

Accounting choice in measurement and comparability: An examination of the effect of the fair value option¹

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ABSTRACT: The choice between historical cost and fair value measurement is one of the most debated issues among accounting academics and practitioners. In this paper, we use the adoption of the fair value option (FVO) to study the effects of measurement choice on accounting quality, captured by comparability. FVO enables entities to use different measurement basis for similar assets/liabilities, raising concerns as to whether it makes similar things look less alike. Using a sample of banks, we find that the adoption of the FVO increases comparability within adopters. We also provide evidence that the FVO adoption increases comparability between adopters and banks that never adopt the FVO, if the use of the FVO complies with the intent of the standard setters to remedy accounting mismatches. Overall, our results suggest that the introduction of measurement choice not only does not harm comparability between entities, but rather increases it.

Keywords: fair value option; comparability; financial instruments; banks.

Data availability: All data are available from public sources.

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I. INTRODUCTION

The role of accounting choice has motivated accounting research over the last several decades. It has been argued that the best practices develop through experimentation, and therefore, accounting choice is essential to the development of accounting standards (Porter 1996; Kothari, Ramanna and Skinner 2010). However, we still have limited empirical evidence of the effects of accounting choice. This is largely driven by the fact that in practice, accounting choice is limited by regulators, because of concerns regarding comparability, consistency and potential for manipulation (Kothari et al. 2010). In this paper, we use the adoption of the fair value option (FVO) as a quasi-experiment to study the effect of accounting choice between fair value and historical cost on comparability of accounting amounts (hereafter also referred to as comparability).

The FVO allows entities to elect fair value measurement for most financial assets and liabilities and certain other items on an instrument-by-instrument basis. It was introduced by both the US and International accounting setters in order to allow accounting to represent the underlying economic relationships between related assets and liabilities and to reduce the volatility arising from the current mixed-attribute accounting model. The possibility of having different accounting treatments for the same asset/liability stirred important debate as to whether the adoption of the FVO compromises the fundamental and enhancing qualitative characteristics of accounting numbers. The American Accounting Association criticized the FVO as yielding noncomparable accounting numbers and two FASB board members dissented from the issuance of the SFAS 159 “The fair value option for financial assets and financial liabilities” mainly because of its expected negative impact on consistency and comparability of financial statements. (AAA 2007; FASB 2007).

Comparability is one of the desired enhancing qualitative characteristics of accounting numbers. Accounting numbers are considered comparable if, when two entities face similar

(different) economic outcomes, the entities report similar (different) accounting amounts (FASB 2010; IASB 2018). A number of papers examine the incentives for the FVO adoption and its effect on the volatility of earnings and information asymmetry (Chang, Liu and Ryan 2021; Fiechter 2011; Guthrie, Irving and Sokolowsky 2011). However, to the best of our knowledge, this is the first study that examines directly whether the adoption of the FVO results in accounting numbers that are less or more comparable to those prior to the adoption.

The effect of the FVO adoption on comparability is not clear a priori. When the option is used in compliance with the intent of the standard setters to remedy accounting mismatches (for brevity, hereafter we refer to such use as “in compliance”), comparability is expected to increase, by enabling entities to better reflect economically-related assets and liabilities in their accounts. For example, an asset (or liability) normally measured at historical cost, used to economically hedge assets/liabilities measured at fair value, can be measured at fair value under the FVO. In this way, changes in the fair value of both sides of the economic hedge can be reflected in earnings in the same period, thus likely reducing accounting mismatches. This is particularly relevant for entities that implement asset-liability management, such as banks.

However, even when the FVO is used in compliance, comparability might decrease. As opposed to hedge accounting (HA) that requires a highly effective hedging relationship and allows HA treatment only for the proportion of the instrument that hedges a particular risk (e.g. the credit risk component or the interest rate component), the FVO requires fair valuing the entire instrument without effectiveness assessment. Fair valuing the whole instrument means that earnings reflect all changes in the instrument rather than only changes resulting from the specific component that is hedged. This can magnify the problem arising from the mixed-attribute accounting model, thus reducing comparability.

Finally, the inherent flexibility in an option-based standard can offer an opportunity for entities to manage earnings. An instrument-by-instrument option allows entities to

opportunistically choose to fair value only selected instruments within the scope of the FVO, thus leaving space for earnings volatility management. Moreover, an entity may choose not to adopt the FVO, even if this will better reflect its economic performance, because of the lack of expertise to implement it or concerns about its effect on earnings. Finally, users can exploit the transition guidance, that requires entities to record the effect of the first adoption in retained earnings. For example, an entity can adopt the FVO for instruments with cumulative unrealized losses and therefore increase future net income by relieving it from these losses. According to the study of Chang et al. (2021) the transition guidance was mainly explored by early adopters of the FVO (entities that adopted in 2007). In all these cases, the economic performance of the entity is obscured, leading to a reduction in accounting comparability.

We investigate the effect of the FVO adoption on comparability using a sample of US bank holding companies. Banks, as the main users of financial instruments, have been at the forefront of the debate over the effects of the FVO. We focus on a single country and industry in order to alleviate concerns that the results are driven by the quality of implementation and enforcement of accounting standards or industry differences (Ball, Kothari and Robin 2000; Daske, Hail, Leuz and Verdi 2008; DeFond, Hu, Hung and Li 2011).

Using data from 2007-2019, we find that 35% of the bank holding companies (238 banks out of the 673) adopted the FVO during this period. Out of the 238, less than 10% (21) are early adopters (i.e., adopted the FVO in 2007). 2009 is the year with the highest number of first-time adopters (50 unique banks). Of the 5,496 bank-quarters in which FVO was elected between 2007 and 2019, 4,574 bank-quarters use the FVO only for assets and 922 bank-quarters use it for liabilities only or for both assets and liabilities. The effect of the FVO election on earnings is quite significant for bank holding companies. For the average bank and in absolute terms, FVO gains/losses represent 9.5% of the net income, with this percentage being

higher for large banks (18.8%) and banks that have high accounting mismatches pre-FVO adoption (11.1%).

We capture accounting comparability following the methodology developed by De Franco, Kothari and Verdi (2011). In line with previous comparability studies, we match banks on operational properties (in our sample of bank holding companies we use the business model and size) (e.g. Barth, Landsman, Lang and Williams 2012; Yip and Young 2012). The adoption of the FVO is expected to influence comparability within adopters and between adopters and non-adopters. Our results show that after banks adopt the FVO (adopting banks) their accounting amounts become more comparable to the ones of banks that previously adopted the FVO (adopted banks). The increase in comparability is more pronounced for the pairs of banks that have high accounting mismatches pre-FVO adoption. This is in line with banks, that have significant economic hedges not reflected in their accounts pre-FVO adoption, benefiting more from the election.

Further, the positive effect of the FVO adoption on comparability between adopting and adopted banks is more pronounced when the adopting banks elect the FVO for liabilities. This is in line with the literature showing that banks reflect better their asset-liability management in their financial statements when fair valuing also their liabilities (Fontes, Panaretou and Peasnell 2018). Comparability is lower when the adopting banks are Level 3 reporters (i.e., measure instruments under the FVO at fair value level 3). This can be driven by the fact that level 3 fair values are based on unobservable inputs, and therefore, likely to deviate between different banks. Finally, we document an increase in comparability when the adopting banks use HA pre-FVO adoption, suggesting that FVO is used to complement, rather than to substitute HA.

When we look at comparability between adopting and non-adopter banks, our results suggest that comparability increases if the decision to elect or not the FVO complies with the

intent of the standard setters to remedy accounting mismatches. This is the case when the adopting banks have high incentives to use the FVO in compliance and the non-adopter banks have no such incentives. We also document that comparability decreases after the FVO introduction in 2007 (post-2007) within non-adopters, alleviating concerns that the increased comparability we document within adopters and between adopters and non-adopters is a result of a positive time trend in comparability. The fact that the FVO adoption takes place in different quarters, also contributes to alleviate concerns that the increased comparability is driven by factors other than the FVO adoption.

Our results contribute to the debate about the role of choice within the accounting standards, indicating that the introduction of measurement choice not only does not harm comparability between entities, but rather increases it (Chang et al. 2021; Christensen and Nikolaev 2013; Guthrie et al. 2011). Our paper also contributes to the debate over fair value accounting by complementing the studies that document benefits of fair value measurement, such as reduced information asymmetry and increased risk relevance (Muller, Riedl and Sellhorn 2011; Blankespoor, Linsmeier, Petroni and Shakespeare 2013; Fontes et al. 2018). Moreover, our study adds to the literature looking at the effect of changes in accounting standards on comparability (Barth et al. 2012; Yip and Young 2012).

Although our setting of US bank holding companies offers several advantages, there are caveats that should be considered when interpreting the results of this study. First, our findings may not generalize to industries/countries with more limited use of the FVO. Second, our comparability metric can be influenced by other accounting and economic factors, which may not be fully addressed by the matching and difference-in-difference procedures.

The remainder of the paper proceeds as follows. Section II presents a review of related academic research, the institutional background and the hypothesis development. Section III

outlines the research design and section IV describes the sample and provides descriptive statistics. Section V presents empirical results and section VI summarizes the findings and contains concluding remarks.

