to the pre- adoption period.

4.2. Population and Study Sample

The study population is represented in the industrial (non-financial) companies registered on the stock exchange in the UAE, by application over the period from 2010 to 2019. The applied study relied on historical data published in the company's annual financial reports.

The researcher relied on the following to include the company in the study sample:

1. The company should have annual financial reports during the study period.
2. That each of the companies in the study sample have uninterrupted trading activity during the period.

3. That the financial year of the company end in December of each year for the purposes of standardization and consistency of measurement.

4.2. Sources of Obtaining Data

The study data was obtained through the financial reports of the study sample companies, which were accessed through the Mubasher UAE website, as well as through the website of those companies. In addition, the closing prices and the number of shares were reached through the annual reports issued by the Emirates Securities and Commodities Authority. The researcher used the Excel program as a basis for data collection and summarization in order to reach the final study variables before entering them into the Statistical Package for the Social Sciences (SPSS) V.22.

4.3. Study Variables

The independent variable in this study is the international financial reporting standards (IFRS), while the conditional accounting conservatism represents the dependent variable, in addition to the control variables. The following is an explanation of these variables:

4.3.1. The independent variable (IFRS)

This variable was measured by adding a dummy variable, which expresses the application or non-application of IFRS during the study period, as it will take the value zero before the application of IFRS (the period from 2010 to the year 2014), and the value one after the application of IFRS (the period from 2015 to 2019).

4.3.2. The dependent variable (Conditional accounting conservatism)

The study used Basu's model to measure conditional conservatism, which relates to the asymmetric timing in earnings between bad and good news. Basu (1997) attributed the existence of the conditional reservation as a result of recognizing the expected economic losses in the current period, while the expected economic gains are recognized in later periods. If the accounting system is conservative, profits pick up on bad news (negative stock returns) relatively faster than good news (positive stock returns).

4.3.3. The controlling variables

The following are the most important controlling variables in this study:
Firm's profitability (ROE): It was measured by the return on assets (ROA), which is the result of dividing the net profit after taxes by the total assets.

Financial Leverage (LEV): It expresses the degree of dependence of the company on debts in its financing structure. The financial leverage was calculated by dividing the total liabilities (debts) into the total assets.

Cash flows Operating (CFO): It is called the working capital ratio and is used to evaluate the company's short-term liquidity in terms of its available assets and deferred debts. It is the result of dividing net cash flows from operating activities by total assets.

Asset turnover ratio (Assets): It is a ratio that measures total sales over average assets. They are used as an indicator of a company's efficiency in generating sales from assets.

Firm's size (Size): The size of the company is considered one of the important variables affecting the level of accounting conservatism. Larger firms are likely to come under greater political pressure than smaller firms. It was measured in the natural logarithm of total assets at the end of each financial period.

4.3.4. Descriptive Statistics

The following table shows a statistical statement of the number of companies in the study sample:

Table 2 Study sample and data collection

Study sample calculation (number of observations)	
Firms from the United Arab Emirates	88
Less: Firms with unavailable data	6
Less: Non –2014 IFRS adopters	1
Total firms included in the sample	81
(×) Firms years observations for 2010 to 2019	10
Less: observations with negative equity or negative total assets	32
Final total number of firms- year observations	778

Source: Prepared by the researcher

Table No. (3) presents the descriptive statistics of the study variables before and after adopting the IFRS standards:

Table 3 Results of the descriptive statistics of the study variables before and after applying (IFRS)

Variables	Before IFRS					After IFRS					F	Sig
	Mean	St.Div	Max	Min	Range	Mean	St.Div	Max	Min	Range		
• Dependent Variable: Conditional Accounting Conservatism												
Return	0.083	0.462	2.787	- 0.900	3.687	0.039	0.384	5.20	- 0.508	5.708	4.433	0.044
• Independent variables: IFRS standards												
IFRS	0.00	0.00	0.00	0.00	0.00	1.00	0.00	1.00	1.00	0.00	*	*
B1 D	0.19	0.392	1.00	0.00	1.00	0.20	0.399	1.00	0.00	1.00	0.088	0.767
B2 R	0.57	0.495	1.00	0.00	1.00	0.60	0.491	1.00	0.00	1.00	0.667	0.414
B3 DR	0.12	0.323	1.00	0.00	1.00	0.03	0.340	1.00	0.00	1.00	0.437	0.509
• Control Variables												
ROE	0.011	0.064	0.212	- 0.65	0.862	0.015	0.161	1.268	- 2.66	3.928	0.250	0.617
Lev	0.850	0.497	3.971	0.218	4.189	0.431	0.451	7.968	0.451	7.517	4.151	0.042
CFO	0.031	0.093	1.184	- 0.670	1.854	0.055	0.288	5.055	- 0.350	5.405	2.826	0.093
Assets	0.213	0.267	2.173	- 0.073	2.246	0.351	0.485	3.452	- 0.120	3.572	3.970	0.047
Size	6.986	3.130	9.754	5.217	4.537	7.219	1.601	9.750	5.898	3.852	50.775	0.000

