Center for Management Science Research
ISSN: 3006-5291 3006-5283 Volume 4, Issue 3, 2026

ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) AND ITS EFFECT ON FINANCIAL TRANSPARENCY AND COMPARABILITY

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DOI: https://doi.org/10.5281/zenodo.22079143

Keywords
International Financial Reporting Standards (IFRS); Financial Transparency; Financial Information Comparability; Earnings Management; Value Relevance; Capital Markets; Institutional Enforcement; Harmonization in Financial Reporting

Article History
Received: 17 January 2026
Accepted: 02 March 2026
Published: 16 March 2026

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Abstract

The globalization of capital markets has necessitated the harmonization of financial reporting standards, culminating in the widespread adoption of International Financial Reporting Standards (IFRS) across more than 140 jurisdictions. This review synthesizes the empirical archival literature examining whether mandatory IFRS adoption achieves its primary objectives of enhancing financial transparency and improving financial statement comparability. Drawing on agency theory and information asymmetry, and signaling frameworks, the paper systematically evaluates the consequences of IFRS adoption across multiple dimensions: accruals quality, earnings management, value relevance, timely loss recognition, comparability of financial information, and capital market outcomes. The review reveals that while IFRS adoption generally increases value relevance and cross-border comparability, the effects on reporting quality and contracting efficiency are heterogeneous and critically contingent upon institutional infrastructure, legal enforcement mechanisms, and firm-level reporting enticements. In strong enforcement environments, mandatory IFRS adoption generates significant capital market benefits including reduced cost of equity capital (26-150 basis points), enhanced market liquidity, and increased foreign institutional investment. However, in weak institutional settings, "label adoption" occurs with minimal improvements in actual reporting transparency. Furthermore, the principles-based nature of IFRS introduces managerial discretion that can facilitate substitution toward real earnings management and degrade debt contractibility due to fair-value volatility. The review highlights an important tension: while IFRS enhances equity market valuation relevance, it often reduces the reliability of accounting numbers for private debt contracting. This paper concludes that IFRS harmonization represents a necessary but insufficient condition for achieving global financial transparency, emphasizing that standard-setting success ultimately depends on complementary institutional reforms and governance mechanisms.

1. Introduction

1.1 Background and Evolution of Global Accounting Harmonization

The globalization of capital markets over the past four decades fundamentally transformed the requirements placed on corporate financial reporting. Historically, public and private enterprises prepared financial statements according to domestic Generally Accepted Accounting Principles (GAAPs), which reflected distinct national legal traditions, tax systems, and corporate governance models (Bryan & Farrell, 1996). However, the resulting fragmentation created substantial information asymmetry across borders, imposing high information-processing costs on international investors and constraining the cross-border allocation of capital (Gooris & Peeters, 2016).

To resolve these market frictions, the International Accounting Standards Board (IASB) formulated International Financial Reporting Standards (IFRS) to establish a single set of high-quality, enforceable, and globally recognized financial reporting standards. A critical milestone in this global harmonization effort occurred in 2005, when the European Union mandated IFRS adoption for the consolidated financial statements of all listed companies under Regulation 1606/2002 (Bengtsson, 2011). Subsequent adoption across more than 140 jurisdictions created an unprecedented natural experiment, allowing academic researchers to evaluate the financial, managerial, and capital market consequences of standardizing reporting principles globally (Cheng et al., 2020).

1.2 Objectives and Scope of the Review

This review synthesizes the empirical archival literature evaluating the adoption of IFRS, focusing on its primary objectives: enhancing financial transparency and improving financial statement comparability. While early research attributed major capital market benefits to standard harmonization such as reduced cost of capital, increased market liquidity, and expanded foreign investment subsequent literature reveals that these outcomes are highly contingent on institutional infrastructure, legal enforcement, and firm-level reporting incentives (RIOUI et al., 2024).

This paper critically reviews theoretical perspectives, empirical methodologies, and empirical findings regarding financial reporting quality, financial statement comparability, contractibility, and market efficiency. In doing so, it highlights the structural mechanisms through which accounting standards interact with national institutions to shape microeconomic and macroeconomic outcomes (Blum et al., 2002).