II. RELATED LITERATURE, INSTITUTIONAL BACKGROUND AND HYPOTHESIS DEVELOPMENT

Related Literature

Two streams of empirical work are relevant to our study. The first stream studies the choice between historical cost and fair value accounting. As the measurement basis is largely determined by regulators, we have limited empirical evidence in this area. IFRS provide a free choice between fair value and historical cost accounting for PPE, investment property and intangibles, requiring ex ante commitment to one of the two measurement methods.² Using this setting, Christensen and Nikolaev (2013) and Cairns, Massoudi, Taplin and Tarca (2011) find very limited use of fair value measurement. Their results indicate that historical cost accounting is considered by managers more appropriate for illiquid non-financial assets.

More closely to our study, a number of papers investigate the determinants of the FVO adoption for financial assets and liabilities, and its effects on the volatility of earnings and information asymmetry. Chang et al. (2021) investigate the determinants of FVO election using a sample of banks. The study finds that early adopters with histories of managing accounting numbers are more likely to elect opportunistically the FVO, while regular adopters elect the FVO in compliance with the standard's intent to reduce accounting mismatches. In line with these results, Guthrie et al. (2011) find that earnings management resulting from opportunistic adoption of the FVO is negligible. Fiechter (2011) examines whether the reduction in accounting mismatch resulting from the FVO adoption is translated into lower earnings

² This choice is not available under US generally accepted accounting principles (GAAP).

volatility. Using a sample of European banks, the study finds that FVO adopters have lower volatility of earnings. In contrast to these findings, Song (2008) finds that banks adopt the FVO primarily for opportunistic reasons. The study finds no evidence of a reduction in volatility of earnings or a change in the hedging activities post-FVO adoption. These results can be driven by the fact that the sample is limited to the 2007-2008 period.

If an entity elects the FVO for liabilities, changes in the fair value of liabilities that arises from changes in own credit risk (OCR) must be separately recognized and disclosed in the financial statements. A number of studies investigates the effects of OCR gains and losses recognition on information asymmetry. For a sample of European IFRS banks, Schneider and Tran (2015) provide evidence that recognizers of OCR gains and losses exhibit lower bid-ask spread. Fontes et al. (2018) find that fair value measurement of assets is associated with noticeably lower information asymmetry and that this reduction is larger when banks also recognize OCR gains and losses. This finding is consistent with OCR gains and losses providing investors with important information on how gains and losses are shared between equity and debtholders (Merton 1974). Lin, Panaretou, Pawlina and Shakespeare (2021) find that OCR gains and losses can explain future changes in credit risk when the fair value of liabilities is based on managerial inputs (Level 3 reporter), suggesting that OCR gains and losses provide inside information to the market.

The second stream of empirical work investigates how changes in accounting standards, both mandatory and discretionary, affect comparability of accounting numbers. Studies investigating IFRS mandatory adoption generally find an improvement in comparability in the period after the IFRS adoption (DeFond, Hu, Hung and Li 2011; Barth et al. 2012; Yip and Young 2012). Yip and Young (2012) cites accounting convergence and higher quality of information as the drivers of comparability improvement. Studies focusing on discretionary application of changes in accounting standards looked at IFRS voluntary adoption (Barth,

Landsman, Lang and Williams 2018), and the effect of lease accounting (Campbell and Yeung 2017). Barth et al. (2018) find that after firms voluntarily adopt IFRS, their accounting amounts are more comparable to those of firms that adopted IFRS earlier and less comparable to those of firms that did not adopt IFRS (i.e., kept the domestic standards).

Most of this literature uses the definition of comparability underlying FASB and IASB's conceptual frameworks: two entities have comparable accounting if they report similar (different) accounting amounts when they experience similar (different) economic events (FASB, IASB). While comparability is one of the desired enhancing characteristics of financial reporting, the empirical construct of comparability is largely unspecified by standard setters. De Franco et al. (2011) developed a comparability measure that has been extensively used in the literature (Yip and Young 2012; Kim, Li, Lu and Yu 2016; Neel 2017, Choi, Choi, Myers and Ziebart 2019). The study regresses earnings on stock returns for pairs of firms, firm *i* and firm *j*, over prior 16 quarters and use the two sets of fitted coefficients to predict firm *i*'s earnings using firm *j*'s returns. Comparability is given by minus the sum of the absolute values of the difference of the two predicted earnings over estimated period. Barth et al. (2012) employ a similar approach to develop a comparability measure using more extensive regressions of earnings on stock returns, cash flows, and prices.

Institutional background

Under US GAAP, the option to measure certain assets and liabilities at fair value is provided in three standards: SFAS 159 "The fair value option for financial assets and financial liabilities"; SFAS 155 "Accounting for certain hybrid financial instruments", and SFAS 156 "Accounting for servicing of financial assets". SFAS 159 gives entities the option to measure most financial instruments at fair value. This option is applied on an instrument-by-instrument

basis, with changes in fair values reported in earnings.³ SFAS 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. SFAS 155 provides the entities the option to measure any hybrid financial instrument containing embedded derivatives at fair value with changes reported in earnings. The standard is effective for fiscal years beginning after September 15, 2006 with early adoption permitted. SFAS 156 requires entities to recognise servicing assets and liabilities at fair value if practicable and provides the option for subsequent measurement of those instruments at fair value, with changes reported in earnings. The standard is also effective for fiscal years beginning after September 15, 2006 with early adoption permitted. The FVO provided by the three standards is irrevocable. Given that we are interested in the effects of the optional fair value measurement, we consider the use of the FVO under all three standards⁴.

The election of the FVO has no immediate effect at inception, given that the financial instruments are initially accounted for at fair value, which is generally similar to historical cost. However, in contrast to historical cost accounting, fair value accounting requires re-estimating fair values at each reporting date and recognizing changes in net income. This means that in subsequent measurement, the FVO allows two entities to account differently for the same instrument if one elects the FVO and the other does not.

Hypothesis development

The adoption of the FVO by an entity can take place at any time between its introduction (2007) and the end of our sample period (2019). We investigate the effect of the FVO adoption

³ The portion of change in the fair value of liabilities that results from changes in entity's own credit risk is recognised in other comprehensive income for fiscal years beginning after December 15, 2017. We do not expect this to affect our results as the FVO is mainly adopted for assets. Even when FVO is adopted for liabilities, only a small number of adopters report own credit risk gains and losses (Lin et al. 2021).

⁴ Our main results are robust if we exclude from our analyses the pairs of banks for which FVO adoption is based on servicing assets (SFAS 156). As the instruments for which the FVO was adopted under SFAS 155 are reported together with the instruments for which the FVO was adopted under SFAS 159, we cannot provide a separate analysis for these two standards.

by looking at comparability pre- and post-FVO adoption between banks that first adopt the FVO (adopting banks) and those banks that adopted the FVO earlier (adopted banks) and between adopting banks and those banks that did not adopt the FVO during our sample period (non-adopter banks), as illustrated in Figure 1.

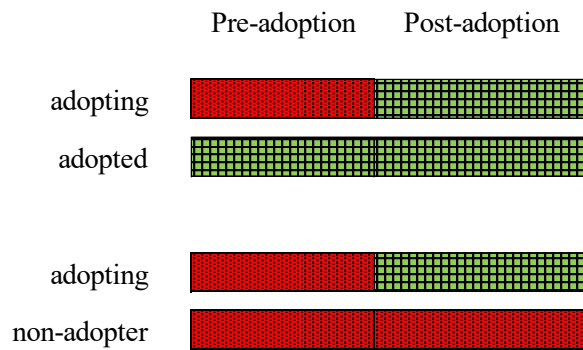


Figure 1: Samples used in the analysis. The red area indicates the period in which the bank is not an adopter of the FVO. The green area indicates the period in which the bank is a FVO-adopter.

Within adopters

Our first hypothesis examines the effect of FVO on accounting comparability within adopters. Our prediction is that comparability of accounting amounts between **adopting** and **adopted banks increases** after the adopting bank adopts the FVO. This is because, after the adopting bank adopts the FVO, two economically similar entities apply similar accounting systems (Chang et al. 2021; Fiechter 2011; Guthrie et al. 2011). This prediction might not be borne if the adoption of the FVO magnifies the problem arising from the mixed-attribute accounting model. Fair valuing the whole instrument under the FVO means that earnings reflect all changes in the instrument rather than only changes resulting from the specific component that is hedged. In this case, comparability would likely decrease. Moreover, banks may simply substitute HA for FVO. In this case, comparability will possibly decrease (or not change). This is because for an instrument to qualify for HA treatment, high hedging effectiveness is required. FVO election requires no effectiveness assessment.

Finally, the inherent flexibility in an option-based standard can offer an opportunity for entities to manage earnings. Users can exploit the instrument-by-instrument provision of the standard, reporting fair values only for some instruments within the scope of the FVO, thus managing earnings volatility. Further, they can exploit the transition guidance to report accumulated gains/losses in retained earnings, enabling them to manage future net income (Chang et al. 2021; Song 2008). In both cases, the economic performance of the entity is obscured, leading to a reduction in accounting comparability.

