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Adoption of International Financial Reporting Standard and Accounting Information Quality

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Abstract
The aim of this paper is to review previous literatures on IFRS adoption and whether the adoption will help in improving accounting quality.Many countries both developed and developing adopts or permits the use of International Financial Reporting Standards ('IFRS') by publicly listed companies with the aim of achieving higher information quality and accounting comparability. However, based on the reviewed articles the empirical evidence proved to be conflicting with some evidenced the benefits of IFRS adoption on the accounting information quality although many state that's these benefits of the adoption defend largely on other external factors such as countries' legal and level of enforcement, culture and investor protection while others found no any benefits arising from the IFRS adoption in respect of information quality.
Keywords: IFRS, Adoption, Information Quality

1. Introduction

Accounting theory argues that financial reporting reduces information asymmetry by disclosing relevant and timely information (Soderstrom & Sun 2007). Due to the fact that, there is a considerable variation in accounting quality and economic efficiency across countries, international accounting systems provide an interesting setting to examine the economic consequences of financial reporting (Outa, 2011). IFRS provide new insights, as firms from different legal and accounting systems adopt a single accounting standard. Hence, international accounting literature provides evidence that accounting quality has economic consequences, such as costs of capital, efficiency of capital allocation and international capital mobility (Soderstrom & Sun 2007).

The primary objective of the accounting standards is to enable corporations to provide investors and creditors with relevant, reliable and timely information which is in line with the IASB"s accounting framework for the preparation and presentation of Financial Statements. This is to contribute towards the achievement of an orderly capital markets around the world (Outa, 2011). According to proponents of International Financial Reporting Standards (IFRS) publicly traded companies must apply a single set of high quality accounting standards in order to contribute to a better functioning capital markets (Dimitropoulos, Asteriou, Kousenidis, & Leventis (2013). Therefore, IFRS adoption has the potential to facilitate cross-border comparability, increase reporting transparency, decrease information costs, reduce information asymmetry, and thereby increasing the liquidity, competitiveness, and efficiency of markets (Ball 2006; Chalmers, Clinch, & Godfrey 2011). These potential benefits rely on the presumption that IFRS adoption provides superior information to market participants and an increased accounting comparability compared to previous accounting regimes (Chalmers et al 2011).

However, there are conflicting empirical evidences that the above is the case. Moreover, while all of these potential benefits provide a persuasive argument for IFRS adoption, the costs associated with such a transition cannot be ignored (Horton, Serafeim & Serafeim 2012). For example, Ball (2006) notes that the fair value orientation of IFRS could add volatility to financial statements. This volatility takes the form of both good and bad information; the latter consisting of noise that arises from inherent estimation error and possible managerial manipulation.

Therefore, the aim of the paper is to review previous literatures on IFRS adoption and whether the adoption will help in improving accounting quality. The remaining part of the paper is organised into the following sections: discussion, prior literatures and conclusion of the study.

2. Discussion Section

2.1 Accounting Quality

According to Chua, Cheong, & Gould (2012) financial reporting quality is related to the concept of transparency defined as the ability of users to see through the financial statements, to comprehend the underlying accounting events and transactions in the company. Similarly, Outa, (2011) described the concept of accounting quality based on the IASB framework; where relevance, reliability, understandability and comparability are key components and therefore, assumed that financial statement with these four qualitative characteristics will have better quality. Moreover, Whie, Jarva and Lantto (2012) have simply described accounting quality as the extent to which the financial statement information reflects the underlying economic situation.

There are two primary qualitative characteristics of information in financial statements, relevance and

faithful representation. Information in financial statements is relevant when it is capable of making a difference to a financial statement user's decisions and has confirmatory or predictive value. Faithful representation means that the information reflects the real-world economic phenomena that it purports to represent (Palea 2013). He further highlights that, there are also some enhancing qualitative characteristics, of comparability, verifiability, timeliness, and understandability.

2.1.2 Measures of Accounting Quality

Most of the studes reviewed operationalize accounting quality using earnings management, timely loss recognition, and value relevance metrics. And they states that firms with higher quality earnings exhibit less earnings management, more timely loss recognition, and higher value relevance of earnings and equity book value, see for example, Barth, Landsman & Lang 2008; Chua et al 2012; Christensen, Lee, & Walken 2007; Paananen, 2008

2.1.3 Earnings management

Earnings management is defined as a ''purposeful intervention in the external financial-reporting process'' while, Earnings smoothing is a specific form of earnings management that occurs when managers take actions to reduce fluctuations in their firms' reported net income (Liu, Yao, Hu, & Liu 2011)..

