



# International Journal of Research in Finance and Management

P-ISSN: 2617-5754  
E-ISSN: 2617-5762  
IJRFM 2024; 7(1): 230-235  
[www.allfinancejournal.com](http://www.allfinancejournal.com)  
Received: 10-01-2024  
Accepted: 17-02-2024

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## IFRS convergence and accounting quality: A comparative analysis of global and Indian corporate

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**DOI:** <https://doi.org/10.33545/26175754.2024.v7.i1c.302>

### Abstract

This paper provides a thorough explanation of the global effects of International Financial Reporting Standards (IFRS) adoption on accounting quality, with special attention paid to Indian situation. It highlights the role of IFRS in promoting uniformity, comparability, and transparency in financial reporting. While IFRS has had generally positive effect on accounting quality, its use in different countries and areas has yielded varying results. The analysis extensively reports the intricate complexities of the Indian scenario and emphasises the significance of constant monitoring, careful review and determined efforts to overcome implementation obstacles in order to sustainably improve accounting quality in the Indian corporate within the IFRS framework.

**Keywords:** IFRS, IND- AS, accounting quality, earnings management

### 1. Introduction

Global accounting has been drastically transformed by International Financial Reporting Standards (IFRS). Regulators now have enormous incentives to standardize accounting standards internationally due to the increased integration of international financial markets and cashflows. Standardized accounting Practices can improve cross-border trading by increasing the comparability of financial information (Ball, 2006) <sup>[10]</sup>, hence many actors of the business and accounting communities have advocated for their adoption worldwide. According to the IFRS Foundation (2023), more than 140 countries have authorised the use of IFRS by domestically listed businesses. This number represents more than 85% of all jurisdictions worldwide. Before the widespread adoption of IFRS, multinational firms operating in multiple locations often faced inconsistencies, incomparability, and additional complexity in their financial reporting. It is argued that IFRS's standardization and uniformity, promotion of transparency and full disclosure, provision of relevant and decision-useful information, reduction of earnings management, incorporation of global best practices, and enhancement of comparability all contribute to a higher quality of accounting. Companies that use IFRS are more likely to produce accurate and transparent financial reports, which is good for investors, Creditors, Regulators and other stakeholders (Armstrong *et al.*, 2010; Lantto and Sahistrom, 2009; Aharony *et al.*, 2010; Bodle *et al.*, 2016;) <sup>[8, 38, 4, 18]</sup>. Transparent disclosure, fair presentation, and the use of reliable and relevant information are just a few of IFRS's principles and regulations that contribute to higher-quality accounting when implemented. The credibility of financial statements is enhanced by IFRS since it provides a standardised framework for financial reporting, making them more comparable. Proponents of IFRS claim that the implementation of IFRS raises the standard for financial reporting, which benefits investors (Daske *et al.*, 2008) <sup>[19]</sup>. However, critics argue that a single set of standards is unlikely to raise value relevance and reliability equally considering the differences across nations. This paper aims to examine how IFRS have impacted global accounting practices and how Indian companies have responded to it. It seeks to address the topic of whether or not the broad adoption of IFRS has led to an improvement in accounting quality on a worldwide scale and in the context of India. This has been done by clarifying the theoretical underpinnings of accounting quality and analysing the impact of IFRS on accounting quality in light of earlier research conducted in India and abroad.