According to the literature on the determinants of the FVO adoption (Chang et al. 2021), regular adopters are more likely to elect the FVO when they exhibit greater accounting mismatches. Accounting mismatches might arise from mixed-measurement model and/or hedge accounting ineffectiveness. In line with this, we expect the increase in comparability to be higher within adopters if they have high incentives to adopt the FVO in compliance with the standards, i.e., if both banks have high accounting mismatches pre-FVO adoption. Banks with low accounting mismatches can still adopt the FVO non-opportunistically, but this adoption is expected to have lower impact on earnings, and therefore on comparability.

To test these predictions, we match adopting to adopted banks and compare the comparability of accounting amounts of these banks pre- and post-adoption. Post-adoption period includes all the quarters in which both banks are users of the FVO. Pre-adoption period includes all the quarters in which only the adopted bank uses the FVO.⁵ Using a pre-and post-adoption comparison enables us to use each pair of banks as its own control, mitigating concerns that the results are driven by differences in the economic characteristics between the banks.

Hypothesis 1a: Comparability increases within adopters post-FVO adoption.

⁵ In the period that both banks are not using the FVO, we do not expect any differences in comparability of accounting amounts, as the banks are using the same accounting system. This is why we exclude observations before the adopted banks adopts the FVO when we test our predictions.

Hypothesis 1b: The increase in comparability within adopters post-FVO adoption is higher if adopters have high incentives to elect the FVO in compliance with the standards.

Between adopting and non-adopter banks

Our second hypothesis investigates the effect of the FVO on accounting comparability between **adopting** and **non-adopter banks**. We expect comparability between adopters and non-adopters to increase if, by adopting the FVO, banks are able to better reflect its economics. However, this prediction might not be borne if (1) the adopting banks do not need to use the FVO to reflect their economics, but adopt it for opportunistic reasons, and/or (2) the non-adopter banks with high accounting mismatches do not adopt the FVO because of lack of expertise or concerns about its effect on earnings. In both cases, post-FVO adoption, banks with similar economic activities choose to apply different measurement basis, and therefore, report different earnings. However, if the FVO elections comply with the intent of the standards to remedy accounting mismatches, we expect comparability between adopters and non-adopters to increase. This is the case when the adopting (non-adopter) banks have high (low) accounting mismatches. To test these predictions, we match adopting banks to non-adopter banks and compare comparability of accounting amounts in the period pre- and post the adopting banks adopt the FVO.

Hypothesis 2a: Comparability increases between adopters and non-adopters post-FVO adoption.

Hypothesis 2b: Comparability increases between adopting and non-adopters post-FVO adoption if FVO elections comply with the intent of the standards to remedy accounting mismatches.

Within non-adopters (comparability pre and post-2007)

We also investigate whether there is a change in comparability post-2007 (i.e., the FVO introduction year) driven by reasons other than the use of the FVO. To do this, we look at the effect of FVO introduction on comparability within **non-adopter** banks. We expect that accounting comparability does not change because of the FVO introduction, as non-adopters use the same accounting measurement to reflect their economics before and after the introduction of the FVO. If there is a time trend in comparability, driven by reasons other than the use of the FVO, we will document a change in comparability within non-adopters. To test this prediction, we match non-adopter to non-adopter banks and compare the comparability of accounting amounts of these banks pre- and post-FVO introduction in 2007.

Hypothesis 3: Comparability does not change within non-adopters post-2007.

Comparability pre- and post-FVO adoption for sample partitions

Next, we investigate the moderating effect of a number of factors on comparability post-FVO adoption. As we mainly look at choices within the FVO, we focus on comparability within adopters. First, we investigate whether the change in the comparability depends on the financial instruments for which the FVO is elected: (1) only for assets, and (2) only for liabilities or for both liabilities and assets.⁶ Most of the liabilities are held at historical cost, while an increasing proportion of assets is measured at fair value, leading to accounting mismatches (McDonough, Panaretou and Shakespeare 2020). Thus, the election of the FVO for liabilities allows for a better reflection of the asset-liability management in earnings. In this case, we predict that comparability is higher when the FVO is used for liabilities. This prediction may not be borne as literature suggests that fair value estimates for assets are more verifiable and understandable to investors than fair value estimates for liabilities (Koonce, Nelson and Shakespeare 2011).

⁶ We cannot investigate separately the effects of adopting the FVO only for liabilities, as the number of banks that do so in our sample is very limited.

This may result in the increase in comparability being less pronounced when the FVO is elected for liabilities.

The level of fair value measurement of assets/liabilities elected under the FVO can also affect comparability. Level 1 fair value estimates are based on quoted prices for identical assets or liabilities in active markets. Level 2 estimates are based on quoted market prices for similar assets or liabilities and inputs other than quoted prices, for example interest rates and yield curves; and level 3 estimates are based on unobservable entity-supplied inputs. The more objective are the fair value measurements, the more likely is that two banks with similar instruments will record similar amounts. If the instruments under the FVO are based on unobservable inputs (i.e., level 3), it is likely that the fair values for similar instruments deviate between different banks. Our prediction is that the increase in comparability of accounting numbers between adopting and adopted banks is less pronounced if the adopting banks measures assets/liabilities under the FVO at fair value level 3.

HA is an alternative way to account for economic hedges between related assets and liabilities. If banks simply substitute HA for FVO, comparability is likely to decrease (or have no change) post FVO-adoption. However, if banks use FVO as a complement to HA, comparability is likely to increase. In this case, economic hedges that were not possible to be accounted under the strict HA rules, will be reflected in the accounting numbers using the FVO.

Hypothesis 4a: The increase in comparability within adopters is higher if FVO is elected for both assets and liabilities.

Hypothesis 4b: The increase in comparability within adopters is lower if assets/liabilities under the FVO are measured at fair value level 3.

Hypothesis 4c: The increase in comparability within adopters is different if banks use hedge accounting (HA) pre-FVO adoption.

III. RESEARCH DESIGN

Matched design

We conduct our tests using a matched sample design, where we select for each bank an economically similar bank. In order to increase the pool of banks for matching and consequently our sample size, we do matching with replacement.⁷ The matching procedure is used to mitigate the effects on our inferences of economic differences between banks unattributable to the FVO.⁸ We match banks on two dimensions: business model and size, both measured at the date the adopting banks adopt the FVO (or in 2007, when we match non-adopters to non-adopters).⁹ First, we require banks to have the same business model. Banks with banking book activities have assets mostly consisting of loans measured at historical cost. Trading activities banks have assets mostly composed of trading instruments that are measured at fair value. Following previous literature, we use the ratio of loans to total assets to control for bank business model (Bischof, Daske and Gebhardt 2011).¹⁰ We classify a bank as banking book activities (trading activities) bank if its ratio of gross loans to assets is above (below) the sample median in each quarter. Second, we require banks to have similar size, measured by total assets. Size is commonly used in the comparability literature to control for economic characteristics (Barth et al. 2012; Yip and Young 2012; Barth et al. 2018). In line with prior studies, we eliminate from our sample any matched pair for which the size difference exceeds 50% in absolute value (Barth et al. 2012).

When we look at the effect of the FVO adoption, we require each pair to have data for at least 4 quarters after the adoption quarter (inclusive), and 4 quarters before the FVO

⁷ Our main results are robust to matching without replacement.

⁸ The fact that banks adopt the FVO in different financial quarters also mitigates those concerns.

⁹ When we divide the sample into four categories resulting from the combination of business model (banking book banks and trading banks) and size (big banks and small banks), we find that the median return in each of the four categories for adopters is not statistically different from the one for non-adopters (untabulated results). These results suggest that return (the proxy for the economic outcome) is similar between adopting and the matched banks.

¹⁰ We avoid using a business model proxy based on income statement as this is influenced by the adoption of the FVO.

adoption. Similarly, when we look at the effect of FVO introduction, we require each pair to have data for at least 4 quarters before and after the FVO introduction date. Our analyses include all the quarters for which both matched banks have data. For example, if the adopting bank has data from 2000Q1 to 2014Q4 and the matched bank has data from 2003Q1 to 2015Q2, our analyses include data from 2003Q1 to 2014Q4. Some banks adopt the FVO and after some time they stop, as the instruments subject to FVO cease to exist, due to maturity and/or disposal. For the adoption period, we consider the time in which the adopting banks starts electing the FVO until the last quarter in which the bank elects the FVO within our sample period.

Comparability

To assess accounting comparability, we follow the methodology developed by De Franco et al. (2011). De Franco et al. (2011) measure has been extensively used in recent comparability studies (for example, Yip and Young 2012; Kim, Li, Lu and Yu 2016; Neel 2017, Choi, Choi, Myers and Ziebart 2019). Two firms, i and j , have more comparable accounting systems if they report similar accounting amounts when they experience similar economic events, and report different accounting amounts when they experience different economic events. Following De Franco et al. (2011), we use earnings as a proxy for accounting amounts and stock return to capture the economic outcome. We also run our results using future cash flows as an alternative proxy for economic outcome.