Most previous studies have further operationalized earning management into income smoothing and managing towards positive earnings. They expect IAS-based earnings to be less managed than domestic standards-based earnings because IAS limits management's discretion to report earnings that are less reflective of the firm's economic performance (Barth et al 2008; Chua et al 2012). Thus, the assumption is that firms with fewer earnings smoothing exhibit more earnings variability.

2.1.4 Timely loss Recognition

Prior studies such as Barth et al 2008; Chua et al 2012; Outa, 2011; Dimitropoulos et al 2013 expect higher quality earnings to exhibit a higher frequency of large losses. Therefore they suggest that one characteristic of higher quality earnings is that large losses are recognized as they occur rather than being deferred to future periods. This characteristic is closely related to earnings smoothing in that if earnings are smoothed, large losses should be relatively rare. Thus, we predict that firms applying IAS report large losses with higher frequency than those applying domestic standards.

Hence, timely recognition of gains and losses is consistent with higher earnings quality, and tends to increase the volatility of earnings relative to cash flows. To test their prediction, they use two metrics of earnings variability, variability of change in net income and variability of change in net income relative to variability of change in cash flow.

2.1.5 Value Relevance

Under value relevance, firms expected with higher quality accounting have a higher association between stock prices and earnings and equity book value because, higher quality earnings better reflect a firm's underlying economics (Landsman, Maydew, & Thornock 2012).

Higher quality accounting results from applying accounting standards that require recognition of amounts that are intended to faithfully represent a firm's underlying economics and subject to less opportunistic managerial discretion (Zéghal, Chtouroum & Sellami 2011; Outa, 201). Moreover, higher quality accounting has less nonopportunistic error in estimating accruals (Outa, 2011).

2.2 Factors that Influence the Effectiveness of IFRS Adoption on Financial Repeorting Quality

While investigating the influence of IFRS adoption on the information quality on the listed 35 IBEX Spain companies Callao, Jarne, & Laínez (2007) opined that culture, strong national outlook, lack of political will, flexilbility and option of compliance with the IFRS standards resulted in the differences between standards information quality globally. While Ahmed, Neel, & Wang (2012) when investigating the impact of mandatory adoption of IFRS on information quality on sampled companies of 20 countries that have mandated the use of IFRS in their reporting stated that what leads to informativeness of a reported numbers depend on the enforcement level (whether strong or weak). It is also confirmed by Landsman et al (2012) while investigating the effects of IFRS adoption in which the study used a sample of 6,067 firms across 27 countries divided into adopter and non adopters (16 and 11 respectively).

Outa (2011) opined when examining the impact of internatinal financial reporting standards (IFRS) adoption on the accounting quality in Kenyan listed companies that, economic political factors influence the incentives of financial statements information preparers on the so called earnings management, timely loss recognision and in general reporting a value relevant statements. The study also sited factors like corporate governance and effectiveness of standards as among the factors impacting on the quality of information provided.

Similarly, An interesting study by Narktatabtee and Patpanichchot (2011) on the European Union mandatory adoption of international financial reporting atandards (IFRS) using the country level and firm level characteristics as factors having influence on the success of the adoption in achieving accounting information quality; the study indicates that from the country perspective factors such as legal investor protection and market

investor protection enhance the quality of accounting information while the firm level factors includes the firm size, volatility of cash flow and volatility in sales and more frequent losses by the company induces the management discretion in adopting measures to manipulate accounting information. Looking at the firm size a small firm can have weak corporate governance resulting in high management discretion.

moreover, Zeghal et al (2011) when determining the effects of IFRS adoption on earning management documented other factors that influence the quality of accounting information which includes, the independence and the efficiency of the board of directors, the existence of an independent audit committee, the existence of block shareholders, the quality of the external audit and the listing on foreign financial markets are important factors for enforcement of IAS/IFRS in France. Mandatory adoption of IAS/IFRS has decreased earnings management level for companies with good corporate governance and those that depend on foreign financial markets. Pope and McLeay (2011), instead, report evidence on the effects of mandatory IAS/IFRS adoption in the European Union, but their work is limited to the 2007–2010 period, and with a specific focus on findings from the European Commission-funded INTACCT project. In line with Zeghal et al, Pope and McLeay document that the effects of mandatory IAS/IFRS adoption largely depend on preparer incentives and local enforcement.