* There is no data that can be inferred

Source: Prepared by the researcher based on the outputs of SPS

Basu conservatively interpreted the difference in the sensitivity of contemporary earnings with respect to economic gains and losses implied by positive and negative changes in stock value, and interpreted the regression coefficients (B1, B2, B3) respectively as the response coefficient to contemporary bad news (i.e., negative market returns). and the coefficient of earnings response to contemporary good news (i.e., positive market returns). And the last, B3, is the response difference between good and bad news, which measures the level of reservation. In this context, conservative accounting indicates that a coefficient value of 3B is expected to be positive and high to be very conservative and vice versa (Basu, 1997).
It is clear from Table No. (3) that there are statistically significant differences at a significant level (5%) in the return on share ratio before and after the adoption of the IFRS standards, respectively (0.044, 0.037), and that the value of the B3 coefficient appeared (0.12, 0.03) before and after the application of (IFRS) respectively. Very low values indicate a low level of conditional conservatism. This means that UAE companies provide unconservative financial reports. The UAE started mandatory application (IFRS) in 2015, we notice a slight decrease in the value of the B3 coefficient from 0.12 before adoption (years from 2010 to 2014) to 0.03 after adoption (years from 2015 to 2019) for UAE non-industrial sector companies. The reason for this is because the UAE had allowed companies to Voluntary adoption before 2015 (IFRS), and on this basis there was no fundamental change in companies' procedures in the period after the mandatory application (IFRS) from what it was in the period before the mandatory adoption. The results showed a slight decrease in the period after adoption from 2015 to 2019.

4.3.5. Study Model

The researcher followed the (Basu) 1997 model to measure the level of conditional conservation. In order to implement this model, we provide the following form:

Table 4 Variables of models of conditional accounting Conservatism

Return	Annual stock return of company i in year t, measured three months after the end of the fiscal year
β_0	The regression model constant represents the profits that are recognized within the revenues of the current period and that were treated in a previous period (or periods) as unrealized gains, and since these gains are not associated with the news of the current period, it is expected that the value of this coefficient positive value (Basu, 1997)

B1	Bad news response coefficient
B2	Profits regression coefficient on market returns, which measures the degree to which Earing respond to good news (Basu 1997).
B_3	It is the difference in the response between good and bad news, which measures the level of conservation in financial reports. The higher the value, the higher the conservation, and if the value is zero, the financial reports are not conservative.
D	A dummy variable takes the value 1 if the return is negative (indicating that the company is reporting losses) and means high conservation, and takes the value 0, but if the return is positive, this means low conservation.
Leverage	Financial Leverage: It was calculated by the ratio of total liabilities to total assets
ROA	Firm's profitability: It is measured by the rate of return on assets
Sales Groth	The ratio of sales to total assets
CFO	The ratio of cash flows from operating activities to total assets
TA	Firm size: Natural logarithm of total assets)
E_{it}	Residual: (the random error) in the regression model for firm i at the period t.

Source: Prepared by the researcher

The researcher explains in the following the model to measure the effect of adopting IFRS standards on conditional accounting conservatism:

$$EPS = \beta_0 + \beta_1 R + \beta_2 D + \beta_3 R*D + \beta_4 IFRS + \beta_5 R* IFRS + \beta_6 D*IFRS_{it} + B_7 R*D_{it} *IFRS_{it} + \varepsilon_{it}$$

As:

IFRS: A dummy variable that takes the value zero in the years before IFRS adoption (from 2010 to 2014), and the value 1 in the years after IFRS adoption (from 2015 to 2019).

4.3.5. Testing the main hypothesis of the study

The study hypothesis was tested to measure the impact of the mandatory application of International Financial Reporting Standards (IFRS) on conditional accounting conservation in UAE industrial companies, using multiple regression analysis. The following table shows the results of this test:

Table 5 Results of multiple regression analysis.

Variables	B	Beta	T	Sig	VIF
Constant	0.473		5.318	0.000	
R	- 0.632	- 0.705	- 16.604	0.000	2.259
D	- 0.012	- 0.011	- 0.138	0.867	4.996
DR	- 0.078	- 0.061	- 1.103	0.270	3.841

IFRS	**- 0.173**	**- 0.197**	**- 4.315**	**0.000**	**2.600**
IFRS*R	**Excluded Variables**				
IFRS*D	**- 0.001**	**- 0.001**	**- 0.014**	**0.989**	**2.413**
IFRS*DR	**0.226**	**0.235**	**4.385**	**0.000**	**3.583**
Lev	**0.011**	**0.082**	**0.865**	**0.387**	**11.127**
ROA	**0.274**	**0.078**	**2.330**	**0.020**	**1.421**
Assets	**- 0.048**	**- 0.040**	**- 1.208**	**0.227**	**12.262**
CFO	**0.004**	**0.002**	**0.049**	**0.961**	**1.804**
Size	**- 0.007**	**- 0.017**	**- 0.588**	**0.557**	**1.040**
R = 0.630		**R Square = 0.396**		**Adjustad R Square = 0.388**	
F = 45.116		**Sig = 0.000**		**Durbin- Watson = 2.115**	

Dependent variable: Earnings Per Share

Source: Prepared by the researcher based on the outputs of SPSS

The results shown in Table (5) indicate that the coefficient of determination R^2 of the model has reached (0.396), which indicates that the variables of the IFRS standards explain (39.60%) of the changes in the conditional accounting conservation, and the rest of the percentage (60.40%) is due to random error In the model, or not including other independent variables that could have been included within the model. The table also shows that the model was significant, as the value of F was (45.116) at a significant level of (0.00), which is less than the acceptable level of significance of (5%), and this means that the adoption of (IFRS) affects the conditional accounting conservation.