We first estimate each entity's functions as follows:

$$Earnings_{it} = \beta_0 + \beta_1 Return_{it} + \varepsilon_{it} \quad (1a)$$

$$Earnings_{it} = \beta_0 + \beta_1 CashFlow_{it+1} + \varepsilon_{it} \quad (1b)$$

Earnings is net income before extraordinary items deflated by lagged market value of equity (MVE). *Return* is the cumulative percentage change in the monthly stock price over the

quarter. *CashFlow* is the cash flow from operations at the end of the quarter scaled by lagged market value of equity. The subscript i refers to bank and the subscript t refers to quarter t . The constant β_0 and the coefficient on *Return (CashFlow)* represent the estimated accounting function for the bank and reflect how economic events are mapped into accounting numbers. We estimate the accounting function for each bank, separately for before and after the adopting bank adopts the FVO, using quarterly data.

We then compute, for each quarter, each bank's predicted earnings using (1) its own accounting function (i) and (2) the accounting function of the matched bank (j). For each bank and quarter, we obtain two predicted earnings ($E(Earnings)_{it}^i$ and $E(Earnings)_{it}^j$), holding the economic event (i.e. return or cash flow) constant. We then compute, for each quarter, the negative absolute difference in predicted earnings as:

$$DiffEarnings_{it} = -|E(Earnings)_{it}^i - E(Earnings)_{it}^j| \quad (2)$$

We do the same process for the matched bank:

$$DiffEarnings_{jt} = -|E(Earnings)_{jt}^j - E(Earnings)_{jt}^i| \quad (3)$$

Comparability ($Comp_{ijt}$) is the mean of (2) and (3) for each matched pair of banks i and j in quarter t . The more comparable are the accounting numbers, the higher (i.e., less negative) is the mean difference in earnings. For our univariate analysis, we calculate comparability per period. Comparability for the pre-FVO adoption period is the mean (median) $Comp_{ijt}$ for all pairs in this period. Similarly, comparability for the post-FVO adoption period is the mean (median) $Comp_{ijt}$ for all pairs in the post-FVO adoption period. We do the same process to estimate comparability pre- and post-FVO introduction (i.e., pre- and post-2007).

IV. SAMPLE AND DATA

We conduct our tests on a sample of US bank holding companies. These banks provide a unique framework for this analysis for a number of reasons. First, as banks are the main users of financial instruments, they have been at the forefront of the debate over the FVO. Second, by using a single country and industry we can rule out that our results are driven by the quality of implementation and enforcement of accounting standards in each country or industry differences (Ball, et al. 2000; Ball, Robin and Wu 2003; Daske et al. 2008; DeFond et al. 2011). An additional benefit is that the bank-pairs are subject to similar economic shocks. Further, on an international level, the FVO was introduced by IASB in the year of mandatory IFRS adoption, making it hard to distinguish between the effects of the FVO and the rest of the changes introduced by the mandatory adoption of IFRS. This is not a concern in the US setting, as the introduction of the FVO did not take place at the same time as any other major change in the US GAAP. Finally, the choice of the sample is driven by data availability considerations. For US bank holding companies, information on the fair value of assets and liabilities under the FVO as well as gains/losses on assets and liabilities under the FVO is provided in databases, enabling us to identify the adoption of the FVO and the extent of its use. This is not the case for a non-US sample.

We draw our sample from SNL (S&P Capital IQ) database as this provides detailed information on assets/liabilities under the FVO. Our sample period starts in 2000, as this is when SNL provides comprehensive reporting of cash flows and finishes in 2019. We start by identifying all active bank holding companies that are covered by SNL between 2007 and 2019. As US bank holding companies start reporting assets/liabilities under the FVO in their FRY-9C reports in the first quarter of 2007, our sample period (2000-2019) includes 7 years before and 12 years after the introduction of the FVO.

Our sample selection process is summarized in Table 1. We obtain the rest of the accounting data from SNL, except gains/losses attributable to hedge ineffectiveness that are

taken from Compustat, and market data from DataStream. After we remove observations with missing data on the FVO adoption, we have 673 unique banks, out of which 238 are FVO adopters. We use this larger sample to provide descriptive information on the FVO adoption. For our analyses, however, we use smaller samples as we require banks to have data to compute our metrics. Given that we require data for at least 4 quarters before and 4 quarters after the FVO adoption (including the adoption quarter), our pre-adoption sample potentially spans from 2000Q1 to 2018Q4. Post-adoption sample potentially spans from 2008Q1 to 2019Q4. This process yields a sample of 478 (379) unique banks used for matching purposes in the earnings-returns (EAR-RET) and earnings-cash flows (EAR-CF) specification. All variables used to compute our comparability metrics are winsorized at 1% and 99% levels to mitigate the effects of outliers.

Table 1, Panel B provides the matched pairs used in our analyses. After we eliminate from our sample the pairs with a ratio of smaller bank size to larger bank size smaller than 50%, we obtain 123 (98) pairs and 4,341 (3,514) bank-quarter observations of adopting – adopted for the EAR-RET specification (EAR-CF specification). Of these, 1,412 (1,142) observations are pre-FVO adoption and 2,929 (2,372) observations are post-FVO adoption. For adopting-non adopter, this process yields 154 (130) pairs with 5,128 (4,222) bank-observations pre-FVO adoption and 4,330 (3,596) observations post-FVO adoption for the EAR-RET (EAR-CF) specification.

Usage of the FVO

Table 2 provides information on the number of unique banks that adopt the FVO for the first time in each year, and of the bank-quarters in which the FVO was used in each year. Panel A includes all banks that are active in the period 2007-2019 (i.e., the period in which banks can adopt the FVO), before we delete observations with missing data. Columns 1-2 provide the

number of banks, both in absolute and relative terms, respectively, that adopt the FVO for the first time in each year (first adoption). There are 21 early adopters in 2007. This represents less than 10% of our sample, whereas regular adopters represent 90% of our sample.¹¹ The number of first-time adopters increases in 2008 (36 unique banks), and 2009 is the year with the highest number of new adopters (50 unique banks). Columns 3-4 provide information on the number of bank-quarters in which the FVO is elected in each year. This number changes in time because of (1) new banks adopting the FVO and (2) adopters stop using the FVO. As the FVO is irrevocable, adopters only stop its election when the instrument for which the FVO is adopted no longer exist.

Columns 5-6 (columns 7-8) provide information on the number of bank-quarters in which the FVO is used for assets only (for liabilities only or both for assets and liabilities). The number of bank-quarters in which the FVO is used for assets only is much higher than the ones in which is used for liabilities only or for both assets and liabilities. For example, in 2009, 307 bank-quarters use the FVO (column 3), out of which 228 use for assets only (column 5), and 79 use for liabilities only or for both assets and liabilities (column 7).

Panel B presents information on the effect of the FVO adoption on net income. The number of bank-quarter decreases because of missing observations on gains/losses on assets/liabilities for which the FVO is elected (*FVOGL*). The mean ratio of absolute *FVOGL* to net income (*NI*) is 9.5%, while, for some banks this is as high as 71.8%. For larger banks (banks with total assets greater than \$50 billion), the effect of the FVO adoption on income is even higher. The mean (median) *FVOGL/NI* is 18.8% (7.9%). This is likely driven by the fact that larger banks have a higher ratio of instruments under the FVO to total assets than smaller banks (untabulated finding). These numbers show that the effect of the FVO adoption on

¹¹ Chang et al. (2021) show that regular adopters comply with SFAS 159 intent to remedy accounting mismatches.

income is economically significant, suggesting that a comparability measure based on earnings aiming to capture the effect of FVO adoption is appropriate.

We also look at the effect of the FVO adoption on net income for banks that have high accounting mismatches pre-adoption, and therefore, high incentives to elect the FVO in compliance with the standards intent to remedy accounting mismatches. In line with Chang et al. (2021), we capture accounting mismatches using (1) the correlation between stock returns and net income before extraordinary items (*REcor*) and (2) gains and losses attributable to hedge ineffectiveness (*HIGL*).¹² *HighAccMis* is an indicator variable for high accounting mismatches that takes the value 1 if the FVO adopter has *REcor* below the sample median pre-FVO adoption and/or *HIGL* in the year prior to the FVO adoption.¹³ In line with our expectations, the ratio *FVOGL/NI* is higher for banks that have high accounting mismatches pre-FVO adoption (*HighAccMis*=1).

Panels C and D provide information for the banks that are included in our matched subsamples. Panel C provides information for the adopting banks included in the matched samples used in the EAR- RET specification. Columns 1-2 (columns 3-4) provide information for the subsamples of adopting-adopted (adopting – non-adopter) banks. Panel D provides the same information but for the pair of banks used in the EAR-CF specification. For the adopting-adopted banks (columns 1-2) there are no observations in 2007. This is because we require an adopted bank to be an adopted for a minimum of 4 quarters at the matching date. Similarly, we do not consider new adopters in 2019, as we require data for 4 quarters post-FVO adoption. The number of observations is lower for the EAR-CF specification, because of missing cash flow data.