2. Theoretical Framework and Conceptual Foundations

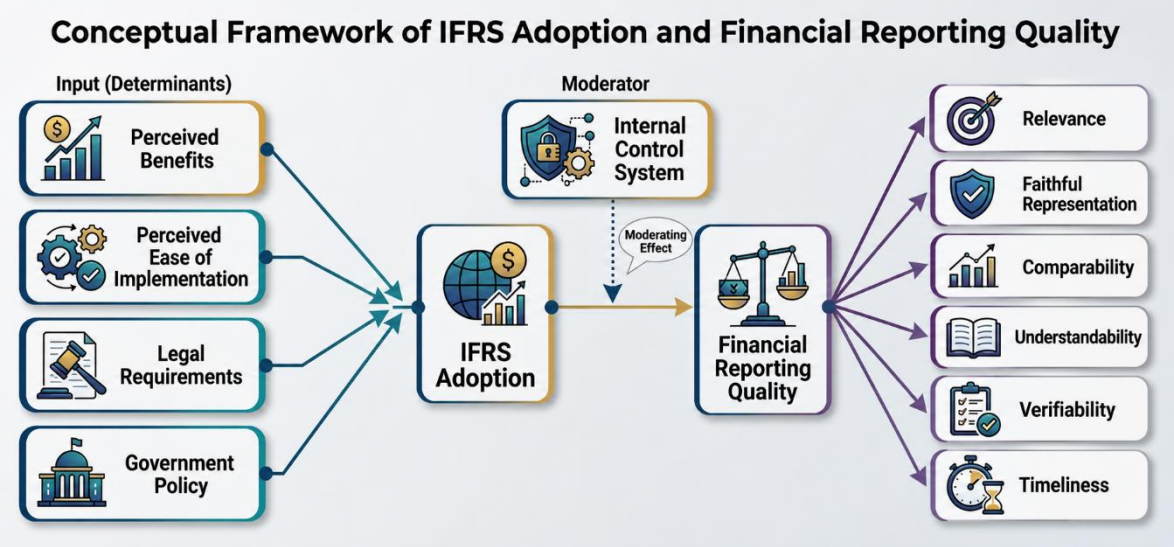
2.1 Agency Theory and Information Asymmetry, and Signaling Mechanisms

The economic justification for harmonizing international financial reporting standards rests on agency theory and information economics. In public capital markets, information asymmetry between corporate insiders and external capital providers creates adverse selection and moral hazard frictions. Information asymmetry elevates a firm's cost of capital because investors demand an adverse selection premium to compensate for trading against better-informed market participants (Meeks et al., 2019).

Under agency theory, high-quality financial reporting standards constrain opportunistic behavior by managers, limiting their capacity to hide adverse economic performance or extract private benefits of control. By replacing diverse local GAAPs with standard, comprehensive disclosure conventions and principles, IFRS aims to restrict managerial discretion and increase the precise signaling of economic earnings (Duru & Tsitinidis, 2013). From the perspective of signaling theory, voluntary or early adoption of IFRS signals corporate governance quality and operational maturity to capital markets, thereby diminishing estimation risk and attracting global equity analysts. The economic transmission mechanism connects principles-based financial reporting standards to reduced information asymmetry, which in turn narrows bid-ask spreads

and drives down the adverse selection component of the cost of capital (Nguyen & Nguyen, 2026).

Figure 1: Conceptual Framework linking the Determinants of IFRS Adoption to Financial Reporting Quality through Qualitative Attributes of Accounting Information



2.2 Structural Definitions: Transparency, Uniformity, and Comparability

To evaluate standard-setting outcomes, accounting scholars distinguish between accounting uniformity, financial transparency, and true financial statement comparability. Financial transparency refers to the degree to which financial statements reflect underlying economic realities without bias, omission, or obfuscation, supported by comprehensive footnote disclosures and reliable asset valuations. Uniformity represents the rigid application of identical accounting conventions and principles across entities regardless of differences in underlying economic contexts (Sunder, 2010).

In contrast, comparability is defined in the IASB Conceptual Framework as the qualitative characteristic that enables financial statement users to identify real economic similarities and differences between business entities. Formally, financial statement comparability exists when two distinct firms facing identical underlying economic events output identical accounting disclosures (Tarca, 2020). The transition from rule-based local GAAPs to principle-based IFRS was intended to increase comparability by eliminating alternative accounting choices. However, because principle-based frameworks require managerial judgment such as fair value estimations and impairment tests the resulting comparability depends heavily on whether management uses this discretion neutrally or opportunistically (Han, 2006).