### Genesis of IFRS

The International Financial Reporting Standards (IFRS) have been designed to make public companies' financial statements uniform, transparent, and simple to compare across national borders. The International Accounting Standards Board (IASB), an independent body responsible for creating international accounting standards, created it and revises it regularly. The IFRS evolved out of an international collaborative effort to standardize accounting procedures. It became clear that inconsistent and non-comparable national accounting standards were a result of globalization, the integration of capital markets, and the difficulties multinational firms experienced when merging financial statements under varying standards. In 2001, the IASB came into being to fix this problem after its predecessor, the International Accounting Standards Committee (IASC), dissolved. The International Accounting Standards Board's major objective was to create a single, high-quality, internationally-recognized set of accounting standards. By using a principles-based approach that emphasizes the significance of transactions, IFRS raises the standard for financial reporting's reliability and transparency. It takes care of new concerns in the field of accounting and makes sure that the standards don't get outdated. Global business operations are facilitated by the use of IFRS, which increases transparency and credibility in financial reporting and in turn increases confidence among stakeholders. As previously discussed by Gordon *et al.*, (2012) <sup>[24]</sup>; Aliabadi & Shahri, (2016) <sup>[6]</sup>; Abad *et al.*, (2017) <sup>[1]</sup>, IFRS has been applied by governments to enhance reporting quality, lower information processing costs, and lessen information asymmetry among capital market participants within and between countries. There are two possible explanations for why implementing IFRS would result in less information asymmetry. To begin, the IFRS provides more requirements for accounting disclosure, which greatly expands the amount of information that can be made public. Second, the increased comparability and openness brought about by IFRS aids investors in making more informed judgments (Zhai & Wang, 2016) <sup>[48]</sup>. Multinational firms may more readily produce consolidated financial statements due to IFRS's standardised framework. According to studies (Judge *et al.*, 2010; Meeks and Swann, 2009) <sup>[33, 40]</sup>, International Financial Reporting Standards (IFRS) increase the credibility, uniformity, and transparency of the world's financial markets.

### Accounting Quality

The term "Accounting Quality" is used to describe the degree to which a company's financial statements can be trusted in terms of their accuracy, completeness, timeliness, and relevancy. It indicates how well a company's financial statements reflect the true economic state of its activities and its financial performance. While there is no universally accepted definition of accounting quality, its attributes can be traced back to what considered "good" financial reporting. These attributes include reliability, accruals quality, earnings persistence, timely loss recognition, earnings smoothing, value relevance and predictability (Knutson and Napolitano, 1998; Healy and Wahlen, 1999; Schipper and Vincent, 2003; Ball, 2006; Dechow and Schrand, 2010; Barth *et al.*, 2008; Legenzova, 2016) <sup>[35, 28, 49, 10, 22, 14, 39]</sup>.

### Attributes of Accounting Quality

In this Study we have focused on aspects of earnings that are most indicative of a company's true economic state. Earnings smoothing, accruals quality, timely loss recognition, and earnings' value relevance are all examples of these characteristics. These are discussed as follows:

#### Earnings Smoothing

Income smoothing, as described by Beidleman (1973) <sup>[16]</sup>, is an endeavor by management to minimize anomalous fluctuations in earnings to the extent permitted by generally accepted accounting procedures. Earnings volatility can be mitigated by employing a technique called "income smoothing," which involves manipulating financial transactions and accounting processes on purpose. Its goal is to show a steady and reliable income stream, which can aid businesses in handling investor impressions, keeping confidence high, and living up to market expectations. Income smoothing strategies include adjusting the timing of revenue recognition and expenses, implementing new accounting procedures, and setting up reserves or provisions. But income smoothing can misrepresent a company's genuine financial standing and performance, weakening the company's trust and transparency. Therefore, managers engage in smoothing as a result of manipulations because they feel pressure from the capital market to declare smooth results that meet performance benchmarks (Graham *et al.*, 2005) <sup>[25]</sup>. According to the studies, the income-smoothing policies were implemented due to the flexibility of the applicable accounting standards, such as changing of accounting policies and techniques and the creation of provisions. Earnings smoothing can be identified by a variety of methods, including the Eckel model, distribution analysis, Benish-M score, trend analysis, etc.

