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Impact of IFRS on Quality of Financial Reporting, Profitability, And Foreign Direct Investment: A Review

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Abstract
The introduction of International Accounting Standards is the most significant development in the field of global harmonization process in accounting. To assist users and participants in the global capital market in making financial decisions, the International Accounting Standard Committee (IASC) set out to create a single set of high-quality, understandable, and enforceable accounting standards. The IFRS Foundation developed the International Financial Reporting Standards (IFRS). The International Accounting Standards Board (IASB) and the recently established International Sustainability Standards Board (ISSB) operate under the IFRS Foundation with a major role of establishing standards. While the ISSB focuses on sustainability disclosure standards, the IASB oversees accounting standards. The IFRS Foundation, a non-profit organization, aims to create globally recognized accounting and sustainability standards that are high-quality, comprehensible, enforced, and globally accepted. These standards, known as International Financial Reporting Standards (IFRS), ensure transparent, consistent, and comparable financial statements across national borders, thereby, making it the common accounting language having global acceptance for the preparation of financial statements, allowing for easy international comparison, reading, understanding, and interpretation. These standards specify the processes and guidelines that organizations must adhere to keep and submit their books of accounts, defining various transaction kinds and other events that may affect finances, as well as rules for defining transactions and their implications on financial statements. The goal of IFRS was to reduce the asymmetry in financial statements that were in existence before the adoption of IFRS to promote uniformity and transparency in financial reporting. Prior to the adoption of IFRS, stakeholders often lacked clarity regarding a company's true financial status. The diverse national accounting standards led to contrasting data representations, making it challenging to assess financial health consistently across borders. IFRS aims to address this by providing a uniform framework for transparent and comparable financial reporting. Furthermore, because of the various policies adopted by the different countries, it was challenging to compare the financial statements of the businesses. IFRS facilitated investor decision-making, and high-quality financial information ensuring effective investment and economic decisions by varied users.

Keywords: IFRS, profitability, FDI

INTRODUCTION

The emergence of International Accounting Standards is the most notable development in the field of promoting the global harmonization process in accounting. To assist users and participants in the global capital market in making financial decisions, the International Accounting Standard Committee (IASC) set out to create a single set of high-quality, comprehensive, and legally binding accounting standards.

The IFRS Foundation created the International Financial Reporting Standards (IFRS), and under it, two boards, the International Accounting Standards Board (IASB) – to establish IFRS accounting standards; and the recently established International Sustainability Standards Board (ISSB) – to establish IFRS sustainability Disclosure standards. The mission of the IFRS Foundation, a non-profit public interest organization, is to develop internationally recognized accounting and sustainability disclosure standards of the highest caliber, comprehensible, legally binding, and internationally recognized. A set of uniform guidelines and procedures known as IFRS facilitates the preparation of financial statements qualifying on the grounds of being transparent, consistent, and comparable across the world, thus, proven to be a common accounting language that is globally acceptable for preparing financial statements so that they can be read, understood, compared, and interpreted easily at the international level. The well-laid-down procedure and policies facilitate entities in maintaining and reporting business transactions, along with the financial impact. IFRS aimed to bring uniformity and transparency in financial reporting by reducing the asymmetry seen earlier in the financial statements when the adoption of IFRS was not made. Formerly, the generally accepted accounting policies were adopted and used by different countries resulting in the presentation of data in a contrasting manner leaving stakeholders in a muddle regarding the actual financial position of the company; simultaneously, making comparison of financial statements of the companies, a difficult task due to the

policies adopted and used by different counties. This financial information benefits varied stakeholders in making effective economic and investment decisions. High-quality financial information has eased the investor in decision-making, and IFRS was introduced for that very purpose.

REVIEW OF LITERATURE

It has become a topic of research for quite a long time how IFRS adoption has impacted the financial statements or financial reporting for companies in various countries. Different types of research have been conducted in this regard. This paper focuses on the research done in the field of IFRS in India as well as in different countries on various aspects of the impact of IFRS.

