

The Impact of Implementing IFRS 15 on Earnings Quality-Evidence from Palestinian-Listed Corporations

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Abstract

The study examines the effect of adopting IFRS 15 (Revenue from Contracts with Customers) on the earnings quality of the Palestine Exchange (PEX) listed firms. Data for the study was collected using the financial statements of fifteen companies covering eight years (2014-2021). The study employs the Modified Jones Model—discretionary accruals to measure the earnings quality. The multiple regression results suggest that adopting IFRS 15 leads to lower earnings quality due to a significant positive relationship between implementing IFRS 15 and discretionary accruals. This study contributes to the literature on earnings quality. It is considered the first to investigate the impact of IFRS 15 on earnings quality using an analytical approach, particularly in Palestine and generally in developing countries.

Keywords

IFRS 15 (Revenue from Contracts with Customers), Discretionary Accrual, Jones Model, Palestine, Earnings Quality

1. Introduction

Revenue is one of the primary key performance evaluation indicators, and proper revenue recognition is essential because it is directly related to the integrity of a company's financial reporting (Kabir & Su, 2022). The main purpose of revenue recognition guidelines is to standardize the revenue guidelines that companies apply; this standardization allows external parties, such as equity investors, lenders, and other creditors, to easily compare the income statements of different companies in the same industry (O'Brien, 2022). The diversity and complexity of customer contracts continuously increase due to various services, products, and their

nature (Lam, 2017). This problem raises the need to establish a new principal-based revenue recognition standard. This standard provides a comprehensive revenue recognition model for all customer contracts to improve comparability across industries, jurisdictions, and capital markets (Ernst and Young Global Limited, 2019).

The quality of accounting information is manifested in the usefulness of financial reporting and its ability to assist users in making decisions about resource allocation (Perotti & Wagenhofer, 2014). High-quality earnings contain a relevant and faithful representation of earnings-related information. However, many managers use the available discretion to intentionally manipulate the nature, timing, and amount of revenue recognized; these activities negatively affect the quality of accounting information (Johnson, 2018). As a result, accounting standards setters such as the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) develop standards to enhance the quality of accounting information by reducing earnings manipulation activities (Chen et al., 2010).

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have developed two uniform standards for measuring, recognizing, and disclosing revenues. IASB issued IFRS 15, and FASB issued ASC 606—Revenue from Contracts with Customers. The primary purpose of these standards is to meet business needs and improve the quality of financial reports and the transparency of information (Ferreira, 2020). The new revenue recognition standard replaces a set of fragmented standards with one standard applicable to different sectors (Huefner, 2016).

Palestine is one of the countries that has made IFRS a legal reference for Palestinian companies in preparing and disclosing annual financial reports and statements since 2004 (Abu-Sharbeh, 2017). Then, in 2006, IFRS gained official approval from the Palestinian National Authority (PNA) to fulfill the stipulation to join the World Trade Organization (WTO). Since 2007, the Palestine Exchange (PEX) has obligated all publicly registered listed companies to prepare annual financial reports and statements compliant with IFRS (Darabee & Karapinar, 2019). Regarding IFRS15 in Palestine, Some Palestinian companies have adopted IFRS 15 since 01/01/2018, especially those audited by one of the Big Four. Many institutions have explained and given some tips and guidelines for applying the standard; for example, the Palestine Monetary Authority held a training course on International Financial Reporting Standards and gave great attention to explaining IFRS 15 (Palestine Monetary Authority, 2019).

IFRS 15 may significantly impact earnings quality as the number of revenues and contract costs and the timing of their recognition may differ significantly from the current practice, considering that this standard requires some additional disclosures (Mattei & Paoloni, 2018). Therefore, the study aims to investigate the impact of implementing IFRS 15 on the earnings quality among Palestinian-listed companies. It limits these companies' accounting problems and enhances reliability in recognized revenues, positively affecting the Palestinian economy.

The structure of this paper is as follows. Section 2 reviews the related literature. Section 3 presents the research methodology. Section 4 provides the empirical results. Finally, Section 5 shows the conclusion and implication of this study.