#### Accruals quality

The quality of accruals refers to how reliable and accurate they are for use in financial statements. Accruals that precisely reflect the underlying economic transactions are considered to be of high quality and add credibility to financial accounts. The credibility of financial reporting might be challenged by earnings management methods, which can result in low accruals quality. Accruals quality is affected by elements including management skill, internal controls, and accounting practices. Analysis of volatility and persistence, comparison of accruals to cash flows, and investigation of the relationship between future cash flows and earnings are all methods used to evaluate the reliability of accruals. Stakeholders' confidence in the financial data used to make choices relies in large part on the accuracy of accruals. Accruals quality in financial reporting is evaluated using a number of different models. The Jones model (1991) <sup>[32]</sup>, the Modified Jones model (1995), the Dechow-Dichev model (2002) <sup>[20]</sup>, the Beneish model (1997) <sup>[17]</sup>, and Kothari model (2005) <sup>[36]</sup> are all examples of such models. These models investigate the connection between accruals and cash flows, the long-term reliability of accruals across time, and the predictive power of accruals. They offer numerical standards by which to judge the accuracy of accruals and identify any earnings-manipulation schemes. These models are useful, but a full evaluation requires considering qualitative aspects as well.

### Timely loss Recognition

Recognizing losses in financial statements as soon as possible after they occur is a crucial part of accounting quality. By doing so, it guarantees that all financial reports can be trusted and compared. By acknowledging losses as soon as possible, businesses may provide their stakeholders more reliable data on the company's financial health and risk exposure, facilitating more educated choices. The timely acknowledgment of losses improves the reliability of financial accounts and displays a dedication to accurate bookkeeping and transparent reporting.

Businesses should, ideally, shut down ventures that are unprofitable. But managers keep running them because they have short-term job perspectives and are motivated by developing an empire (Ball, 2001)<sup>[1]</sup>. Earnings timeliness is measured with the use of Basu timeliness model (1997)<sup>[15]</sup>.

### Value relevance of Earnings

When discussing how much reported earnings impact investors' valuation of a firm, we refer to value relevance of earnings. It's a symbol of how reliable and helpful earnings are as a monetary yardstick. An increase in value relevance indicates that investors place more weight on profits as a source of information about a company's financial performance and future. Value-relevance factors include financial reporting quality, earnings measurement accuracy, and earnings persistence. Assessing value significance requires a statistical analysis of the relationship between profits and stock prices. It's useful for assessing a company's financial health and making strategic choices among investors, analysts, and other interested parties. Because it indicates the function of accounting information in delivering crucial information to investors for evaluation purposes, value relevance is a direct indication of information advantages for decision-making. In particular, value relevance is important because it ties in with the fundamental objective of the financial report, which is to assist current and future investors, lenders, and other creditors evaluate the value of the firm (Udeh & Ezejiofor, 2018)<sup>[45]</sup>. This means that consumers of the data should be able to extrapolate results into the future. Before the user may be disempowered in the decision-making process, enough information must be made accessible to them (Al-Wattar & AL-Shafeay, 2019)<sup>[7]</sup>. The value relevance of reported profits is put to the test with the use of the price earnings model created by Ohlson (1995)<sup>[42]</sup>.

### Impact of IFRS on Accounting Quality at Global level.

As already stated IFRS are a set of stringent standards meant to improve the reliability of financial reports. For different reasons, countries throughout the world have begun to embrace or agree upon IFRS. The goals of globalisation, attracting foreign investment, and open financial reporting all have a role in driving IFRS adoption. It enables participation in foreign capital markets and conforms to the disclosure norms of major stock exchanges throughout the world. Harmonisation and comparability are improved by adoption or convergence, leading to more reliable data and more informed choices. Countries within a region are more likely to adopt IFRS as a group if they are subject to the same regional pressures and duties. This choice is also impacted by the pre-existing legal and