¹² Chang et al. (2021) also use the standard deviation of income and the notional value of derivatives to capture accounting mismatches and the cost of hedge accounting. However, their study shows that these variables are not significant in explaining the regular election of the FVO.

¹³ The inference of our results does not change if we estimate accounting mismatches based only on the correlation between stock returns and income (*REcor*). We cannot run the analysis separately for hedging ineffectiveness, as the number of banks that have *HIGL* is very low.

Table 3 presents the descriptive statistics for the main variables used in computing the comparability metrics. Variable definitions are provided in Appendix A. Panel A provides information on the input variables for our comparability metric and firm characteristics. Columns 1-3 provide information for the adopting banks, and columns 4-6 provide information for the adopted banks. Finally, columns 7-9 provide information for the non-adopter banks matched to adopting banks (used in the subsample adopting - non-adopter). As we can see, the different group of banks have very similar mean economic outcomes, business model and size, indicating a good outcome of the matching procedure.

Panel B provides descriptive statistics of the variables used in the univariate and multivariate analyses for the various subsamples and for the two specifications (EAR_RET and EAR-CF). The mean comparability metric is very similar in the two specifications, both for the adopting-adopted and the adopting-non-adopter groups. The adoption of the FVO for liabilities by the adopting bank is limited in our sample (*FVOAL* or *FVOL_D*), in line with earlier studies that look at the FVO adoption for liabilities (Lin et al. 2019). Further, 19-20% of the adopting banks measure more than 80% of their instruments under the FVO at fair value level 3 (*L3_D*), while 38-41% are a HA-user pre-FVO adoption (*HedgeAccPre*).

V. RESULTS

Univariate analysis

Table 4 provides mean and median accounting comparability metrics for the different sample partitions. Panel A presents findings related to comparability between adopting and adopted banks. The results show a positive change in the mean and median comparability metric, suggesting that comparability increases after the adopting bank adopts the FVO. The increase in comparability is statistically significant at 1% level. This result is in line with our expectation (Hypothesis 1a). After the adopting banks adopts the FVO, two economically

similar entities apply similar accounting systems, thus report similar earnings. In Panels A1 and A2, we split the pair of adopters into Group 1 and 0. Group 1 includes all pairs where both the adopting and adopted bank have high incentives to adopt the FVO in compliance with the standards ($HighAccMis=1$). We allocate all other pairs into Group 0. The number of observations decreases because of missing data on the variables used to compute $HighAccMis$. In line with our expectation (Hypothesis 1b), when we use the EAR-RET specification, the mean (median) comparability increase is higher for Group 1 than for Group 0. This is also the case for the mean increase in comparability when we use the EAR-CF flow specification.

Panel B presents findings related to comparability between adopting and non-adopter banks. The median effect of the FVO adoption on comparability is positive and significant, indicating that most of the pairs experienced an increase in comparability after the adopting banks adopt the FVO (Hypothesis 2a). However, when we look at the mean effect, the change in comparability is negative and significant when we use the EAR-CF specification to capture comparability. This suggests that there are some pairs of banks that experience a large decrease in comparability post-FVO adoption.

In panels B1 and B2 we repeat the analysis, splitting our pairs of banks in Group 1 and 0. In Group 1, we include only pairs where the FVO elections comply with the intent of the standards to remedy accounting mismatches. This is the case when the adopting (non-adopter) has high (low) incentives to adopt the FVO in compliance with the standards. In other words, when the adopting has $HighAccMis=1$ and the non-adopter $HighAccMis=0$. All other pairs are in Group 0. In line with our expectation (Hypothesis 2b), pairs in Group 1 experience an increase in comparability post-FVO adoption. On the other hand, pairs in Group 0 experience a decrease in mean comparability, indicating that some pairs in this group experience a large decrease in comparability post-FVO adoption. This latter result can be driven by non-adopting banks with high accounting mismatches not adopting the FVO because of lack of expertise or

concerns about its effect on earnings and/or by adopting banks electing the FVO opportunistically. Thus, post-FVO adoption, banks with similar economic activities choose to apply different measurement basis, and therefore, report different earnings.

Finally, Panel C presents findings related to comparability within non-adopter banks (Hypothesis 3). While we predict comparability not to change post-2007 (post-FVO introduction) for these banks, we find a decrease in comparability. As these banks are not users of the FVO, the decrease in comparability is driven by factors other than the FVO adoption. This can potentially reflect changes in the operating environment of the banks. In this case, banks become less economically similar over time. The negative trend in comparability may also reflect other changes in the financial reporting environment. Based on this result, the positive effect on comparability we document earlier is not likely to be driven by a time trend.

Multivariate analysis

To further investigate the effect of the FVO adoption on comparability, we perform multivariate regressions for our different sub-samples. First, we estimate the following model:

$$Comp_{ijt} = b_0 + b_1 FVO + b_2 TA_{Ratio} \quad (4)$$

where $Comp_{ijt}$ is the comparability of pair of banks i and j in quarter t , and FVO is an indicator variable that equals 1 if t is in the post-FVO adoption period, and 0 otherwise. A statistically significant b_1 coefficient indicates that accounting comparability changes between the pre- and post-FVO adoption periods. In line with Yip and Young (2012), we also control for differences in size. TA_Ratio is the ratio of the size of the smaller firm in the pair to the size of the larger firm in the pair.

Regression results are presented in Table 5. For the results presented in Panel A (Panel B), we capture comparability using the EAR-RET (EAR-CF) specification. Columns 1-4 present results for the matched pairs of adopting and adopted banks, while columns 5-8 present results for matched pairs of adopting and non-adopter banks. From column 1 we can see that

the coefficient on *FVO*, indicating the adoption period, is positive and statistically significant. This result remains when we include in our regressions time fixed effects (column 2) to control for omitted variables that change across banks.

In columns 3-4, we include a variable indicating that the bank-pair belongs to Group 1 (*Group1*) and its interaction with *FVO*. As in table 4, the number of observations decreases because of missing data for the variable used to allocate pairs into Groups 1 and 0. The coefficient on *Group1*FVO* is positive and statistically significant in 3 out of 4 cases (Panel A, column 3 and Panel B columns 3-4), suggesting that the increase in comparability is higher if the adopters have high accounting mismatches pre-FVO adoption.

When we look at the pairs of adopting-non-adopters in columns 5-8, the coefficient on *Group1*FVO* is positive and statistically significant (and larger in absolute terms than the coefficient on *FVO*). These results suggest that the comparability increases if FVO elections comply with the intent of the standard setters to remedy accounting mismatches. In line with the results presented in Table 4, Panel B2, comparability for pairs that belong to Group 0 decreases post-FVO adoption.

In Table 6, we investigate the moderating effect of a number of choices within the FVO adoption as well as the effect of the use of HA. Therefore, we focus on the pairs of adopting-adopted banks. Panel A (Panel B) presents results using the EAR-RET (EAR-CF) specification to capture comparability. *FVOAL* or *FVOL_D* indicates the adoption of FVO for liabilities or for both assets and liabilities by the adopting bank. In both panels, the coefficient on this indicator variable is positive and statistically significant, indicating that the positive effect on comparability post-FVO is more pronounced when the FVO is elected also for liabilities. This result is in line with the use of fair values for both assets and liabilities allowing to better reflect the asset-liability management in the financial statements (Hypothesis 4a).

Next, we investigate the effect of fair value levels (Hypothesis 4b). To do this, we classify our FVO adopters into Level 1 and/or 2 (Level 3) reporters, if in a specific quarter they report more than 80% of their assets and liabilities under FVO at fair value level 1 and/or 2 (level 3). *L3_D* indicates that the adopting bank is a Level 3 reporter. In line with Hypothesis 4b, the coefficient on this indicator variable is consistently negative and significant. This result can be driven by the fact that level 3 fair values are based on unobservable inputs, and therefore, more likely to deviate between different banks, thus reducing comparability.

Finally, in the last column of Table 6, we control for the use of HA (Hypothesis 4c). *HedgeAccPre* takes the value of 1 if the adopting bank uses HA pre-FVO adoption and 0 otherwise. The coefficients on the interaction of *HedgeAccPre* and *FVO* are consistently positive and statistically significant, indicating that comparability is higher when the adopting bank is a HA user pre-FVO adoption. This result is in line with FVO complementing, rather than substituting the use of HA.

Further sensitivity analyses

To investigate the robustness of our findings, we conduct several additional tests. First, we test if our results are driven by the use of replacement in the matching procedure. We re-run our main analysis using matching without replacement. While the number of observations decreases, our results are robust. Second, we test whether our results are robust to the use of (1) an alternative proxy for size, using lagged market value of assets and (2) an alternative timeframe for returns, computing returns over the period starting 2 months before and finishing 1 month after the quarter end. Untabulated results are in line with our main analysis.