Various research has been conducted in this field of IFRS relating to profitability, accounting quality, value relevance, and Foreign Direct Investment (FDI) inflows after the implementation of IFRS. A brief discussion of a few pertinent studies in this context is provided below: -

1. IFRS and Financial Reporting Quality

IFRS adoption has always been linked with the financial reporting quality, it was viewed that it would increase the quality of reporting. The implementation of Ind AS in India has resulted in enhanced financial report quality, greater transparency, information asymmetry, and comparability. It has also benefited the capital market with lower capital costs and more capital inflows. (Bansal, 2022; Saravanan & Firoz, 2022; Saji, 2022; Meshram & Arora, 2021).

According to a European empirical study, the implementation of IFRS enhances financial reporting's quality and, consequently, investors' ability to use it. However, the effect on reporting depends on the institutional setting of the firm (Palea, 2013). Another South Korean study also found that using certain variables, such as earnings management and timely loss recognition on financial transactions after the nation switched from its domestic standards to IFRS, had a positive effect on the financial reporting quality. The results corroborate and expand upon previous research showing the positive effects of IFRS on capital markets in Korea and the accounting environment. (Kimberly G. Key a & Jeong Youn Kim b, n.d.). These findings are also validated by another research based in Saudi Arabia (Mohammad Nurunnabi a b et al., 2022). According to this study, Reporting under IFRS adoption has led to advances in the financial reporting process in terms of transparency, as evidenced by descriptive pages and instructive notes.

According to Hameedi et al. (2021), banks' market value increased and their financial performance improved as a result of the adoption of IFRS, thereby, improving the caliber of financial reporting in the banking industry. Additionally, according to James Ilaboya et al (2018), there was a noticeable improvement in the quality of financial reporting following the adoption of IFRS.

Hameedi et al. (2021) observed that the adoption of IFRS resulted in an increase in the market value of banks and an improvement in their financial performance. As a result, the banking sector has also witnessed an improvement in the financial reporting quality. Also, as per another research, After the implementation of IFRS, Significant improvement was seen in the financial reporting quality..

In this regard, however, a lot of studies seem to diverge. For instance, in an empirical investigation of the effect of IFRS on the accounting standards of Kenyan listed businesses, it was found that there was little difference in the pre-and post-adoption accounting standards following the implementation of IFRS (Outa, n.d.).

2. IFRS and profitability

There are many reasons to support the concept of IFRS adoption by a country. One such reason is the impact on the profitability of the company after the adoption of IFRS. Results of various studies showed a positive impact on profitability, generally by testing various accounting ratios and figures. There are various studies based on the Indian context regarding profitability and IFRS. A study examined the impact of leverage ratios, liquidity ratios, and profitability ratios after the implementation of IFRS and concluded a significant change in leverage ratios (Thomas, n.d.). (Achalapathi and Bhanusireesha n.d.) conducted a study that showed that IFRS implementation has resulted in a noteworthy rise in valuation ratios, profitability, and liquidity. Another study (Rao et al., n.d.) that found a substantial quantitative impact of IFRS/Ind AS on a few chosen accounting figures and ratios supports this claim. The impact of IFRS and Ind AS on the applicability of financial reporting was also noted to be favorable. However, a study (Das & Saha, 2017) examined how the adoption of IFRS affected Indian companies' market value and financial statements. and the results showed that while there is an absolute difference in the quantitative indicators that are calculated based on the financial statement, which is simultaneously prepared with IGAAP and IFRS, there is no statistical evidence to support this claim (apart from liquidity position). This is supported by another paper (Pramanick, n.d.), which examined the companies' comparative positions using financial statements prepared per Ind AS and IGAAP. It discovered that, for the most part, Ind AS-based practices had no appreciable impact on the balance sheet and profit and loss statement when compared.