3. Impact of IFRS Adoption on Financial Reporting Quality

3.1 Accruals Quality, Earnings Management, and Real Discretion

Empirical literature yields nuanced conclusions regarding whether mandatory IFRS adoption systematically improves accounting reporting quality. Early archival studies reported that adopting IFRS significantly reduced discretionary accruals, smoothed net income less frequently, and limited opportunistic earnings management compared to domestic GAAPs. The elimination of explicit domestic accounting choices under IFRS was found to constrain managers from manipulating accounting accruals to meet short-term earnings targets (George et al., 2016).

However, subsequent research demonstrates that restricting accrual-based earnings management can unintendedly incentivize managers to substitute toward real earnings management (REM), such as

overproduction to artificially depress cost-of-goods-sold or discounting sales to temporarily boost revenue. While accrual management involves non-cash accounting choices within legal boundaries, real earnings management alters actual operational cash flows, potentially impairing long-term firm value (Tunyi & Machokoto, 2026). Furthermore, in jurisdictions characterized by weak legal enforcement, managers have leveraged the subjective fair-value mechanisms embedded in IFRS to manage earnings through subjective asset impairment provisions and mark-to-market valuations (Reosti, 2020).

3.2 Value Relevance and Timely Loss Recognition

Value relevance measured by the statistical association between market equity prices and accounting metrics such as net income and book value of equity is a primary benchmark for financial reporting transparency (Beisland, 2009). Archival evidence indicates that mandatory IFRS adoption generally increases the value relevance of both net income and equity book value across public capital markets. The inclusion of fair-value adjustments ensures that balance sheets more closely mirror current economic asset values, providing informative signals to equity market participants (Okafor et al., 2016).

Conversely, the impact of IFRS on conditional conservatism the asymmetric requirement to recognize economic losses more rapidly than economic gains remains debated. Studies focusing on European markets reveal that mandatory IFRS transition did not uniformly increase timely loss recognition. In code-law legal regimes where accounting reporting historically aligned with tax regulation, standardized principles led to decreases in conditional conservatism due to managerial incentives to avoid reporting premature fair-value write-downs (Guermazi & Khamoussi, 2018).

3.3 Contractibility of Accounting Numbers and Debt Contracting

A key insight in the IFRS literature is the divergent impact of standardized accounting and financial reporting assumptions, conventions and principles on capital market equity valuation versus private debt contracting. While fair value accounting and principle-based estimations enhance the value relevance of financial metrics for equity investors, they frequently degrade the contractibility of accounting numbers in formal debt agreements. Fair value valuation and impairment principles and treatments enhance balance sheet relevance for equity valuation, but managerial discretion in these estimations introduces earnings volatility and degrades contractibility (Becker et al., 2021).

Debtholders rely on accounting metrics such as interest coverage ratios and debt-to-equity thresholds to construct covenants that restrict managerial expropriation. Because IFRS introduces greater fair-value volatility and managerial discretion into net income calculations, accounting numbers under IFRS become less reliable for covenant monitoring (Kratz et al., 2006). Consequently, private debt agreements following mandatory IFRS adoption often incorporate explicit covenant modifications, exclude fair-value adjustments, or shift toward non-financial covenants to compensate for the reduced contractibility of reported numbers (Li, 2023).

4. Financial Information Comparability Dynamics

4.1 Cross-border vs. Within-country Comparability

Evaluating comparability requires distinguishing between cross-border reporting alignment and domestic within-country comparability. The primary mandate of IFRS harmonization was to establish cross-border comparability, allowing institutional investors to compare firm performance across different national jurisdictions without manual reconciliation. Empirical studies confirm that mandatory IFRS adoption increased cross-border financial

comparability among publicly traded firms, particularly among businesses operating within similar industry sectors and institutional regimes (Wang, 2014).

However, standardizing financial reporting conventions and principles for publicly listed entities can create an intentional within-country comparability divide. In jurisdictions where mandatory IFRS is restricted to public capital markets while private entities continue using national GAAPs, within-country financial comparability drops sharply (Rahman 2002). For example, empirical evaluations in Germany and Italy demonstrated that while cross-border peer comparability rose for public firms, domestic comparability between public IFRS adopters and private local-GAAP firms degraded. This intra-national divergence increases information acquisition costs for domestic credit providers and distorts resource allocation across corporate sectors (Cascino & Gassen, 2015).