Third, we investigate if our results are driven by the inclusion of the adopters of the FVO for servicing assets in the analysis (under SFAS 156). For the period 2007Q1-2009Q1 data on servicing assets under the FVO is reported together with repos for which the FVO was

adopted under SFAS 159. Since 2009Q2 the database provides data separately on the use of FVO under SFAS 156, as banks are required to provide more detailed data on their regulatory reports. Our main results are robust if we exclude from our analyses the pairs of banks for which the FVO adoption is based on (1) servicing assets and repos in the period 2007Q1-2009Q1 and (2) servicing assets in the period 2009Q2-2019Q4. As the instruments for which the FVO was adopted under SFAS 155 are reported together with the instruments for which the FVO was adopted under SFAS 159, we cannot provide a separate analysis for these two standards.

When we investigate the change in comparability post-2007 within non-adopters, we included in our analysis all pairs of non-adopters for which we have data during the sample period. To make sure that the documented decrease in comparability post-2007 is not driven by the use of a broader sample of banks, we re-run these results using only the non-adopter banks that are matched with adopting banks in our analyses. To do this, we match the non-adopter banks used in the adopting – non-adopter pairs with similar non-adopters. This process generates between 53-58 pairs of non-adopter banks, depending on the comparability metric. In line with the results presented in Table 4, untabulated results show a decrease in comparability within non-adopters post-2007, indicating a negative time trend in comparability.

VI. CONCLUSIONS

The role of accounting choice is the subject of a long-standing debate among accounting regulators, practitioners and academics. Yet, because in practice accounting choice is limited by regulators, the empirical evidence in this area is limited. This study uses the introduction of the FVO to investigate the effect of managerial choice of measurement basis on comparability of accounting amounts.

Using a sample of 673 US bank holding companies, we find that 35% of banks adopt the FVO at some time during the years 2007 to 2019, and mostly for assets. We define accounting amounts as being comparable if they allow similar (different) economic events to be converted into similar (different) accounting amounts. We predict and find that after banks adopt the FVO (adopting banks), their accounting amounts become more comparable to the accounting amounts of banks that adopted the FVO before them (adopted banks). We also provide evidence that the FVO adoption increases comparability between adopters and non-adopters if the FVO elections comply with the intent of the standard setters to remedy accounting mismatches. In addition, we document a negative trend in comparability within non-adopters, alleviating concerns that the increased comparability within adopters is driven by factors other than the FVO adoption.

The positive effect on comparability within adopters is more pronounced when adopting banks elect the FVO also for liabilities, in line with banks reflecting better their asset-liability management in their financial statement. Also, we find that comparability is higher when the adopting bank is a HA user pre-FVO adoption, suggesting that FVO is used to complement, rather than substitute HA. However, comparability is lower when the adopting bank is a Level 3 reporter. This result can be driven by the fact that level 3 fair values are based on unobservable inputs, and therefore, likely to deviate between different banks.

Our results contribute to the debate about the role of measurement choice within the accounting standards and add to the empirical evidence on the effects of changes in accounting standards on comparability. Overall, our evidence indicates that FVO is used by firms to better reflect their economics, improving accounting comparability. Our results also contribute to the literature that documents benefits of fair value measurement.

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Appendix A

Variable Definitions

<i>Return</i>	the cumulative percentage change in the monthly stock price over the quarter, computed using the return index at the end of the quarter divided by the return index at the beginning of the quarter minus 1, winsorized at top and bottom 1% (source: Datastream).
<i>CashFlow</i>	cash flow from operations at the end of the quarter scaled by lagged market value of equity, winsorized at top and bottom 1% (source: SNL).
<i>Earnings</i>	net income before extraordinary items deflated by lagged market value of equity, winsorized at top and bottom 1% (source: SNL).
<i>BM</i>	the ratio of book value of gross loans not under FVO to total assets, at the end of the quarter. <i>BM</i> is used as a proxy for the business model (source: SNL).
<i>Size</i>	the book value of total assets, at the end of the quarter, in million dollars (source: SNL).
<i>Comp</i>	the estimated comparability between a pair of matched banks (greater values represent greater comparability). Section “Comparability” provides details on how the comparability metric is estimated.
<i>FVO</i>	a variable that indicates post-FVO adoption period. It takes the value of one for the period starting from the quarter in which the adopting bank first adopts and ending in the last quarter in which the bank uses the FVO, and zero otherwise.
<i>TA_Ratio</i>	the ratio of the size of the smaller firm in the pair to the size of the larger firm in the pair.
<i>FVOAL or FVOL_D</i>	an indicator variable that takes the value of one if the adopting bank adopts the FVO for assets and liabilities or only for liabilities in the specific quarter and zero otherwise.
<i>L3_D</i>	an indicator variable that takes the value of one if the adopting bank is a fair value Level 3 reporter and zero otherwise. We consider a bank to be Level 3 reporter if 80% or more of its assets and liabilities classified as FVO are measured at fair value level 3 in the specific quarter.
<i>HedgeAccPre</i>	an indicator variable that takes the value of one if the adopting bank was a HA user in the period prior to the FVO adoption and zero otherwise.
<i>REcor</i>	the correlation between quarterly returns (source: Datastream) and quarterly net income before extraordinary items divided by beginning total assets (source: SNL) over the four quarters prior to the FVO adoption for adopters (prior to the regular adoption of FVO in 2008Q1 for non-adopters).

- HIGL* gains or losses on ineffective hedges in the year prior to the FVO adoption for adopters (prior to the regular adoption of FVO in 2008Q1 for non-adopters) (source: Compustat).
- HighAccMis* a variable indicating the existence of high accounting mismatches pre-FVO adoption for adopters (pre-2008Q1 for non-adopters). It takes the value one if the bank has *REcor* below the sample median and/or non-zero *HIGL*, and zero otherwise.
- Group1* indicates that both banks in the matched sample have high incentives to use the FVO in line with the intent of the standard setters to remedy accounting mismatches. For pairs of adopting-adopter banks it takes the value one if both banks have *HighAccMis*=1, and zero otherwise. For pairs of adopting-non adopter banks, it takes the value one if the adopter has *HighAccMis*=1 and the non-adopter *HighAccMis*=0, and zero otherwise.

Tables

TABLE 1
The sample

Panel A: Sample used for matching purposes (unique banks)	EAR-RET specification (returns, MVE, NI)			EAR-CF specification (CF, MVE, NI)		
	Total	Adopters	Non-adopters	Total	Adopters	Non-adopters
Active BHC in the period Q12007-Q42019; out of which	673	238	435	673	238	435
<i>Less banks with missing data for</i>						
- regression data	-149	-31	-118	-237	-44	-193
- threshold of minimum 8 quarters (at least 4 before and 4 after date of adoption)	-46	-46	0	-57	-57	0
Sample used for matching	478	161	317	379	137	242

Panel B: Matched samples	EAR-RET Specification		EAR-CF Specification	
	Pairs of banks	bank-quarters	Pairs of banks	bank-quarters
Adopting - Adopter of which	123	4,341	98	3,514
pre-FVO adoption		1,412		1,142
post-FVO adoption		2,929		2,372
Adopting - Non-adopter of which	154	9,458	130	7,818
pre-FVO adoption		5,128		4,222
post-FVO adoption		4,330		3,596

The table presents data on sample selection. Panel A provides information on all bank holding companies (BHC). Active BHC include all U.S. listed BHC available on SNL (S&P Cap IQ) that have total assets greater than zero in any of the quarters of the period Q12007-Q42019. Panel B presents the matched pairs used in our univariate and multivariate analysis. Banks are paired based on the business model and size at the date of adoption of the adopting bank. We do matching with replacement.

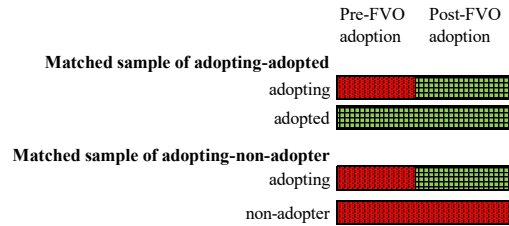


TABLE 2

Fair value option: extent and effect on net income

Panel A: All banks

	Date of first adoption (Adopting)		FVOAll		FVOA		FVOAL or FVOL	
	(1) unique banks	(2) %	(3) bank- quarters	(4) %	(5) bank- quarters	(6) %	(7) bank- quarters	(8) %
2007	21	9%	71	1%	22	0%	49	5%
2008	36	15%	208	4%	115	3%	93	10%
2009	50	21%	307	6%	228	5%	79	9%
2010	11	5%	353	6%	275	6%	78	8%
2011	11	5%	373	7%	300	7%	73	8%
2012	35	15%	444	8%	373	8%	71	8%
2013	14	6%	498	9%	420	9%	78	8%
2014	8	3%	519	9%	449	10%	70	8%
2015	17	7%	531	10%	462	10%	69	7%
2016	15	6%	563	10%	490	11%	73	8%
2017	12	5%	567	10%	493	11%	74	8%
2018	4	2%	548	10%	485	11%	63	7%
2019	4	2%	514	9%	462	10%	52	6%
Total	238	100%	5,496	100%	4,574	100%	922	100%