Numerous studies conducted in various nations also demonstrate a favorable effect on the company's profitability. A study conducted in Germany and Italy found that after the IFRS adoption, a positive impact on the major financial ratios was seen (Cordazzo, 2014). The same was supported by a second study examining how IFRS affected a sample of Israeli

companies and revealed notable changes to balance sheets, Key financial ratios, and income statement items. (Markelevich et al, 2010).
Furthermore, the analysis of the combined value relevance of net income and book value of equity for a sample of Greek companies by Tsalavoutas et al. (2011) revealed a noteworthy increase in the value relevance of the book value of equity following IFRS. For 104 Nigerian companies, the relationship between firm profitability and IFRS was also investigated. The results showed that EPS and ROA were higher under NGAAP (Nigerian Generally Accepted Accounting Policies) than under IFRS. (Paulinus et al.,2018). Another study that focused on Spanish companies found that, after examining the effects of the implementation of IFRS on the Income Statements of 28 chosen companies that were listed on the Spanish index IBEX 35, the net profit reported under IFRS and PGC differed significantly. (Pompeu Fabra, n.d.). Few studies indicated that the IFRS adoption had no effect at all or a negative one on the company's profitability. According to a study conducted on Norwegian countries, following the implementation of IFRS, there was no increase in the value relevance of key accounting figures. (Gjerde et al., 2008). A study examined how IFRS affected the quality of accounting and the accounts for 1,065 listed Australian companies. According to the findings, after IFRS, there was a rise in liabilities and a fall in equity and earnings (Goodwin et al., 2007).

According to a study conducted in the Ethiopian banking industry, since the adoption of IFRS, there has been an evident shift in the liquidity, return on equity, and leverage of commercial banks. Consequently, financial analysts and investors should keep a close eye on the liquidity ratio (LR), return on equity (ROE), and leverage (LEV) since the IFRS implementation has a significant impact on them.
(Ali Abebe, 2022).

3. IFRS and Foreign Direct Investments

Studies conducted by various researchers have concluded that IFRS adoption acts as a catalyst for improving the FDI inflows in a country by bringing more transparency to the presentation of financial statements. Many of these studies conducted have been grouped country-wise/region-wise.
In the context of African countries, a study (Musah et al., 2020) found a positive and significant impact of IFRS adoption on foreign direct investment (FDI) inflows. Another study (Akisik et al. 2020) studied the relationship shared between IFRS, FDI, human development, and economic growth in Anglophone and Francophone African countries for the period ranging between 1997 and 2017 to conclude a positive relationship between FDI inflows and IFRS adoption in both groups. This paper also suggested that there is a connection between FDI and IFRS, and to maximize the positive effects of FDI on national economies, policymakers should endeavor to enforce IFRS effectively. Another study (Gu & Joseph Prah, 2020) conducted to analyze the impact of IFRS adoption on FDI and the economy, revealed the existence of a positive correlation between FDI, IFRS, and economic growth. Focussing on Specific African Countries, the study (Ajibade et al., 2019) attempted to analyze the association of IFRS adoption with FDI and economic growth to conclude that IFRS by itself cannot ensure that FDI inflows into African nations will increase, so caution must be exercised in the policies designed to attract FDI inflows. Moreover, it seems that international investors are worried about operating expenses in an IFRS-regulated environment when it comes to Africa and that adopting IFRS would not have as much of an impact on maintaining or increasing the level of foreign direct investment (FDI) in African nations as basic institutional frameworks like the legal system, the rule of law, and the degree of corruption do (Matthias Nnadi & Teerooven Soobaroyen, 2015). African nations should work to fortify their financial systems by implementing high-quality, globally recognized accounting standards like the IFRS to enhance their business climate, boost investor confidence, and draw in foreign direct investment (Matthew Yaw Owusu et al., n.d.) as findings of a study indicate that, on average, FDI inflows are higher into African nations that have adopted IFRS than into those that have not.
Another paper (Duenya et al., 2020) investigated the IFRS adoption effect on FDI in four Anglophone West African countries, namely Ghana, Gambia, Nigeria, and Sierra Leone, and discovered some intriguing and contrasting findings, wherein, the adoption of IFRS had a favorable effect on FDI inflows to Ghana and Sierra Leone However, On the other hand, Nigeria and the Gambia saw a notable decline in foreign direct investment (FDI) inflow following the implementation of IFRS.
Studies have also been conducted to determine the degree to which African nations that have adopted IFRS have successfully transformed economic and governance aspects into foreign direct investment (FDI) and foreign portfolio investment (FPI). One of the studies, in this context, concluded that while the sample countries' adoption of IFRS was similar, their success in luring foreign investment varied (Oberholzer et al., 2022).
Another study on a sample of 42 African nations was conducted between 2001 and 2012 to address a crucial issue, i.e., the influence of IFRS adoption on FDI while considering the institutional ‘plague’ — corruption – in the African region. The study's principal contention is that the institutional frameworks of developing nations, particularly those in Africa, impede the growing worldwide push for these nations to adopt IFRS to increase their appeal to foreign investors. The results through GMM and the feasible generalized least square methods reveal that African countries will benefit more from IFRS by strengthening their institutional framework, than having a static institutional framework and then adopting IFRS. This result is robust in diverse respect.(Uchenna, n.d.-b)