4.2 Methodological Approaches to Measuring Comparability

Accounting scholars employ multiple quantitative models to operationalize financial statement comparability across firms and time periods. The dominant empirical framework in the literature is the accounting function model developed by De Franco, Kothari, and Wasley (2011), which defines accounting as a mapping from economic events to financial statements (Neel & Safdar, 2024). Econometrically, stock returns serve as a proxy for underlying economic events, while net income represents the accounting output, estimated via the firm-specific regression:

$$\text{Earnings}_{it} = \alpha_i + \beta_i \text{Return}_{it} + \epsilon_{it}$$

Accounting comparability between firm i and firm j is operationalized by taking the estimated accounting function parameters of firm i and applying them to the economic returns of firm j, evaluating the absolute average difference in predicted accounting output. Lower absolute differences reflect higher financial statement comparability (Lang et al., 2010).

Alternative empirical strategies include cash flow comparability models, which measure the output mapping between operating cash flows and accruals or net earnings, isolating cash realization properties from accounting accrual estimations. Additionally, scholars utilize structural accounting index metrics, such as the Whittington Comparability Index, which computes absolute normalized differences in financial metrics across reporting frameworks:

$$\text{DIFFNI} = \left| \frac{\text{Net Income}_{\text{Local GAAP}} - \text{Net Income}_{\text{IFRS}}}{\text{Net Assets}_{\text{IFRS}}} \right|$$

This index quantifies macro-level convergence frictions and isolated valuation gaps between reporting frameworks (Penman, 2001).

5. Capital Market and Economic Consequences

5.1 Market Liquidity and Cost of Equity Capital

The broad economic justification for mandatory IFRS adoption is that improved transparency and comparability yield tangible capital market benefits. The transmission mechanism moves from standardized IFRS conventions and principles to lower processing and information search costs, which reduces information asymmetry and broadens the foreign investor base. This structural shift decreases bid-ask spreads and lowers the firm's cost of equity capital (George et al., 2016).

Daske, Hail, Leuz, and Verdi (2008) conducted a global study examining mandatory IFRS transitions across 26 countries, documenting statistically significant average capital market improvements around the implementation date. Specifically, mandatory adoption generated an average decrease in the cost of equity capital of approximately 26 basis points during the transition period (Daske et al., 2008). Market liquidity also improved, as demonstrated by reductions in bid-ask spreads, drops in the proportion of zero-return trading days, and declines in the Amihud illiquidity metric. Country-specific evaluations in strong enforcement environments, such as Spain, documented combined joint cost of capital reductions reaching up to 150 basis points when reporting upgrades coincided with national enforcement enhancements (Alquist et a., 2018).

Meta-analyses synthesizing over 50 empirical studies confirm that IFRS adoption systematically reduced the cost of equity capital and enhanced secondary market liquidity worldwide. Lower information asymmetry reduces the adverse selection component of the bid-ask spread set by market makers. Additionally, standardized reporting lowers information search and processing costs for foreign market participants, expanding investor bases and driving down required equity returns (Leuz & Wysocki, 2016).

5.2 Cross-border Capital Flows and Foreign Investment

Standardizing financial reporting frameworks mitigates international investment friction. DeFond et al. (2011) demonstrated that mandatory IFRS adoption attracted significant inflows of foreign institutional capital, specifically increasing foreign mutual fund investment holdings in adopting jurisdictions. The influx of cross-border institutional capital occurs because international fund managers can analyze foreign financial metrics using standard valuation models without incurring costly local GAAP adjustments (Di Giovanni, 2005).

Furthermore, IFRS implementation affects primary equity markets by lowering initial public offering (IPO) failure rates. Mandating IFRS disclosures prior to an IPO significantly reduces information asymmetry between issuing founders and prospective global investors, decreasing the risk of post-pricing withdrawal by up to 93% in structured samples. This indicates that financial statement transparency directly reduces failure risks in primary market capital formation (Alidarous, 2025).

