Chapter 17

A Review of the Literature on IFRS Adoption From the Perspective of the Value Relevance

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ABSTRACT

International Financial Reporting Standards (IFRS)-based financial reporting has become widespread all around the world especially after its mandatory adoption in the European Union in 2005. There are several objectives of IFRS-based financial reporting, all of which depends on the idea of a single set of high-quality standards as frequently highlighted by promoters of IFRS. This literature review depicts a comprehensive picture of the archival research on the impact of IFRS-based reporting on capital markets from the perspective of the value relevance (VR) concept. First, the VR concept, as well as models employed to measure the VR, are described. Afterwards, selected studies of the archival research are grouped, summarized, and discussed. Finally, archival research is methodologically analyzed by considering different dimensions. All in all, this literature review provides information on IFRS adoption from the perspective of the VR.

INTRODUCTION

By catering financial information of the reporting entity, financial reporting contributes to the decision-making of existing or potential resource providers of the entity (IASB, 2010). This is the general objective of financial reporting. By analyzing the literature on objectives of financial reporting, Zeff (2013) defines two major approaches: the functionalist approach describes objectives as intention-based and the representationalist approach defines objectives as measurement-based. In other words, the former seeks any information to meet the intended actions of intended users while the latter is just about provid-
ing information about identified variables. Among all recognition criteria of FASB (1984), relevance falls under the functionalist approach as financial information is relevant if it plays a significant role in decision-making, and reliability belongs to the representationalist approach since financial information is reliable ‘if it represents what it purports to represent’ (Barth, Beaver, & Landsman, 2001, p. 80). Bischof and Daske (2016) and Nguyen and Molinari (2013) illustrate that i) relevance assists users of financial statements in evaluating past, present or future transactions through predictive values, and ii) reliability depicts completeness and faithful representation of accounting information as well as the non-existence of any material error and bias.

As discussed above, more reliable and relevant accounting information eventually results in higher financial reporting quality. A rich body of research analyses several financial reporting quality measures belonging to different legal families which are majorly shaped by commercial law systems. La Porta et al. (1998) underscore that English-originated common law and Roman-originated civil law create today’s commercial laws. Although the groundbreaking study of La Porta et al. (1998) provide a comprehensive and very detailed picture regarding these law families, it can be summarized as follows: investor protection is higher in common law countries than in civil law countries. Based on this classification, the literature extensively documents that the financial reporting quality in common law countries is superior to the financial reporting quality in code law countries (Knauer & Wöhrmann, 2016). In other words, accounting information is more reliable and relevant in common law countries. This evidence indicates that accounting standards in different law families may be improved in order to provide a higher level of financial reporting quality. The convergence of accounting standards from the inferior one to the superior one came into the scene at the beginning of the 1970s: International Accounting Standards Committee was established by professional accounting authorities of ten countries in order to adopt a single set of accounting standards, which is named International Accounting Standards (IAS, henceforth), for cross-border listings. The Committee published the first international conceptual framework in 1989 and the initial comprehensive set of thirty-one IAS in 1990; afterwards, the convergence process fastened. In 2002, the European Parliament enacted the Regulation which requires all listed companies in the European Union (EU, henceforth) to prepare their consolidated financial statements based on International Financial Reporting Standards (IFRS, henceforth) as of the beginning of 2005. This decision of the EU significantly accelerated the way to a single set of accounting standards: by following the EU, several countries including Australia, Hong Kong, New Zealand, South Africa, and Turkey implemented IFRS-based financial reporting in 2005. As of the end of the third quarter of 2018, IFRS-based financial reporting is mandatory in 144 countries.

The EU Regulation 1606/2002 defines the objective of IFRS adoption as improving and enhancing the level of transparency and comparability of financial statements which is expected to result in efficient functioning capital markets within the Community level as well as the individual member state level. Brüggemann et al. (2013) provide a detailed discussion on the objectives of IFRS-based reporting; financial reporting objectives of IFRS include transparency and comparability. They also highlight that capital markets objectives and macroeconomics objectives are strongly related to financial reporting objectives. Ball (2016, p. 548) briefly summarizes advantages of IFRS-based reporting including increased transparency, comparability, efficiency, and lower cost of capital; and he further underlines that “most of the expected benefits involve the efficiency of markets”.

As underscored by De George et al. (2016) and Walker (2010), promoters of IFRS generally emphasize a single set of high-quality accounting standards; and these objectives are majorly based on this high-quality emphasize.