Another study through sample of 92 countries, comprising of both developed and developing countries for the period 2002-2010 was conducted examining the impact of IFRS adoption on quality of global financial reporting and investment decisions considering the timedimension (i.e. the number of years a country has adopted IFRS). The study also attempted to highlight role of institutions in this relationship. The results derived through the baseline model comprising of the macro-economic, structural covariates and measures of institutions, IFRS adoption and the interactions between institutions and IFRS adoption, alongwith System Generalized Method of Moments estimation technique, highlights that IFRS is not able to attract much of FDI and institutional development plays a substitutive role in this regard. Thus, the countries adopting to IFRS should drive for the development of their institutional capacity by framing such policies that will support private investment, regulatory quality, and rule of law, property rights and protection and control of corruption.((Uchenna, n.d.-a)

For sub-Saharan African counties, a recent study (Leykun Fisseha, 2023) examined the effect of the level of adoption of IFRS., i.e. full or partial adoption, and found that in both the scenarios, partial or full adoption, there is a negative effect on FDI inflows in these countries.
Specifically in the context of Nigerian countries, (Jinadu et al., 2016) the study attempted to examine whether the adoption of IFRS has significantly wedged Foreign Direct Investments (FDI) in Nigeria. The conclusions drawn revealed results like many other studies, wherein, a positive and significant relation exists between IFRS and adoption and FDI inflows. Implementing IFRS will encourage FDI inflows and economic growth, according to a different study (Okpala, 2012) that investigated the impact of IFRS adoption on Foreign Direct Investment and Nigeria's economy.
In the context of European countries, IFRS adoption ensured compliance with high-quality disclosure and transparency as laid down in the OECD Corporate Governance Principle by improvising consolidated statements' quality (value relevance) (Müller, 2014).
Another study, where the sample was from the European Union and several other countries (Louis, n.d.), revealed that FDI inflows increased significantly because of IFRS implementation, which is consistent with IFRS' primary objective. The adoption of IFRS by unlisted companies has a lower impact on foreign direct investment (FDI) inflows than that of listed enterprises.(Camelia Iuliana Lungu cornelia Dascălu et al., n.d.)
Evidence supporting the favorable effects of IFRS adoption on goods trade and foreign direct investment (FDI) was shown in a study on European Accounting Harmonization. (Ramos Márquez, 2011). Moreover, focussing on the interdependency between IFRS and FDI, another study thoroughly examined the recent developments that international accounting harmonization had brought about in context of migration, and foreign direct investments. The study argues that the globalization of the economy has created new challenges for policymakers seeking to regulate the social, political, and economic spheres of life. It also highlights the reciprocal relationship between capital and labor in economic theory and reality and how these changes have affected the volume and structure of international trade, capital flows, and human migration. (Procházka & Procházková Ilinitchi, 2011)
For ASEAN countries, (Nejad et al., 2018) conducted an empirical test of ten ASEAN countries between 2001 and 2016 and discovered the existence of a positive correlation between IFRS and FDI inflows, indicating that IFRS plays a significant role in FDI inflows and, ultimately, economic growth. Another study (Yousefinejad et al., 2018) examined the connection between FDI inflows and IFRS adoption and found a positive and significant relationship between IFRS adoption and FDI inflow. Yet, another study attempted to get empirical evidence of the effect of tax rates and the adoption of IFRS on Foreign Direct Investment (FDI), as well, as attempts to identify whether a country needs to adopt IFRS fully, converge IFRS, or not use IFRS to increase FDI. The study, using a quantitative descriptive approach on 54 observations of 9 countries of the ASEAN Economic Community (AEC) during the years 2011 to 2016, derived results showing that the tax rate in a country negatively affects FDI and the adoption of IFRS by a country has a positive effect on FDI, while simultaneously tax rates and the adoption of IFRS significantly affects FDI (Pertiwi & Ningtiyas Nazar, 2019).