2. Literature Review and Hypothesis Development

2.1. The Development of IFRS 15

IFRS 15 directs entities to the basic principles they must follow when reporting revenues and to recognize revenues when promised goods or services are transferred to customers for a consideration representing what they expect to receive in exchange for those goods or services (Lam, 2017). IASB and FASB issued this standard in a joint deliberation; this cooperation between these standards setters aims to omit any misleading or inconsistencies related to revenue recognition in literature, establish a restricted framework when addressing revenue recognition issues, diminish revenue recognition requirements' complexity, and enhance revenue recognition comparability of revenue recognition practices across industries, entities, and jurisdictions, which will, in turn, provide financial users with useful information to make decisions (Ernst and Young Global Limited, 2019).

IFRS 15 has replaced many fragmented standards: IAS 11 (Accounting for Construction Contracts (1979); Construction Contracts (1993); IAS 18 (Revenue Recognition (1982); Revenue (1993); IFRIC 13, IFRIC 15 (Customer Loyalty Programs); IFRIC 18 (Transfers of Assets from Customers) and SIC 31 (Revenue—Barter Transactions Involving Advertising Services). However, developing this standard started in 2001 when the IASB adopted both IAS 11—Construction Contracts and IAS 18—Revenue and SIC 31 Revenue—Barter Transactions, involving Advertising Services, which determines the circumstances of how advertising services' revenues can be reliably measured. Then, in June 2002, a revenue project was added to the IASB's agenda to be discussed and issued. In December 2008, both IASB and FASB published a "Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers" to receive any comments not after June 19, 2010, as then on June 24, 2010, ED/2010/6 Revenue from Contracts with Customers was published to discuss and develop the requirements (IFRS Foundation, 2022). The first effective date was in January 2017, but it was postponed until January 2018. In 2015, the boards decided to postpone the mandatory effective date of the standard to January 1, 2018. In 2016, IASB published new clarifications related to IFRS 15 to clarify how to apply principles and provide transitional relief. Finally, January 2018 was the effective date, and all companies and institutions were obligated to apply this standard (Ernst and Young Global Limited, 2019; IFRS Foundation, 2024).

2.2. Earnings Quality Concept

The earnings quality term is difficult to define, considering it has no specific evaluation criteria (Lyimo, 2014). This concept has multiple measurements that could be used to assess the quality of earnings (Francis et al., 2004).

Earnings management is generally defined as the planned timing of revenue,

gains, expenses, and losses to smooth out fluctuations in earnings. Managers use earnings management to maximize their utility and benefits and enhance the corporate market value (Farichah, 2017). Healy & Wahlen (1999), Shuli (2011), Scott & Mary Ann (2015), and Dechow & Skinner (2000) have examined the definition of earnings management. Healy & Wahlen (1999) noticed that earnings management happens when managers change financial statements to achieve misleading purposes. Shuli (2011) agreed with Healy & Wahlen (1999), stating that the earnings management concept can be defined as intentionally manipulating a company's earnings to achieve some targets. Scott & Mary Ann (2015) combined opportunistic earnings management and Efficient Earnings Management to define earnings management. On the other hand, Dechow & Skinner (2000) didn't accept all definitions that relate to the managers' intent, which can't be noticed and is unrelated to accounting figures and numbers. Therefore, they agreed with this definition of earnings management which is the intentional misrepresentation of financial information in financial statements by omitting or misstating amounts or disclosures to deceive investors.