Panel B: Effect of FVO adoption on net income

	N	Mean	Median	Std Dev	Min	Max
FVOGL/NI	3,781	9.5%	1.0%	18.5%	0.0%	71.8%
by size:						
<i>large banks</i>	757	18.8%	7.9%	23.4%	0.0%	71.8%
<i>small banks</i>	3,024	7.2%	0.5%	16.2%	0.0%	71.8%
by FVO incentives:						
<i>high accounting</i>	2,147	11.1%	1.8%	19.3%	0.0%	71.8%
<i>low accounting mismatches</i>	1,634	7.4%	0.4%	17.2%	0.0%	71.8%

Panel C: Adoption in matched samples - EAR-RET specification

	Adopting - Adopted banks				Adopting - Non-adopter banks			
	(1)		(2)		(3)		(4)	
	Date of first adoption (Adopting)		FVOAll (Nr of pairs = 123)		Date of first adoption (Adopting)		FVOAll (Nr of pairs = 154)	
	unique banks	%	bank- quarters	%	unique banks	%	bank- quarters	%
2007	0	0%	0	0%	14	9%	47	1%
2008	16	13%	58	2%	30	19%	168	4%
2009	35	28%	155	5%	36	23%	258	6%
2010	11	9%	223	8%	11	7%	316	7%
2011	9	7%	247	8%	9	6%	335	8%
2012	19	15%	285	10%	20	13%	395	9%
2013	6	5%	295	10%	7	5%	420	10%
2014	3	2%	296	10%	3	2%	421	10%
2015	10	8%	290	10%	10	6%	425	10%
2016	5	4%	284	10%	5	3%	421	10%
2017	6	5%	277	9%	6	4%	385	9%
2018	3	2%	271	9%	3	2%	384	9%
2019	0	0%	248	8%	0	0%	355	8%
Total	123	100%	2,929	100%	154	100%	4,330	100%

Panel D: Adoption in matched samples - EAR-CF specification

	Adopting - Adopted banks				Adopting - Non-adopter banks			
	(1)		(2)		(3)		(4)	
	Date of first adoption (Adopting)		FVOAll (Nr of pairs = 98)		Date of first adoption (Adopting)		FVOAll (Nr of pairs = 130)	
	unique banks	%	bank- quarters	%	bank- quarters	%	bank- quarters	%
2007	0	0%	0	0%	10	8%	35	1%
2008	12	12%	43	2%	28	22%	143	4%
2009	26	27%	115	5%	32	25%	218	6%
2010	8	8%	166	7%	8	6%	267	7%
2011	7	7%	180	8%	7	5%	280	8%
2012	17	17%	225	9%	17	13%	322	9%
2013	5	5%	234	10%	6	5%	337	9%
2014	3	3%	230	10%	3	2%	324	9%
2015	9	9%	238	10%	8	6%	343	10%
2016	4	4%	238	10%	4	3%	349	10%
2017	4	4%	238	10%	4	3%	327	9%
2018	3	3%	240	10%	3	2%	335	9%
2019	0	0%	225	9%	0	0%	316	9%
Total	98	100%	2,372	100%	130	100%	3,596	100%

The table provides information about the election of the FVO. Panel A includes all banks active in any quarter between 2007 and 2019 and provides information on the number of new banks that adopted the FVO each year (columns 1-2). Columns 3-8 provide information on the total number of bank-quarters in which FVO is elected each year. FVOAll provides the number of quarters in which the FVO is elected for assets and/or liabilities. FVOA provides the number quarters in which the FVO is elected only for assets. FVOAL or FVOL provides the number of quarters in which the FVO is elected for both assets and liabilities or for only liabilities. Panel B provides information on the effect of FVO adoption on net income. FVOGL/NI is the absolute ratio of gains and losses on FVO to net income, winsorized at top 5%. The information is then decomposed by (i) size, where big (small) banks are the ones with total assets greater (lower) than \$50B, and (ii) incentives to adopt FVO. A bank has high incentives to adopt the FVO if it has high accounting mismatches prior to FVO adoption. All the variables are described in Appendix A. Panels C and D reports information for the matched samples used in our analyses.

TABLE 3

Descriptive statistics for various samples

Panel A: Input variables for Comp and firm characteristics

	Adopting (N = 9,458)			Adopted (N = 4,341)			Non-adopter (N = 4,689)		
	(1) Mean	(2) Median	(3) Std Dev	(4) Mean	(5) Median	(6) Std Dev	(7) Mean	(8) Median	(9) Std Dev
EAR - RET specification									
Return	0.02	0.01	0.14	0.02	0.01	0.15	0.02	0.01	0.13
Earnings	0.02	0.02	0.03	0.01	0.02	0.04	0.02	0.02	0.03
BM	0.67	0.69	0.12	0.68	0.69	0.09	0.68	0.69	0.11
Size (in million)	17,356	2,528	50,215	9,545	3,547	18,011	2,756	1,155	4,254
EAR - CF specification									
	(N = 8,058)			(N = 3,514)			(N = 3,418)		
CF	0.03	0.02	0.07	0.04	0.03	0.08	0.03	0.03	0.06
Earnings	0.02	0.02	0.02	0.01	0.02	0.04	0.02	0.02	0.02
BM	0.67	0.68	0.13	0.68	0.69	0.10	0.67	0.69	0.12
Size (in million)	19,223	3,095	53,479	10,662	4,497	19,282	3,014	1,134	4,824

Panel B: Variables in the various samples

	EAR - RET specification Adopting-Adopted (N=123)						EAR - CF specification Adopting-Adopted (N=98)					
	N	Mean	Median	Std Dev	Min	Max	N	Mean	Median	Std Dev	Min	Max
Comp	4,341	-0.02	-0.01	0.02	-0.19	0.00	3,514	-0.02	-0.01	0.02	-0.22	0.00
FVO	4,341	0.67	1.00	0.47	0.00	1.00	3,514	0.68	1.00	0.47	0.00	1.00
TA_Ratio	4,341	0.88	0.94	0.13	0.51	1.00	3,514	0.88	0.94	0.13	0.51	1.00
FVOAL or FVOL_D	4,341	0.04	0.00	0.20	0.00	1.00	3,514	0.04	0.00	0.19	0.00	1.00
L3_D (all instrum)	4,028	0.19	0.00	0.39	0.00	1.00	3,313	0.20	0.00	0.40	0.00	1.00
HedgeAccPre	4,087	0.38	0.00	0.49	0.00	1.00	3,435	0.41	0.00	0.49	0.00	1.00
	Adopting-Non adopter (N=154)						Adopting-Non adopter (N=130)					
Comp	9,458	-0.01	-0.01	0.02	-0.27	0.00	8,058	-0.01	-0.01	0.01	-0.16	0.00
FVO	9,458	0.46	0.00	0.50	0.00	1.00	8,058	0.45	0.00	0.50	0.00	1.00
TA_Ratio	9,458	0.93	0.97	0.10	0.50	1.00	8,058	0.92	0.96	0.11	0.50	1.00

The table provides descriptive statistics. Panel A provides descriptive statistics on the input variables for the comparability metric as well as on other firm characteristics. Panel B provides descriptive statistics on the variables used in regressions for the various samples. All variables are defined in Appendix A.

TABLE 4
Univariate analysis

		EAR - RET specification			EAR - CF specification		
Panel A: Matched sample Adopting - Adopted (all banks)							
		(N = 123)			(N = 98)		
	Pred.	bank- quarters	Mean effect	Median effect	bank- quarters	Mean effect	Median effect
Pre-FVO adoption		1,412	-0.0216	-0.0138	1,142	-0.0226	-0.0135
Post-FVO adoption		2,929	-0.0131	-0.0069	2,372	-0.0134	-0.0059
	Post-Pre (+)		0.0085***	0.0069***		0.0092***	0.0076***
Panel A1: Matched sample Adopting - Adopted (Group1)							
		(N = 36)			(N = 31)		
	Pred.	bank- quarters	Mean effect	Median effect	bank- quarters	Mean effect	Median effect
Pre-FVO adoption		305	-0.0252	-0.0146	232	-0.0275	-0.0140
Post-FVO adoption		1,043	-0.0130	-0.0075	857	-0.0129	-0.0069
	Post-Pre (+)		0.0122***	0.0071***		0.0145***	0.007***
Panel A2: Matched sample Adopting - Adopted (Group 0)							
		(N = 79)			(N = 62)		
	Pred.	bank- quarters	Mean effect	Median effect	bank- quarters	Mean effect	Median effect
Pre-FVO adoption		950	-0.0208	-0.0130	788	-0.0230	-0.0156
Post-FVO adoption		1,764	-0.0133	-0.0066	1,444	-0.0141	-0.0060
	Post-Pre (+)		0.0075***	0.0064***		0.0088***	0.0096***

Panel B: Matched sample | Adopting - non adopter (all banks)

Pred.	(N = 154)			(N = 130)		
	bank- quarters	Mean effect	Median effect	bank- quarters	Mean effect	Median effect
Pre-FVO adoption	5,128	-0.0107	-0.0061	4,462	-0.0082	-0.0055
Post-FVO adoption	4,330	-0.0111	-0.0050	3,596	-0.0089	-0.0048
Post-Pre (+)		-0.0004	0.0011***		-0.0008***	0.0007***

Panel B1: Matched sample | Adopting - non adopter (Group1)