For South Asian countries, a study (Manawatu et al. 2019) investigated the potential moderating effect of IFRS adoption on the relationship between conditional accounting conservatism and foreign direct investment (FDI) in the South Asian region.
In the context of OECD countries, a study (Chen et al., 2014) focussed on the convergence of accounting standards and FDI and found that FDI inflows and IFRS compliance were positively correlated. The study further concluded that the adoption of uniform financial reporting standards helps in lowering the information barrier to foreign direct investment, thereby, encouraging cross-border investments.
In the context of CIS Countries, according to a study examining how IFRS affected foreign direct investment inflows into the CIS, the OLS estimator indicates that IFRS positively affects FDI inflows. FDI inflow and IFRS adoption, however, are negatively correlated, per the findings of LSDVC. (Sanjar et al., 2022).
In the case of MENA countries, a study on inward foreign direct investment, IFRS adoption, and institutional quality concluded the existence of a positive correlation between FDI inflows and IFRS adoption, reflecting that implementation of accounting standards by the countries increases FDI inflows. (Cieślik & Hamza, 2022).

Regarding developing or poor countries, to determine the impact of embracing IFRS, by developing countries, on FDI inflows in contrast to those that have not. A dynamic panel analysis was conducted to suggest that, in the presence of institutional quality, the countries that adopted the IFRS experienced better FDI inflows. (Matthew Yaw Owusu et al., 2017).
Another study examined the effect of IFRS adoption on foreign direct investment inflows into 38 developing nations between 2008 and 2014 to conclude that adopting IFRS positively impacts FDI inflows. (Audit Financiar & Pricope, 2017).

CONCLUSIONS

The primary aim of this research paper is to conduct a comprehensive review of existing literature concerning the relationship between International Financial Reporting Standards (IFRS) and various critical variables, including profitability, accounting quality, and Foreign Direct Investment (FDI). Numerous studies in this domain suggest that the adoption of IFRS has made significant contributions towards enhancing the quality of financial reporting. Furthermore, it enables a deeper understanding of an entity's financial information, allowing for meaningful comparisons with other organizations. These comparisons extend beyond merely selecting the best investment option; they also inform a wide range of strategic decisions.
The research indicates that countries that have successfully adopted IFRS are better positioned in terms of attracting FDI. Early implementation of IFRS in the system has proven beneficial for FDI inflows in these countries. Several international studies have extensively explored this topic, especially in nations that adopted IFRS before India did, to highlight the positive impact of IFRS implementation on financial reporting quality.
Turning our attention to India, major studies conducted in this context focused on implementation problems and the likely impact of the same on the profitability of the company. Since, IFRS was phased into Indian corporations between April 1, 2015, and April 1, 2017. With the implementation now complete, it is essential to analyze the post-implementation effects. The fundamental purpose of converging Indian accounting standards with IFRS was to align Indian corporate financial statements with global norms. This harmonization facilitates easy access to financial statements for potential investors. However, a critical question remains: Has the volume of FDI in Indian companies increased following the IFRS implementation, and if so, to what extent? Further research is needed to address this crucial aspect.

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