Also Daske, Hail, Leuz, & Verdi (2008) document modest but economically significant capital market benefits around IAS/IFRS mandatory adoption. However, such market benefits occurred only in countries where firms had incentives to be transparent and where legal enforcement was strong.

However, Prather-Kinsey, Jermakowicz, & Vongphanith (2008) provide evidence on the heterogeneity in the capital market consequences of mandatorily adopting IAS/IFRS by showing that firms from code law countries experienced more significant market benefits from implementing IFRS than firms from common law countries. For a sample of European firms from 14 different countries, Barth et al. (2008) also suggest that, even if IAS/IFRS are higher quality standards, the effects of features of the financial reporting system other than the standards themselves, including enforcement and litigation, can eliminate any improvement in accounting quality arising from IAS/IFRS adoption.

Dimitropoulos et al (2013) prooves while analysing the influence of internatioanl financial reporting standards (IFRS) adoption on the accounting information quality that there are firm specific characteristics that impact on the quality of information provided by IFRS which includes, firm size, firm growth opportunities, risk and quality of audit. The study also based on the review of previous literature found that law type and level of enforcement of a country plays a great deal in the quality of the information provided by its financial statements of companies. Cang, Chu, & Lin (2014) also documented similar findings while investigating the IFRS effects on the accounting quality in china where the study found that market and econimic factors plays role in the quality of accounting information.

Ding, Hope, Jeanjean, & Stolowy (2007) also documented that simply adopting IAS/IFRS may not necessarily improve national accounting systems unless countries implement profound changes in economic development policy, corporate governance mechanisms, and financial market functioning in general.

A stream of research argues that a firm’s reporting incentives, and not accounting standards, is the primary factor that determines the informativeness of accounting statements, As a result, if incentives do not change after IFRS adoption, mandating IFRS will have no effect on the information environment (Horton, et al 2012). This is similar with the findings of Hellman (2011) that examines the influence of IFRS adoption in the Sweden context, he found a less impact of IFRS on information quality due to the weak level of enforcement as a result of rigidity of Swedish legal system to change and enforce the IFRS adoption. This study proofs that it is not the standards that ensures the accounting quality but many other important factors.

2.3 Major Items Resulting in Differences between National and IFRS Standards

According to Callao et al (2007) while investigating the effect of IFRS adoption on the financial reporting numbers’ quality noted that, the major items in financial statements that resulted in the disagreement between national and international financial reporting standards are amortisation of goodwill over the useful life of the investment, financial assets measure ment, R&D recognision, expenses clasification and defered tax accounting. While, Ahmed et al (2012) documented that IFRS is different from most national stansards on the perspective that it limit management discretion through the limited alternatives offering, recognision of liability as it is principles based and the use of fair value accounting.

Undoubtedly, what differenciate between an international standard (IFRS) and domestic standards reporting quality are confined in the differences in consideration of transaction items such as the goodwill and other intangibles, financial intruments, taxation and share based payments (Chalmers et al 2011).

3. Prior Results on IFRS and Accounting Information Quality

Ahmed et al (2012) examined a sample of 1600 firms from 20 different countries that have mandated the adoption of IFRS based on the proxies of earning management, income smoothing and aggressive reporting, the

result of these 1600 firms of 20 different countries was compared with a benchmark sampled firms from 15 different countries that did not adopt IFRS. The result of the study indicated an increased in income smoothing, aggressiveness in reporting accruals and a significant decrease in timeliness in loss recognision for those firms that have adopted IFRS from the 20 countries compared to the non adopters of the 15 countries and there was no significant difference with regards to beating earning target between both the adopters and non adopters.

Similarly, Cang et al (2014) examined the contribution of international fianacial reporting standards adoption in China in which the study check the analyst coverag use of above line items (ALIs) and bottom line items (BLIs) to control earning management. The results indicates that IFRS adoption through its fair value criteria and flexibility gives more opportunities for managers to practice earning management hence IFRS adoption reduces the quality of accounting information in China.