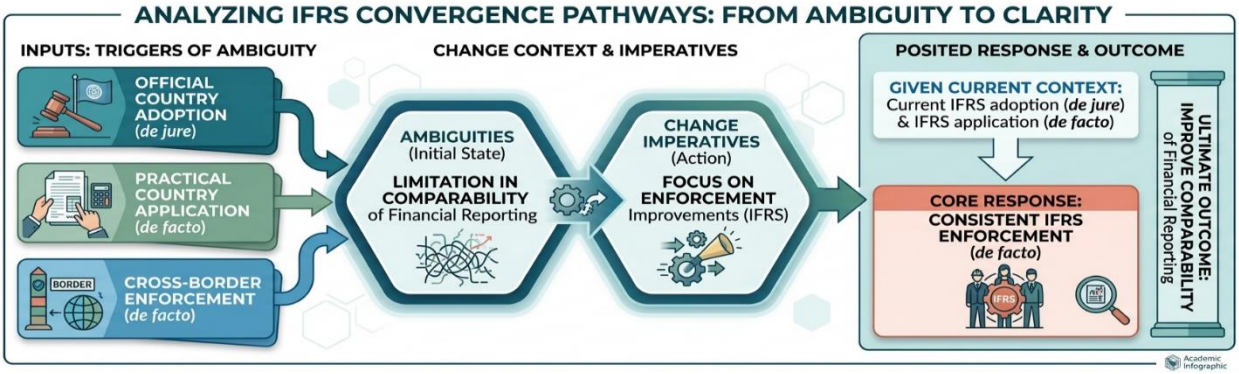
6. Institutional Moderation, Enforcement, and Reporting Incentives

6.1 Legal Regimes and Enforcement Infrastructure

A critical finding in second-generation IFRS literature is that standardized accounting conventions and principles do not operate in an institutional vacuum. De George, Li, and Shivakumar (2016) note that many early capital market benefits attributed exclusively to IFRS standards were co-determined by concurrent overhauls in national legal enforcement and regulatory auditing systems. When the implementation of IFRS standardized conventions and principles is combined with weak institutional enforcement, "label adoption" occurs with minimal changes in actual reporting quality (Alidarous, 2025). Conversely, when paired with strong enforcement overhauls, genuine gains in financial transparency and market liquidity are realized.

The capital market consequences of mandatory IFRS adoption depend directly on national legal regimes and enforcement strength. Strong enforcement settings typically characterized by common-law legal origins, rigorous securities regulatory oversight, strong auditor independence, and robust institutional protections exhibit significant reductions in cost of capital and substantial liquidity gains (Foucault et al., 2023). Conversely, in code-law jurisdictions with weak institutional enforcement, mandatory IFRS adoption yields negligible improvements in reporting transparency or market liquidity. Without credible enforcement mechanisms, the flexibility inherent in principle-based financial reporting standards allows managers to comply nominally without altering their underlying disclosure practices (Houqe, 2018).

Figure 2: Process Pathway of IFRS Convergence, De Facto Enforcement Imperatives, and Comparability Outcomes



6.2 "Label Adoption" versus Credible Implementation

The divergence in accounting outcomes across jurisdictions highlights the concept of "label adoption" versus genuine implementation. Daske et al. (2009, 2013) demonstrated that many adopting firms act as "label adopters," changing their official reporting framework to IFRS while making minimal operational changes to their actual financial transparency (Chehade & Procházka, 2024).

Managerial reporting incentives driven by corporate governance structures, executive equity ownership, reliance on public capital markets, and taxation links ultimately dictate financial reporting outcomes. When corporate governance is weak and managers face incentives to obfuscate bad news or smooth earnings, adopting high-quality principles-based standards like IFRS does not produce transparent financial reports. Consequently, IFRS harmonization is a necessary, but insufficient, condition for achieving global financial statement transparency (Larcker & Tayan, 2020).

7. Comparative Synthesis of Empirical Findings

The structured synthesis below categorizes core empirical dimensions, key measurement metrics, observed market consequences, institutional moderators, and representative literature sources (Katsikeas et al., 2016).

Table 1: Matrix of Empirical Evidence on IFRS Adoption Consequence Dimensions

Empirical Dimension	Key Metric / Methodology	Primary Direction of Effect	Core Explanatory Mechanism	Primary Literature Sources
Accruals Quality	Discretionary Accruals Models (Jones / Modified Jones)	Decreased Accruals Management	Elimination of explicit local GAAP accounting alternatives	Barth et al. (2008); De George et al. (2016)
Real Earnings Management	Production Costs & Discretionary Expense Anomalies	Increased Real Manipulation	Substitution away from monitored accruals toward real activities	Unal et al. (2014); Ahmed et al. (2013)
Value Relevance	Price & Return Regressions (R^2 on Net Income & Equity)	Statistically Significant Increase	Fair value incorporation and comprehensive balance sheet valuation	Barth et al. (2008, 2012); Earnings Relevance