Pred.	(N = 34)			(N = 25)		
	bank- quarters	Mean effect	Median effect	bank- quarters	Mean effect	Median effect
Pre-FVO adoption	1,205	-0.0189	-0.0073	929	-0.0095	-0.0062
Post-FVO adoption	878	-0.0141	-0.0048	617	-0.0089	-0.0048
Post-Pre (+)		0.0048***	0.0024***		0.0006	0.00138***

Panel B2: Matched sample | Adopting - non adopter (Group0)

Pred.	(N = 113)			(N = 104)		
	bank- quarters	Mean effect	Median effect	bank- quarters	Mean effect	Median effect
Pre-FVO adoption	3,781	-0.0081	-0.0057	3,521	-0.0078	-0.0054
Post-FVO adoption	3,344	-0.0103	-0.0049	2,963	-0.0089	-0.0049
Post-Pre (?)		-0.0022***	0.0008		-0.0011***	0.0005

Panel C: Matched sample | Non adopter - non adopter (all banks)

Pred.	(N = 214)			(N = 132)		
	bank- quarters	Mean effect	Median effect	bank- quarters	Mean effect	Median effect
Pre-2007	3,890	-0.0089	-0.0050	2,724	-0.0059	-0.0046
Post-2007	9,975	-0.0131	-0.0080	5,153	-0.0115	-0.0054
Post-Pre (?)		-0.0042***	-0.003***		-0.0056***	-0.0008***

This table presents the results of the univariate tests. Post FVO-adoption and pre FVO-adoption (Post-2007 and Pre-2007) corresponds to period after and before the FVO adoption (after and before the FVO introduction). A positive (negative) difference between post and pre-adoption (post and pre-2007) indicates an increase (decrease) in comparability after the adopting adopts the FVO (after the introduction of the FVO in 2007). Panel A presents the results for the sample of matched pairs of adopting and adopted banks. Panel A1 and A2 present the results according to the incentives to adopt FVO. Panel B presents the results for the sample of matched pairs of adopting and non-adopter banks. Panel B1 and B2 present the results according to the incentives to adopt FVO. Panel C presents the results for the sample of matched pairs of non-adopters and non-adopters banks. All variables are defined in Appendix A. *, ** and *** indicate statistical significance at 1%, 5% and 10% levels, respectively, two sided.

TABLE 5
Multivariate analysis

Panel A: Matched pairs of adopting-adopted and adopting-non adopter banks | EAR-RET specification

	EAR - RET specification							
	Adopting - adopted banks				Adopting - non adopter banks			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	-0.0212*** (-8.58)	-0.0056* (-1.84)	-0.0203*** (-7.91)	-0.0051 (-1.61)	0.0031 (1.62)	0.0068*** (2.95)	0.0052*** (2.69)	0.0095*** (4.1)
FVO	0.0085*** (11.93)	0.0031*** (3.7)	0.0075*** (8.39)	0.0023** (2.31)	-0.0006 (-1.34)	-0.0013** (-1.96)	-0.0023*** (-4.84)	-0.0034*** (-4.77)
Group1			-0.00441*** (-3.05)	-0.0025* (-1.72)			-0.0107*** (-16.15)	-0.0104*** (-15.85)
FVO*Group1			0.00467*** (2.77)	0.0025 (1.49)			0.007*** (6.95)	0.0066*** (6.55)
TA_Ratio	-0.0005 (-0.18)	-0.0072*** (-2.69)	-0.0005 (-0.19)	-0.0071*** (-2.59)	-0.0148*** (-7.28)	-0.0138*** (-6.81)	-0.0143*** (-7.02)	-0.0135*** (-6.63)
Year FE	NO	YES	NO	YES	NO	YES	NO	YES
R - square	3.29%	7.98%	3.43%	8.31%	0.57%	2.81%	3.55%	5.69%
Adj. R- square	3.24%	7.68%	3.33%	7.95%	0.55%	2.60%	3.51%	5.45%
Observations	4,341	4,341	4,062	4,062	9,458	9,458	9,208	9,208

Panel B: Matched pairs of adopting-adopted and adopting-non adopter banks |EAR-CF specification

	EAR - CF specification							
	Adopting - adopted banks				Adopting - non adopter banks			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	-0.0434*** (-15.12)	-0.0225*** (-6.54)	-0.0425*** (-14.16)	-0.0235*** (-6.55)	-0.0002 (-0.16)	0.0028** (2.21)	0.0002 (0.22)	0.0033** (2.54)
FVO	0.0103*** (12.37)	0.0026*** (2.62)	0.0096*** (9.29)	0.0022* (1.92)	-0.0009*** (-3.57)	-0.0016*** (-4.2)	-0.0013*** (-4.7)	-0.002*** (-4.92)
Group1			-0.00416** (-2.39)	-0.00153 (-0.9)			-0.0017*** (-4.17)	-0.0015*** (-3.85)
FVO*Group1			0.00601*** (3)	0.00428** (2.18)			0.0018*** (2.9)	0.0016*** (2.59)
TA_Ratio	0.0228*** (7.47)	0.0131*** (4.32)	0.0214*** (6.77)	0.013*** (4.15)	-0.0086*** (-7.39)	-0.0084*** (-7.47)	-0.0087*** (-7.44)	-0.0085*** (-7.52)
Year FE	NO	YES	NO	YES	NO	YES	NO	YES
R - square	4.93%	12.79%	5.50%	12.93%	0.79%	8.26%	1.03%	8.42%
Adj. R- square	4.87%	12.44%	5.38%	12.51%	0.76%	8.02%	0.98%	8.16%
Observations	3,514	3,514	3,321	3,321	8,058	8,058	8,030	8,030

This table reports regression results on the effect of FVO adoption on comparability. Panel A (B) presents the results when comparability is captured using the earnings-return (earnings-cash flow) specification. Columns 1-4 include the results for the matched pairs of adopting-adopted banks and columns 5-8 for the adopting – non adopter banks. All variables are defined in Appendix A. *, ** and *** indicate statistical significance at 1%, 5% and 10% levels, respectively (two sided).

TABLE 6

Moderating effect of FVO choices and Hedge Accounting for adopting-adopted banks

Panel A: EAR - RET specification

	EAR - RET specification					
	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	-0.0217*** (-8.77)	-0.006** (-1.98)	-0.0219*** (-8.65)	-0.0055* (-1.74)	-0.0209*** (-8.16)	-0.0073** (-2.33)
FVO	0.0082*** (11.49)	0.0028*** (3.33)	0.0096*** (12.32)	0.0037*** (4.04)	0.0071*** (7.99)	0.0026*** (2.66)
FVOAL or FVOL_D	0.0043*** (2.6)	0.0045*** (2.82)				
L3_D			-0.0033*** (-3.58)	-0.0022** (-2.45)		
HedgeAccPre					-0.002 (-1.6)	-0.0012 (-1.02)
HedgeAccPre*FVO					0.0053*** (3.61)	0.0041*** (2.82)
TA_Ratio	0.0001 (0.04)	-0.0066** (-2.47)	0.0003 (0.12)	-0.007** (-2.56)	-0.0002 (-0.06)	-0.0059** (-2.17)
Year FE	NO	YES	NO	YES	NO	YES
R - square	3.44%	8.15%	3.80%	8.82%	4.37%	8.51%
Adj. R- square	3.37%	7.83%	3.73%	8.48%	4.27%	8.15%
Observations	4,341	4,341	4,028	4,028	4,087	4,087

Panel B: EAR - CF specification

	EAR - CF specification					
	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	-0.0441*** (-15.24)	-0.0233*** (-6.74)	-0.0446*** (-15.12)	-0.0233*** (-6.51)	-0.0451*** (-14.89)	-0.0256*** (-7.19)
FVO	0.0101*** (12.07)	0.0023** (2.33)	0.0114*** (12.4)	0.0029*** (2.71)	0.0072*** (6.75)	0.00004 (0.03)
FVOAL or FVOL_D	0.0039* (1.93)	0.0048** (2.49)				
L3_D			-0.0034*** (-3.16)	-0.0018* (-1.72)		
HedgeAccPre					-0.0035** (-2.51)	-0.003** (-2.22)
HedgeAccPre*FVO					0.0079*** (4.63)	0.007*** (4.26)
TA_Ratio	0.0236*** (7.66)	0.014*** (4.59)	0.0241*** (7.68)	0.014*** (4.49)	0.026*** (8.22)	0.0171*** (5.43)
Year FE	NO	YES	NO	YES	NO	YES
R - square	5.03%	12.94%	5.28%	13.40%	5.77%	13.15%
Adj. R- square	4.95%	12.57%	5.19%	13.01%	5.66%	12.74%
Observations	3,514	3,514	3,313	3,313	3,435	3,435

This table reports regression results on the moderating effect of a number of choices within the FVO adoption and hedge accounting on comparability for adopting-adopted. Panel A (B) presents the results when comparability is captured using the earnings-return (earnings-cash flow) specification. All the variables are defined in Appendix A. *, ** and *** indicate statistical significance at 1%, 5% and 10% levels, respectively, two sided.