Moreover, Callao et al. (2007), for instance, do not find that the value-relevance of financial reporting improved for a sample of Spanish firms, whereas comparability even worsened after IAS/IFRS implementation. Similar results are provided by Morais and Curto (2008), who report a negative impact of IAS/IFRS adoption on the value-relevance of accounting numbers for a sample of Portuguese firms, and likewise, Paananen and Lin (2009) for a sample of German firms. Jarva and Lantto (2012) also fail to find systematic evidence that mandatory IFRS adoption resulted in improved accounting quality for a sample of Finnish firms. Gjerde, Knivsflå, & Sættem (2008), instead, find mixed results for firms listed on the Oslo Stock Exchange. Their analysis provides little evidence of increased value-relevance for IAS/IFRS numbers when comparing and evaluating the two accounting sets unconditionally. When evaluating the change in accounting figures, the reconciliation adjustments to IAS/IFRS are found, instead, to be marginally value-relevant.

However, Barth et al (2008) examine whether application of International Accounting Standards is associated with higher accounting quality. Find that firms applying IAS from 21 countries generally evidence less earnings management, more timely loss recognition, and more value relevance of accounting amounts than do a matched sample of firms applying non-US domestic standards. Also, Zeghal et al (2011) found that, mandatory adoption of IAS/IFRS is associated with a reduction in the earnings management level although the results was induced by other factors such as corporate governance, market protection, directors power etc. Moreover, Chua et al (2012) examined 172 Australian listed firms for the period of eight (8) years, the study used proxies of earning management, timely loss recognition and value relevance (market based measure) in assessing accounting quality. The evidence shows that IFRS adoption enhances the accounting quality of these firms. Also Dimitropoulos et al (2013) documented similar result on Athens Stock Exchange listed companies in Greece with a sample of 101 firms for the period of eight years.

Furthermore, Narktatabtee and Patpanichchot (2011) study shows that adoption of international financial reporting standards helps in accounting information quality when supplemented by both an effective country level and firm level characteristics. Likewiae, Landsman et al (2012) examined the impact of IFRS adoption on the earning announcement using abnormal return volatility and abnormal trading volume as proxies, the study used a sample of 6,067 firms divided into two groups one representing adopters and the other group represents non-adopters; the evidence shows that IFRS enhance the earning announcement but level of enforcements plays great role. Also, Agostino, Drago, & Silipo (2011) report positive effects of IAS/IFRS adoption on the value-relevance of accounting data for a sample of European banks.

Contrarily, Devalle, Onali, & Magarini (2010) focus on companies listed on five European stock exchanges – Frankfurt, Madrid, Paris, London, and Milan – and find mixed evidence: the value-relevance of earnings on share price increased following the introduction of IFRS in Germany, France, and the United Kingdom, while the value-relevance of book value decreased, except for the United Kingdom. However, Horton et al (2012) investigated the effects of IFRS adoption on the accounting quality and whether mandatory IFRS adoption improves firms' information environment. They find that after the mandatory transition to IFRS, forecast accuracy and other measures of the quality of the information environment improve significantly more for mandatory adopters. Moreover, they find that the larger the difference between IFRS earnings and local GAAP earnings the larger is the improvement in forecast accuracy. This result increases the confidence that IFRS adoption causes the improvement in the information environment. However, a contrary result was documented by Paananen, (2008) that there has been no increase in financial reporting quality over the two first years after the adoption.

Barth, Landsman, Lang, & Williams (2006) find that an international sample of firms that voluntarily adopted IFRS up to 2003 exhibits lower levels of earnings management and more timely loss recognition than a matched sample of firms using local GAAP. However, Lee et al. (2008) (cited in Chua et al 2012) argue that if IFRS matters, then firms in countries that had lower disclosure quality and dependence on equity financing prior to mandatory IFRS should experience a greater impact after mandatory adoption. However, using implied cost of equity capital as an indicator, they find no effect among such countries even after two years under the new accounting standards. Similarly, Christensen, et al (2007) compare how accounting quality is affected by the adoption of IFRS for two groups of firms in Germany: a) those that perceive net benefits of IFRS and b) those

that have no incentives to adopt and are forced to comply. They find no accounting quality improvements for those firms that resist IFRS until 2005, when it is evident in those firms that voluntarily adopt IFRS.

4. Conclusion Section

This paper discusses prior empirical research on the effects of IFRS adoption on financial reporting quality. It adopts a value-relevance perspective and focuses on both developed and developing countries' experience. The paper reviewed both mandatory and voluntary IFRS adoption across developed and developing countries. This study found some what contradicting evidences with some evidenced positive correlation between IFRS adoption and accounting quality while others does not. When many of these studies further investigated for proofs they found that there are some factors that influence the accounting quality different and external to the financial standards which mainly includes, legal and political environment, culture, investor protection and preparers incentives etc.

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