

Accounting Quality, IFRS, and Corruption: A Proposed Framework

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ABSTRACT

This study presents a framework that can be tested to assess how the implementation of International Financial Reporting Standards (IFRS) affects the quality of accounting practices. The framework is built on the belief that accounting should be influenced by social, political, and cultural factors. The study aims to investigate whether the positive impact of IFRS implementation on accounting quality can be further influenced positively or negatively by the national culture and the level of corruption within firms at the country level. To validate this proposition, further research is needed to conduct an empirical study.

Keywords: Accounting quality, corruption, IFRS, national culture

1. Introduction

International Financial Reporting Standards (IFRS) have been widely accepted by countries worldwide as their accounting standards. By 2018, over 130 countries had converged or adopted IFRS, moving away from their national Generally Accepted Accounting Principles (GAAP). Although there are several differences between IFRS and GAAP, one significant distinction is that IFRS follows a principles-based approach, allowing for different interpretations of specific transactions, while GAAP provides more detailed and stricter guidelines for financial reporting preparation [29].

However, the debate on whether one standard is superior to the other has not reached a final conclusion [13]. Proponents of IFRS argue that it enhances comparability of financial statements and reduces reconciliation costs [6]. Conversely, some have raised concerns about IFRS. First, it is suggested that IFRS may lead small and medium enterprises to incur unnecessary expenses during implementation [2]. Second, IFRS has not yet demonstrated a clear improvement in accounting quality [1]. Third, the flexibility offered by IFRS may potentially increase earnings management [9, 11]. Consequently, researchers have not reached a consensus on whether the adoption of IFRS improves financial reporting quality. While some studies [5], [30], among others, have found improvements in accounting quality, other researchers [18, 19, 20, 26], among others, have not observed such enhancements.

Our study speculates that the impact of IFRS on accounting quality is not solely determined by IFRS itself, but is also influenced by other institutional factors. References [14], [10], [4] argue that accounting quality differences can be attributed to various environmental attributes. However, one important attribute that has received limited attention in relation to IFRS and accounting

quality is corruption and national culture. While research on the link between corruption and accounting quality is limited [25], studies on corruption in business and management settings have been more prevalent. Similarly, [31] notes a lack of interest among accounting researchers in corruption issues, despite [7] suggesting that the output of financial reporting is heavily influenced by a country's legal framework, including the level of corruption, as shown in their study on the relationship between auditing, accounting transparency, and enforcement bodies.

Several studies have found compelling evidence of the detrimental impact of a culture of corruption on accounting quality. Using data from local public firms in China, [12] discovered that firms affiliated with corrupt officials exhibited higher accounting quality after the arrest of those officials. This finding underscores the significant role of a strong regulatory environment in determining the quality of accounting information. However, we do not argue that corruption culture directly affects accounting. Instead, we propose that the positive effects of IFRS on accounting quality are more pronounced in a stronger regulatory environment.

Reference [41] suggests that the economic consequences of adopting IFRS are diminished in countries with a higher corruption culture. [5] also observed a stronger effect of IFRS on accounting quality. Accordingly, firms adopting IFRS may be incentivized to enhance transparency and accountability, leading to higher accounting quality.

In addition to corruption, some researchers argue that national culture significantly influences how management exercises discretion to manipulate earnings [16, 23]. Regarding IFRS, [21] found an interrelationship between national culture, earnings management, and IFRS implementation. Our study explores whether the positive effects of IFRS on accounting quality are influenced by the national culture in which firms operate. This positive effect of IFRS on accounting quality may be attributed, albeit to a limited extent, to its potential to reduce earnings management.

Indeed, the quality of accounting information is also shaped by diverse national cultures. Although numerous empirical studies have examined the implications of IFRS implementation, [36] notes that limited research has focused on the factors that accelerate or decelerate such implementation. Similarly, [33] agrees that firms' compliance levels with IFRS vary across countries and over time. Based on this, we present a testable conceptual framework that aims to uncover the reasons behind the conflicting findings regarding the implementation of international accounting standards and accounting quality.