Cross-Border Comparability	De Franco et al. (2011) Earnings-Return Mapping	Substantial Increase	Uniform accounting and financial reporting conventions and principles applied across international peer groups	Yip & Young (2012); Cascino & Gassen (2015)
Within-Country Comparability	Output Distance Between Public & Private Firms	Decrease / Fragmentation	Divergence between mandatory public IFRS & private local GAAP	Cascino & Gassen (2015); Fülbier & Klein (2015)
Market Liquidity	Bid-Ask Spread; Amihud Illiquidity Ratio	Lower Spreads & Higher Turnover	Reduced information asymmetry and lower adverse selection risks	Daske et al. (2008); Li (2010); Market Microstructure
Cost of Equity Capital	Implied Cost of Capital Models (Ohlson / Easton)	Decreased (~26 to ~150 bps drop)	Lower estimation risk and expanded international investor demand	Daske et al. (2008); Meta-Analysis Literature
Debt Contractibility	Covenant Tightness & Modifications	Reduced Contractibility	High volatility of fair value net income reduces covenant stability	Ball, Li, & Shivakumar (2015); De George et al. (2016)

Table 2: Comparative Analysis of Institutional and Implementation Drivers

Institutional Driver	Low / Weak Regime Trajectory	High / Strong Regime Trajectory	Net Capital Market Impact	Representative Citations
Legal Enforcement & Regulatory Oversight	"Label Adoption" occurs; minimal changes in reporting behavior	Genuine operational enforcement; material rise in disclosure quality	Benefits heavily concentrated in strong enforcement regimes	Daske et al. (2008); Christensen et al. (2013)
Legal Tradition (Common Law vs. Code Law)	Code Law: Historical tax alignment resists fair-value income volatility	Common Law: Investor-oriented markets align with fair-value principles	Faster adoption and greater liquidity gains in common-law regimes	Ball et al. (2000, 2003); La Porta et al. (1998)
Firm Reporting Incentives	Weak governance drives opportunistic earnings management via fair value	Strong governance restricts manipulation; promotes financial transparency	Managerial incentives override standardized accounting and financial reporting conventions and principles in shaping reporting quality	Ball (2001, 2006); Leuz (2003); DeFond et al. (2011)
Adoption Strategy (Mandatory vs. Voluntary)	Mandatory adoption forces compliance among reluctant, low-incentive firms	Voluntary adoption self-selects high-transparency firms with immediate benefits	Voluntary adopters exhibit larger initial cost of capital reductions	Daske et al. (2008); Christensen et al. (2015)

CONCLUSION

This review critically synthesizes the extensive empirical literature evaluating the consequences of mandatory IFRS adoption, revealing a nuanced and contingent relationship between standardized accounting and financial reporting conventions and principles, and their intended outcomes. While IFRS adoption generally enhances value relevance and cross-border comparability, the magnitude and direction of these effects depend critically on institutional infrastructure, legal enforcement, and managerial reporting incentives.

The evidence demonstrates that IFRS reduces information asymmetry and lowers the cost of equity capital in strong enforcement regimes, yet produces minimal improvements in weak institutional settings where "label adoption" prevails. A fundamental tension emerges from this literature: IFRS simultaneously improves equity market valuation relevance while degrading debt contractibility. The principles-based framework with fair-value mechanisms enhances balance sheet relevance for equity investors but introduces volatility and managerial discretion that complicates covenant monitoring for debtholders. Additionally, restricting accrual-based earnings management may inadvertently incentivize substitution toward real earnings management, potentially impairing long-term firm value. The review underscores that IFRS harmonization alone is insufficient for achieving global financial transparency. Policy-makers and standard-setters must recognize that institutional quality, legal enforcement, auditor independence, and corporate governance mechanisms are equally critical determinants of reporting outcomes. Future research should examine the dynamic interplay between accounting and financial reporting standards and institutional evolution, particularly in emerging economies where institutional development remains ongoing. Moreover, the growing complexity of business transactions and the rise of intangible assets necessitate continued refinement of IFRS to balance flexibility with comparability. Ultimately, the success of global accounting harmonization depends not only on standard-setting excellence but also on the broader institutional ecosystem that determines whether standards are credibly implemented and enforced.

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