regulatory environment, with some nations opting to converge their national standards with IFRS in order to find an acceptable compromise between local adaptation and international conformity. The selection is influenced by the resources, preparedness, and industry-specific elements available to each country, as well as the difficulties of the implementation process. Decisions on whether or not to adopt or converge are determined by a country's priorities, available resources, and the need to strike a balance between global harmonisation and specific regional norms. The effect of implementing IFRS on the quality of financial reports has been the subject of much research. Most research has based its accounting quality criteria on things like earnings management, value relevance, timely loss recognition, the cost of capital, and information asymmetry. Management's freedom for falsifying financial statements is constrained, according to Soderstrom & Sun (2007)<sup>[43]</sup>, since IFRS reporting increases transparency. The increased reporting quality and comparability brought about by the mandated transition to IFRS was shown by Horton *et al.* (2013)<sup>[31]</sup> to have a direct impact on the accuracy of analysts' forecasts. Overall, studies examining how IFRS affects the quality of accounting have shown contradictory findings. Accounting quality was observed to increase in some research (e.g., Barth *et al.*, 2008; Key & Kim, 2020; Dimitropoulos *et al.*, 2013; Kim, 2016)<sup>[14, 34, 23, 50]</sup>, yet decrease in others (e.g., Jeanjean & Stolowy, 2008; Abdul-Baki & Haniffa, 2020; Ahmed *et al.*, 2013;)<sup>[14, 2, 51]</sup>. Barth *et al.* (2008)<sup>[14]</sup>, using data from 21 nations, found that voluntary adopters had better accounting quality. However, Ahmed *et al.* (2013)<sup>[5]</sup> found that after adopting IFRS, accounting quality decreased across a sample of 20 nations. Accounting-based qualities (less earnings smoothing and less discretionary accruals) were shown to grow after IFRS implementation in the EU, whereas market-based metrics (less value relevance) were found to decrease, as stated by Zeghal *et al.* (2012)<sup>[47]</sup>. Most of the research on IFRS's effect on accounting quality has been conducted on samples from developed nations; nevertheless, there are substantial structural variations between developed and developing economies that should be taken into consideration. After reviewing data from six ASEAN nations Zahratun *et al.*, (2019) found IFRS convergence increases the chance of less discretionary accruals leading to greater quality Earnings. Convergence to IFRS has been found to increase Discretionary Accruals and reduce Timely Loss Recognition for Chinese Businesses. Thus IFRS adoption have had a mixed results on the accounting quality at Global level.

### IFRS Convergence and Accounting Quality in India

The adoption of IFRS in India is unique as opposed to other nations (such as Australia, Canada, France, Germany, or other members of the European Union), India chose the road of convergence rather than adoption. Indian GAAP is being brought into conformity with IFRS. As a result of this convergence, the standards are now known as Indian Accounting standards (IND-AS). Since convergence necessitates the acceptance of certain disparities in the presentation, measurement, recognition, and disclosure of different items, it is possible that the advantages of the widely acclaimed IFRS-based standards will not accrue to the nations who choose to pursue convergence. Through a