This study suggests that earnings smoothing, accounting conservatism, and earnings management can serve as proxies for accounting quality. These proxies reflect managerial discretion in making financial and accounting choices, which can distort accounting performance. They may also indicate the potential for firms to mislead stakeholders, including shareholders, banks, customers, and financial intermediaries. Furthermore, accounting conservatism may reflect how firms respond to asymmetrically recognize bad news compared to good news, thereby influencing accounting quality.² Propositions

2. Accounting, Corruption and National Culture

Accounting has long been recognized as a crucial element in the context of new public management. This is because accounting can serve as a barrier and facilitate a robust accountability framework. It is not surprising, therefore, that global financial institutions like the International Monetary Fund and World Bank encourage countries to adopt accrual accounting systems. The shift from cash-basis accounting is aimed at providing more transparent and reliable accounting information. As stated by [33], corruption is not limited to the public sector alone; it has become a prevalent issue in the private and corporate sectors, even in more developed countries.

The concept of national culture, initially introduced by Hofstede in his influential books in 1991 and 2001, refers to how the social environment structurally influences the thoughts and actions of individuals worldwide. According to Hofstede, the patterns of the structural environment, such as schools and living communities, have observable effects at the country level, leading to variations in the extent of national culture among nations. He defines national culture as "the collective programming of the mind which distinguishes the members of one group or category of people from another" (p. 260).

The Declining Positive Consequences of IFRS in High Corruption Culture

In limited study contexts, the influence of politics and corruption on accounting has been examined by [38,40]. Additionally, [35] conducted research that revealed a link between corruption in developing countries and the absence of government regulations, which in this case is represented by ambiguous accounting standards. Numerous studies have consistently demonstrated that corruption is detrimental and has negative consequences on overall firm performance [8,39].

This study posits that corruption, which has become ingrained within a particular country, can easily permeate the organizational context. As stated by [3], corruption can be normalized over time when moral agency declines. In highly corrupt countries, managers may justify practices such as earnings smoothing and earnings management as acceptable means to increase their personal wealth.

Although the impact of corruption on accounting has received limited research attention, several studies have attempted to examine the relationship between earnings management, earnings opacity, and a corrupt organizational climate [37,27,34]. For instance, in a study encompassing 34 countries, [34] found that low accounting quality contributes to an unhealthy organizational

climate, characterized by a lack of transparency and accountability. Similarly, [37] found a connection between earnings opacity and corruption in a specific country. A study conducted in China by [17] also revealed a positive correlation between earnings opacity and corruption. Moreover, [31] discovered higher levels of earnings manipulation among firms operating in countries with a high perceived corruption index. [15,32] further supported these findings by highlighting the interrelation between corruption and transparency, as well as the influence of information asymmetry on corruption.

Proposition 1: The positive consequences of IFRS may be dampened for the firms in highly corrupted index.

The Effect of National Culture on the IFRS-Accounting Quality Relationship

In addition, this study examines the influence of national culture on the positive relationship between IFRS and accounting quality. More than forty years ago, the need to connect accounting with its social, political influences, and culture was observed by [24]. Culture, as defined by Hofstede, is "the collective programming of the mind," which is expressed not only through values but also through symbols, heroes, and rituals. Numerous researchers have long argued that cultural domains have a significant impact on accounting practices. For instance, the patterns of earnings management, carbon disclosure, tax evasion practices, and the extent of corporate governance vary across different national cultures. In a study involving 14 European Union member countries, [22] found that firms with lower levels of individualism tend to exhibit higher levels of conditional conservatism.

However, this study goes further by examining whether the positive effect between IFRS and accounting quality (specifically earnings management and earnings smoothing) is influenced by

various dimensions of national culture. Specifically, we test four original cultural dimensions proposed by Hofstede, namely power distance, uncertainty avoidance, individualism vs. collectivism, and femininity vs. masculinity.

Proposition 2: The positive effect of IFRS to accounting qualities is affected by national culture dimension of firms' particular country.

3. Conclusions

This research is driven by the lack of conclusive evidence regarding the relationship between IFRS implementation and accounting quality. Therefore, we propose new hypotheses that challenge the notion of a straightforward linear relationship between IFRS and accounting quality. Specifically, our study suggests that the effect of IFRS on accounting quality is non-linear and influenced by factors such as corruption and national culture. This introduces a promising avenue for addressing the ongoing debate on whether harmonized accounting standards, like IFRS, truly enhance accounting quality.

Future research can further develop these propositions through rigorous empirical investigations that incorporate various measures of accounting quality, such as earnings management, earnings smoothing, value relevance of accounting information, and earnings persistence. Additionally, given the broad nature of the IFRS concept, further studies can explore the impact of different stages of IFRS implementation, ranging from the early convergence process to full implementation, as well as the voluntary vs. mandatory adoption of IFRS, or the process of IFRS convergence itself [42]. Exploring the qualitative aspects of IFRS implementation [44, 43, 45] would also be an interesting avenue to pursue.

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