The table also shows that the relationship between international financial reporting standards (IFRS) and conditional accounting conservation is a reversible relation, as the regression coefficient reached (-0.173), and this indicated the negative impact of IFRS on conditional conservation, meaning that the adoption of IFRS has led to a decreasing in the level of conditional accounting conservation.

The regression equation for the effect of the independent variables (IFRS) on the dependent variable (conditional accounting conservation) can be clarified as follows:

EPS = 0.473 - 0.632 R - 0.012 D – 0.078 DR - 0.173 IFRS - 0.001 IFRS*D + 0.226 IFRS*DR + 0.011 Lev + 0.274 ROA – 0.048 Assets + 0.004 CFO – 0.007 Size

4.3.6. Conclusion of the Applied Study

This applied study aimed to empirically investigate the impact of adopting International Financial Reporting Standards (IFRS) on the level of conditional accounting conservatism in UAE industrial companies. The results show that there is a significant negative association between IFRS adoption and conditional conservatism, indicating that IFRS adoption leads to lower levels of conditional conservatism in financial reporting. IFRS standards provide more flexibility and allow companies to recognize gains and losses in a more symmetrical manner, reducing the asymmetric timeliness in earnings that is characteristic of conditional conservatism.

The results have practical implications for companies, investors and regulators in the UAE. The decrease in conditional conservatism after IFRS adoption suggests that financial reports may become less prudent and subjected to more management judgement. This could pose challenges for investors in interpreting and comparing financial statements across companies. Regulators may need to monitor the impact of IFRS adoption on financial reporting quality and consider measures to maintain an appropriate level of prudence and transparency in companies' disclosures.

In conclusion, while IFRS aims to improve financial reporting through greater transparency and comparability, the decrease in conditional conservatism observed in this study points to the need for regulatory oversight to ensure continued high standards of conservatism and accountability in financial reporting practices in the UAE. Future research expanding the sample size and period could provide further evidence on the long-term effects of IFRS adoption on financial reporting quality in the UAE.

5. Conclusion

In general, conservatism is the tendency that accountants choose when facing uncertainty in economic transactions, to report lower estimates for asset and revenue values, but higher estimates for liability and expense values. Conservatism in accounting ensures that expenses estimates in accounts are not overstated and revenues estimates are not overstated. The conservatism bias seems to be closely related to the concept of perception, where conservatism indicates that profit should not be recognized before it is realized. Strling suggests that conservatism may actually be the origin of the principle of perception (Strling, 1967).

This topic discusses the concept of conservatism from the beginning of the last century until today. The researcher believes that the concept of conservatism has gone through several stages. The first stage represented the beginnings, which can be called the "descriptive stage." It included a description of conservatism and its applications from the perspectives of early thinkers, writers, researchers, and regulatory bodies. In addition, these definitions, which do not distinguish between types of conservatism, do not help specialists measure it, which may lead to conflicting conclusions. Therefore, the second stage came, which progressed towards the accounting measurement function that Basu began in 1997 when he introduced a model for measuring conservatism. Basu derived his model from his understanding of what conservatism represents. Basu benefited from the first stage, which was generally characterized by describing conservatism as requiring the recognition of future expenses and losses quickly, which Basu called bad news. Whereas revenues and profits are not recognized until they are realized, which Basu described as good news that requires high levels of verification. Basu's model focused on the relationship between profits and stock returns to measure the degree of conservatism in financial statements. In 2000, Beaver & Ryan introduced an unconditional measure of conservatism, the market-to-book ratio. Thus, we can summarize the second stage, in which accounting conservatism is generally regarded as an asymmetric degree of verification required to recognize good news as gains compared to the degree of verification required to recognize bad news as losses.

In the third stage, the measurement area expanded, which can be called the "standards stage," which became active at the beginning of the new millennium with the implementation of IFRS. This opened up an area for researchers to delve into this field to this day. Studies have emphasized the importance of conservatism as an important measure of accounting quality within an international framework (Ball et al. 2000, Watts 2003 a and b, Ball et al. 2003, Barth et al. 2008, and Ball et al. 2008).

The fourth stage coincided or overlapped with the ongoing third stage, where the justifications for conservatism were revealed by the writer Watts in two articles referred to as the Penman articles in 2003. This was followed by the emergence of types of conservatism (conditional conservatism and unconditional conservatism) presented by both Beaver & Ryan in 2005.

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