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Editorial Open Access

The Quality of IFRS Financial Reporting

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Editorial:

Theoretical argument suggests that adoption of International Financial Reporting Standards (IFRS) will enhance the quality of financial reporting [1,2]. The argument is based on the notion that using a common accounting standard is expected to improve the quality of financial reporting. On the other hand, several studies have argued that the adoption of IFRS will create room for manipulating accounting numbers, because IFRS is a principle-based set of standards. In other words, IFRS encourages managers to be creative and to use professional judgment, which will decrease the comparability, transparency, relevance and reliability of financial information, and hence have an impact on the quality of reporting [3,4]. The key question is whether IFRS reports improve the quality of published financial information.

IFRS have been developed by the International Accounting Standards Board (IASB) and are to be implemented without regard for differences in socio-economic and political environments between different countries. IASB has no power in any country and the adoption of IFRS depends on national regulatory bodies [5]. These bodies are supposed to monitor and enforce the implementation of IFRS to ensure and maintain full IFRS compliance.

Controversy has surrounded the application of IFRS related to disclosure, presentation, and recognition and measurement issues. The main source of this controversy is that IFRS incorporates Fair Value Accounting (FVA), which is a market-based technique. This technique is difficult, in general, to implement, especially where markets do not operate effectively. It also involves more subjectivity, which increases earnings volatility [6,7]. In his research, Krumwiede [8] found that FVA failed to improve transparency in financial reporting, and this has had a negative impact on the users of financial information. This raises important questions as to whether IFRS does improve financial disclosure, presentation, recognition and measurement practices.

A number of studies (Cairns [9]) consider IFRS to be "fair value based standards" as the aim of the IASB is to implement full fair value accounting for all standards. However, it has been argued that FVA practices to measure assets and liabilities can lead to controversial outcomes, especially when markets suddenly become illiquid. This raises questions about the fairness of such practices. Ball [6] states that FVA practices should not be the same in all countries and that there is a risk of differences being hidden by a veneer of uniformity. He notes that, "The notion that uniform standards alone will produce uniform financial reporting seems naïve". In addition, Nobes and Parker [10] question the role of the true and fair view principle and its role in IFRS adoption. In a similar vein, Kirk [11] argues that major groups with an interest in financial reporting have the same perception of "true and fair view", but that concept is not the same as the concepts of "fairly present" or "fair presentation".

Rodriguez-Perez et al. [12] discuss the impact of applying FVA rather than historical-cost-based valuations on companies' efficiency and profitability. Their results indicate that a change to fair-value accounting could affect analysts' perceptions. However, the majority of analysts are more likely not to be affected. They said that, "It is unclear how such a change would affect the analysis of financial statements and to what extent it could modify analysts' perceptions of companies' condition and performance" [1].

Although there is a long history of debate in accounting over the relative merits of uniformity and flexibility, no resolution has been reached [13,14]. According to Hope [15], flexibility allows management to more accurately reflect the firm's performance through its financial reports. However, flexibility could also make it more difficult to compare firms cross-sectionally and inter-temporally, and may also make it easier for management to distort reality in reporting performance. The enforcement of accounting and reporting standards encourages management to follow the prescribed rules [15].

In summary, the current literature provides mixed results about the adoption of IFRS around the world. Most countries adopt IFRS to generate comparability and transparency benefits. However, the effective adoption of IFRS in different countries depends on their enforcement and monitoring mechanisms. This may indicate that IFRS adoption in countries which have weak regulatory frameworks and enforcement mechanisms will not be able to improve the quality in their financial reporting [6]. In short, previous studies have shown inconclusive results and sufficient evidence has not been presented to make the argument for or against the adoption of IFRS.

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[1] For the same line of research please see McEnroe [16] and Gjerde et al. [17]

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