2.2.1. Earnings Quality Measures

The most common indicators that measure earnings quality are value relevance, accrual quality, persistence, predictability, smoothness, and earning surprise. Kargin (2013) defines value relevance as the ability of the accounting information disclosed in the financial statements to capture the firm value. Barth et al. (2008) state that accounting information is value-relevant when predicted and has a significant relationship with the stock price. Accrual Quality is the difference between cash from operating and recorded earnings from business, which indicates accrual quality (Richardson et al., 2001; Desai et al., 2004). Moreover, Errors in estimating the accrual have also been used to measure the accrual quality (Francis et al., 2004; Zhou, 2008; Johnston, 2009). The large value obtained from each method implies poor earnings quality, and a small value obtained from each method indicates high-quality earnings (Lyimo, 2014). Earnings persistence is defined as the continuity and durability of the current earnings (Moienadin & Tabatabaenasab, 2014). More persistent earnings are more sustainable and high quality; likewise, less persistent earnings are more transitory and considered lower quality. Penman & Zhang (1999) and Schiemann & Guenther (2013) stated that earnings predictability deals with how well past earnings can explain current earnings. Dempster & Oliver (2019) employed earnings restatements as a proxy for the quality of earnings in a multi-factor return model.

The goal of income smoothing is to reduce the fluctuations in earnings from one period to another to portray a company as having steady earnings. It's intended to smooth out periods of high income vs. periods of low income or periods with high expenses vs. periods of low expenses (Tucker & Zarowin, 2006). Earning surprise is one of the earnings smoothing measures; it can be calculated by dividing the value of net operating assets at the beginning and scaling them by total sales (Barton & Simko, 2002; Abdelghany, 2005).

2.2.2. IFRS Effect on the Quality of Accounting Information

Several prior studies confirmed that adopting IFRS adds value to the quality of accounting information and reduces earnings management activities. [Barth et al. \(2008\)](#) stated that adopting IFRS has decreased earnings smoothing (earnings management), as IFRS imposes specific guidelines and procedures to follow when recognizing accounting information to prevent opportunistic managerial behavior; this, in turn, has improved earnings quality. [Chen et al., 2010](#)) agreed with [Barth et al. \(2008\)](#), realizing that adopting IFRS decreases earnings management via accruals or income smoothing. [Da Silva et al. \(2019\)](#) suggest adopting IFRS to improve accounting information and produce high-quality earnings. [Ismail et al. \(2013\)](#) found that earnings reported in the post-IFRS period had lower earnings management and higher value relevance. [El Idrissi Rioui et al. \(2021\)](#) concluded that implementing IFRS led to fewer earnings management and higher earnings quality. On the other hand, other prior researches indicate that IFRS does not affect earnings quality, as declared by ([den Besten et al., 2015](#); [Fuad et al., 2019](#)).

2.3. The Impact of IFRS 15 on the Quality of Accounting Information

In European and developed countries, [Morawska \(2021\)](#) aimed to investigate if implementing IFRS 15 in Poland has affected earnings management using discretion in revenue recognition to avoid losses and earnings decreases. The study confirmed that adopting IFRS 15 decreases the magnitude of earnings management practices aimed at avoiding losses and earnings decreases, which use discretion in accrued revenue recognition. On the other hand, [Bernouilly & Sensi Wondabio \(2019\)](#) concluded that implementing IFRS 15 affects the revenue recognition and financial reporting preparation processes. [Tutino et al. \(2019\)](#) examined the effect of IFRS 15 on earnings quality using the Jones Model (1995). They used data from Italian-listed companies in two main sectors: Telecommunications (due to the high degree of earnings management variation) and Utilities (due to the restricted regulations regarding accounting data). The results showed that IFRS 15 negatively affected the earnings management practices, which enhanced earnings quality due to the careful analysis and monitoring of revenues. [Belsom & Berhe \(2021\)](#) evaluated the effect of IFRS 15 on value relevance for 1830 listed firms in ten countries in the EU. After adopting the standard, they concluded that the relationship between accounting values and share prices is much stronger for European listed companies.

In Arab countries, most studies have used descriptive statistics to examine the effect of implementing the standard (IFRS 15) on Earnings quality. [Altaie \(2019\)](#) seeks to answer the main question, “Does the adoption of IFRS 15 in the Iraqi environment enhance the quality of accounting profits?” and found no significant impact on the effect of IFRS 15 on the quality of net profits. Other studies focused on adopting IFRS 15 from the viewpoint of external auditors, such as [Altaji & Alokdeh \(2019\)](#), by investigating the effect of IFRS 15 on the quality of accounting information, but in terms of relevance and faithful representation of the financial

reporting. They found that IFRS 15 affects the quality of accounting information and the relevance and faithful representation of accounting information included in the reports. On the other hand, [Khersiat \(2021\)](#) used case studies to investigate the effect of IFRS 15 on earnings quality in telecommunications companies. They concluded that there is a statistically significant effect of IFRS 15 as measured by the services' revenue, sales revenue, and contract assets on total revenues and owner equity.