gradual convergence process, India embraced IFRS. Since April 1, 2016, all publicly traded firms in India have been required to use the IFRS-compatible Indian Accounting Standards (Ind AS). Larger listed firms were given priority while transitioning to Ind-AS since the transition was staggered based on company net-worth. Companies having a net worth of above 5bn (INR) were required to implement IND AS in the first phase (effective as of April 1, 2016), while those with a net worth of over 2.5bn (INR) were required to do so in the second phase (effective as of April 1, 2017). The adoption was aided by the Institute of Chartered Accountants of India (ICAI), which issued accounting standards associated with Ind AS and held training sessions for its members. India provided sector-specific recommendations and worked with industry specialists to solve problems that were unique to that area. Changes were also made to the Companies Act, 2013 to bring it in line with Ind AS. With the hope of attracting international investment and bringing Indian accounting practises in line with global norms, India adopted IFRS in an effort to improve financial reporting's transparency, comparability, and quality. Transition was aided by the gradual method, regulatory assistance, and harmonisation with the laws. Following the adoption of Ind-AS, FRQ (financial reporting quality) has emerged as a top priority. It's possible that company managers may be tempted to take advantage of the flexibility afforded by the Ind-AS in order to make compromises on the FRQ. Many studies assessing Earnings management actions have been undertaken in Indian environment. Himanshu & Singh, (2020) used Modified Jones and Beneish models to find the impact of Ind As on earnings Management. Results from the Modified Jones model show that Ind-AS do not significantly affect Earnings Management. But after adopting Ind-AS, all ratios except LVGI exhibit a substantial association with Earnings Management, evidenced by the Beneish model. A total of nine industries out of the sample of twenty-eight were found to have potentially manipulated financial statements. There has been a rise in the proportion of manipulators to non-manipulators, although this trend reversed during the early stages of Ind-AS's spread. An examination of the Beneish model reveals widespread PP&E manipulation on the part of businesses. Ind-AS 16, which mandates an annual re-evaluation of useful life and depreciation method, can be exploited by businesses to manipulate the values of PP&E. The degree of earnings smoothing and the quantity of discretionary accruals have grown in post-adoption years, which, according to Bansal and Garg (2021) <sup>[13]</sup>, considerably lowers accounting quality. Also the study found that after implementing IND AS, test companies are less likely to recognise losses in a timely manner and have profits that are less valuable to investors. The findings as a whole suggest that the quality of accounting has drastically dropped because of the implementation of IND-AS. One possible explanation is that India's enforcement procedures and infrastructure aren't as robust as they should be (Adhikari *et al.*, 2021; Bansal and Garg, 2021; Key and Kim, 2020) <sup>[13, 2, 34]</sup>. These outcomes are also attributable to the flexibility provided in IFRS for the recognition and measurement of assets (Langmead & Soroosh, 2009) <sup>[37]</sup>. Also, the differences between the original IFRS and the converged version of IFRS may account for the observed

phenomena. The converged form is anticipated to weaken the goal of IFRS, which is to restrict management discretion (Ball, 2016) <sup>[11]</sup>. Over the course of the IFRS enforcement era for Indonesia and India, Srivastava and Muharam (2021) <sup>[44]</sup> discovered that book values and profits had both improved in value relevance. Bansal (2023) <sup>[12]</sup> based on an analysis of 2,685 companies listed on the Bombay Stock Exchange (BSE) concluded that the implementation of IFRS-converged standards in India initially had a negative effect on the capital market. The research indicated that when comparing test companies to benchmark firms, all three variables (equity capital cost, cost of debt, and information asymmetry) increased while market liquidity declined. The impact was seen more strongly by smaller firms. There was initially a negative impact, but as time went on, the learning curve effect stepped in, and companies exhibited improved capital market responses in future years of adoption. Subsequent research highlighted that, despite initial difficulties, companies progressively adapted to the new standards and experienced enhanced market responses. However, with the passage of time, IFRS can ensure improvement in transparency, comparability, and market efficiency in Indian corporate.

### Conclusion

With the widespread implementation of IFRS, accounting standards have become more uniform, transparent, and comparable throughout the globe. This has led to better corporate governance, more stringent disclosure norms, and a greater emphasis on determining whether or not a company is trading at a fair value. The implementation of IFRS has also aided in the growth of international trade and attracted investors from outside. The impact on accounting quality, however, has been less than positive due to difficulties in implementation, varied degrees of enforcement, and the need for ongoing education and training. The success and speed with which a country adopts IFRS varies greatly from one another. While there has been development in many areas, the degree to which different countries have improved the quality of their accounting systems varies greatly. In light of this, it is clear that consistent and high-quality financial reporting throughout the world requires constant oversight and review in order to identify and resolve any problems that may arise during implementation.

The effect of introducing Ind AS on the quality of accounting in India is a topic of discussion. Initially accounting quality has reportedly been on the decrease, with some attributing it to worries about the economy and the regulatory system. Causes have been identified, including difficulties in regulation enforcement, disagreements over the appropriateness of accounting practises, problems with corporate governance, and insufficient scrutiny from regulatory agencies. It is possible that these issues are harming the quality of accounting by calling into question the reliability and comparability of financial reports. It is not largely accepted, but more research is required to ascertain the effect of Ind AS implementation on India's accounting practises.

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