Based on the above arguments, the following hypotheses have been developed:

H₁: There is a statistically significant impact of implementing IFRS 15 on earnings quality.

3. Data and Empirical Methodology

3.1. Sample Selection

This study focuses on Palestinian-listed companies that have adopted IFRS 15. This study uses secondary data represented in financial reports extracted from the companies' official websites and the Palestine Exchange (PEX) website. We divide the data before IFRS 15 (2014-2017) and after IFRS 15 (2018-2021). The original population consisted of 48 companies. The sample contains fifteen companies from three sectors (Service, Investment, and Manufacturing). The sample selection depended on three criteria: first, these companies have adopted IFRS 15; second, the availability of published financial statements for 2014-2021; third, exclusion of the firms from insurance, banking, and financial institution sectors due to their different accounting treatments. As indicated in [Table 1](#), the total number of final samples was 120 firm-year observations.

Table 1. Sample distribution.

Number of firms listed in PEX	48
Less: Firms from the Banking and Financial Institutions sector	(8)
Less: Firms from the Insurance Sector	(8)
Less: Firms have incomplete financial statements and data for the period 2014-2021	(17)
Number of sample firms	15
Number of years in this study	8
Number of observations	120

The number of sample firms is arranged in [Table 2](#).

Table 2. Sample distribution by the sector.

#	Industry Name	Number of firms
1.	Service	3
2.	Investment	7
3.	Manufacturing	5

3.2. Research Models and Data Analysis Methods

3.2.1. Determining the Dependent Variable (Discretionary Accruals)

Discretionary accruals are the dependent variable of our main regression model. This variable is determined using the Modified Jones Model (1995). This model is still the best approach to detecting earnings management compared to all other methods in educational circles (Chen et al., 2010). Referring to Almaharmeh & Masa'deh (2018), discretionary accruals can be determined by applying the following three steps:

Step One: Estimating the following regression equation.

$$\frac{TA_{it}}{LTA_{it}} = a_1 \frac{1}{LTA_{it}} + a_2 \frac{\Delta REV_{it}}{LTA_{it}} + a_3 \frac{PPE_{it}}{LTA_{it}} + \varepsilon_{it} \quad (1)$$

In the above model, TA_{it} are total assets for firm i in year t , LTA_{it} is Lagged total assets for firm i in year t , ΔREV_{it} is the change in Sales Revenues (Revenues in year t -Revenues in year $t-1$) for firm i in year t , PPE_{it} is the gross property, plant, and equipment for firm i in year t , a_1, a_2, a_3, a_4 are the Coefficients that must be estimated to calculate the NDACC using the ordinary least squares (OLS), ε_{it} is the residuals or Error term for firm i in year t .

Step Two: Calculating the Discretionary Accruals ($DACC_{it}$)

The Discretionary or Abnormal Accruals ($DACC_{it}$) is the difference between the Total Accruals ($TACC_{it}$) and the Nondiscretionary Accruals ($NDACC_{it}$) as shown below:

$$DACC_{it} = \frac{TACC_{it}}{LTA_{it}} - NDACC_{it} \quad (2)$$

where $DACC_{it}$ are Discretionary accruals for firm i in year t , $TACC_{it}$ is the total Accruals for firm i in year t , LTA_{it} is the lagged total assets for firm i in year t , $NDACC_{it}$ is the nondiscretionary accruals for firm i in year t .

Step Three: Calculating the nondiscretionary accruals using the following equation:

$$NDACC_{it} = a_1 \frac{1}{LTA_{it}} + a_2 \frac{\Delta REV_{it} - \Delta REC_{it}}{LTA_{it}} + a_3 \frac{PPE_{it}}{LTA_{it}} \quad (3)$$

where $NDACC_{it}$ is the nondiscretionary accruals for firm i in year t . LTA_{it} is the lagged total assets for firm i in year t , ΔREV_{it} is The change in Sales Revenues (Revenues in year t -Revenues in year $t-1$) for firm i in year t , ΔREC_{it} is the change in Account Receivable (Account Receivable in year t -Account Receivable in year $t-1$) for firm i in year t , PPE_{it} is The gross property, plant, and equipment for firm i in year t and a_1, a_2, a_3, a_4 are Alphas, coefficients, or parameters.

3.2.2. The Study Model

Based on all previous equations and clarifications, we can end up with the following models to be tested in this study to examine the effect of implementing IFRS 15 on earnings quality as follows:

$$|DACC_{it}| = a_0 + a_1 IFRS15_{it} + a_2 SIZE_{it} + a_3 LEV_{it} + \varepsilon_{it} \quad (4)$$

Model (4) includes one dependent variable: the absolute value of discretionary accruals, $|DACC_t|$ and the main independent (dummy) variables IFRS15. The control variables are the company size (SIZE) and Leverage (LEV). These variables are defined as follows: $|DACC_{it}|$ is an absolute value of discretionary accruals in year t . IFRS 15 is a dummy variable that takes the value 0 for a period before adopting IFRS 15 and 1 for the period after adopting IFRS 15. According to Model (4), a significant negative coefficient on IFRS15 indicates that companies have lower absolute discretionary accruals in the IFRS15 implementation period than in the pre-implementation period. Companies have less attitude toward earnings management after implementing IFRS15, which indicates a higher quality of earnings in the implementation period.

4. Empirical Results

4.1. Descriptive Statistics

The collected data were deeply analyzed for the period before (PRE) and after (POST) the adoption of IFRS 15, as summarized in **Table 3**. The results indicate that the means of the Discretionary accrual increased from 0.0442 to 0.0697. Regarding the control variables, company size increased from 17.7759 to 17.9852, while Leverage rose from 0.3206 to 0.3543. The increase in the mean value of the discretionary accrual indicates the increase in earnings management activities after implementing IFRS 15.1.

4.2. The Correlation Analysis

Table 4 exhibits the correlation between the study variables; the results indicated a significant positive correlation between Disc Accrual and IFRS 15 and Leverage. On the other hand, there is a weak and negative relationship between Disc Accrual and Size, but this relationship is not statistically significant. However, Leverage was positively correlated with Disc. Accrual.

Table 3. Descriptive statistics.

Variables		Mean	Median	Variance	Std. Deviation	Min.	Max.
Disc Accrual	PRE	0.0442	0.0331	0.002	0.03981	0.000	0.17
	POST	0.0697	0.0561	0.004	0.06198	0.000	0.31
Size	PRE	17.7759	17.7855	2.921	1.70921	14.95	20.74
	POST	17.9852	18.0960	2.456	1.56730	15.39	20.59
LEV	PRE	0.3206	0.2984	0.049	0.22248	0.02	0.80
	POST	0.3543	0.4007	0.039	0.19805	0.01	0.68

4.3. Regression Results

This section presents the multiple regression analysis results that are necessary to

test the constructed hypothesis.

The Effect of IFRS 15 on the Earnings Quality

Table 5 presents the multiple regression results for Model (4); this model aims to investigate the effect of applying IFRS 15 on the quality of earnings. The primary interest in this analysis is the IFRS 15 coefficient. Results demonstrate a significant and positive relationship (at a 1% significant level) between applying IFRS 15 and discretionary accruals (Disc. Accruals), which implies that the extent of management of earnings at the time of IFRS 15 adoption is more compared to the extent of management of earnings in the period before the IFRS 15 adoption. Regarding control variables, the company's Size (SIZE) has a negative relationship with discretionary accruals (Disc. Accruals); this indicates that larger firms have less discretionary accruals (Disc. Accruals) and less attitude toward earnings management.

Table 4. Pearson correlation.

	Disc. Accrual	IFRS15	Size	LEV
Disc. Accrual	1	0.239** (0.008)	-0.105 (0.255)	0.161 (0.078)
IFRS15		1	0.064 (0.486)	0.081 (0.382)
Size			1	0.427** (0.000)
LEV				1

Note ***significant for a two-tailed test at 0.01 level; ** significant for a two-tailed test at 0.05 level; * significant for a two-tailed test at 0.10 level. The numbers in parentheses are significant values or p-values.

Table 5. Regression results.

Model (4)			
Variables	Coefficients	t	Sig
Constant	0.153	2.858	0.005***
IFRS15	0.025	2.677	0.008***
SIZE	-0.007	-2.288	0.024**
LEV	0.060	2.451	0.016
	F-Value	5.146 (Sig. 0.002**)	
	Adjusted R ²	0.095	

Note: *** significant for two-tailed test at 0.01 level; ** significant for two-tailed test at 0.05 level; * significant for a two-tailed test at 0.10 level.

On the other hand, Leverage (LEV) has a positive relation with (Disc. Accruals); this indicates that firms with greater Leverage would have greater discretionary accruals and more extent of earnings management. As a result, we can reject the developed hypothesis; applying IFRS 15 increases earnings management activities and leads to lower earnings quality.

4.4. Discussion of Findings

The main findings of this study demonstrate that with the implementation of IFRS 15, the revenue recognition from the contract with customers increases the discretionary accruals as an indicator of increasing earnings management, which leads to lower earnings quality. This result is consistent with (Napier & Stadler 2020; de Souza et al., 2022; Onie et al., 2022), who found that applying IFRS 15 increases earnings management. Napier & Stadler (2020), based on the review of corporate annual reports, comment letters, and interviews, shows that the IFRS 15 has had little impact on the recognition and measurement of revenue. Onie et al. (2022) confirm that there is little evidence that the IFRS 15 improved the relevance of earnings. De Souza et al. (2022) used Dechow and Dichev's (2002) accrual quality model; they also found a similar result of a reduction in the quality of earnings after adopting IFRS15. On the other hand, the study's results contrast with those of (Altaji & Alokdeh, 2019; Bernouilly & Sensi Wondabio, 2019; van Wyk & Coetsee, 2020; Morawska, 2021), who found that adopting IFRS 15 enhances the quality of accounting information.

Moreover, they show that the five-stage revenue recognition process creates an appropriate framework for recognizing the revenue of construction contracts. In addition, they show that adopting IFRS 15 would affect the revenue recognition and financial reporting preparation processes as well as the internal control environment, information, and technology system. Other studies, such as Altaie (2019), showed no significant relationship between adopting IFRS 15 and the quality of accounting profits in the Iraqi environment.

5. Conclusion

The main purpose of this study is to examine the effect of adopting the International Financial Reporting Standard 15—Revenues from Contracts with Customers—on the earnings quality of Palestinian-listed corporations from 2014 to 2021. This research used regression models based on Discretionary Accruals. The main findings indicate that implementing IFRS15 increases discretionary accruals as an indicator of increasing earnings management, leading to lower earnings quality.

This study contributes to the literature on earnings quality. It is considered the first to investigate the impact of IFRS 15 on earnings quality using an analytical approach, particularly in Palestine and generally in developing countries. This study was motivated by the less prior evidence and investigation in Arab and Middle Eastern countries of the effect of IFRS 15 on earnings quality using an analytical approach. In addition, this study is very specific and concentrates on one standard, IFRS 15, while most of the previous research used to study the effect of IFRS in general. Moreover, this study fills the research gap on this topic; it would be the starting point for future studies to examine the effect and find new and unique results that could make financial users (investors, auditors, and others) aware of the standard's role.

Despite its significance, the study has limitations that open avenues for further

research opportunities. These include a relatively small sample size, limited data availability, and the unique political and economic circumstances of Palestine, where the companies operate. Thus, future research can be done by expanding the sample size to include more than one country.

Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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