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The effect of adopting international financial reporting standards on fraud detection and auditors' professional judgment using the structural equation model

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Abstract

The purpose of this research is to investigate the effect of adopting international financial reporting standards on fraud detection and auditors' professional judgment using the structural equation approach. This study is applied research; analytically cross-sectional in design. The statistical population of this research was formed by the audit organization and audit institutions that are members of the public accountants community during 2023 and the sample size was determined by using Cochran's formula of 196 people. The sampling method in this research is simple random. A standard questionnaire was used to measure the international standards of financial reporting, fraud detection, and professional judgment. Considering that in the current study, the relationships between variables were studied in the framework of a causal pattern, inferential statistics were analyzed using structural equation modeling and using Lisrel software. The results of the research showed that the adoption of international financial reporting standards had a significant relationship with professional judgment and detection of fraud.

Keywords: international financial reporting standards, fraud detection, professional judgment
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1 Introduction

In today's complex and interconnected global economy, transparent and reliable financial reporting plays a vital role in establishing trust and facilitating stakeholder decision-making. International Financial Reporting Standards (IFRS), developed by the International Accounting Standards Board (IASB), aim to create a single, transparent language for financial reporting worldwide and have been adopted and implemented by a large number of countries [7]. These standards place a greater emphasis on principles and professional judgment compared to the traditional rule-based approach, seeking to enhance flexibility and adaptation to changing economic conditions. This shift in approach is expected to lead to improved quality of financial information, increased comparability between companies, and ultimately, enhanced transparency.

Alongside these objectives, a key aspect expected to benefit from IFRS adoption is the auditing system's ability to detect fraud and ensure the accuracy of financial statements [13]. Auditors, as guardians of financial information, play

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a fundamental role in identifying and reporting material misstatements, whether arising from error or fraud. Therefore, any change that affects the quality of reporting and financial information could potentially impact auditors' ability to perform their duties, particularly in the areas of fraud detection and the application of professional judgment.

The paradigm shift in financial reporting, particularly the transition to principle-based standards like IFRS, has had profound effects on the auditing profession [1]. While IFRS is designed to enhance transparency, reduce opportunities for reporting manipulation, and improve comparability, its principle-based nature necessitates greater professional judgment from both financial statement preparers and auditors [17]. This presents a double-edged sword: on one hand, it can provide auditors with better tools to understand and evaluate financial information; on the other hand, it may create more complexities and require diverse interpretations, thereby opening avenues for concealing fraud or exploiting existing ambiguities [12].

The adoption of International Financial Reporting Standards (IFRS) with the aim of increasing the transparency and comparability of financial statements can make fraud detection more difficult, as hiding fraudulent activities is harder in a transparent environment. This principles-based approach, which emphasizes the true nature of transactions, can reduce opportunities for earnings management. However, the flexibility of IFRS also brings complexities and may create room for hiding sophisticated fraud within complex transactions, especially if auditors lack sufficient knowledge of these standards [5]. Therefore, while IFRS can be a tool against fraud, it also requires greater vigilance and specialized knowledge from the auditing profession [16].

The transition to IFRS significantly increases the role of auditors' professional judgment. Auditors must now interpret and apply general principles to diverse client situations, requiring deep knowledge of IFRS, continuous learning, and increasing expertise [18]. This greater reliance on judgment, while potentially leading to better audit insights, creates challenges in ensuring consistent application across the profession and elevates auditor responsibility [9]. Furthermore, the complexity of IFRS can fuel an "audit expectation gap," where users expect auditors to prevent fraud, whereas the primary role of auditing is to provide reasonable assurance. Consequently, auditors under IFRS face a more complex and nuanced task [8].

In this context, Iran's situation as one of the countries embarking on the path of IFRS adoption and implementation is of particular significance. Despite efforts to align with these standards, numerous challenges, including differences in institutional structures, the maturity of capital markets, the training and professional capacities of auditors, as well as existing legal and regulatory frameworks, can influence the interpretation and application of IFRS and, consequently, its impact on the auditing profession. International studies on the relationship between IFRS adoption and fraud detection or auditors' professional judgment have yielded mixed results; some research points to increased transparency and reduced fraud, while others highlight increased complexity and uncertainty. These discrepancies underscore the need for localized research tailored to the specific circumstances of each country [4]. The adoption of International Financial Reporting Standards (IFRS) in many countries has been undertaken with the aim of increasing transparency, harmonizing reporting methods, and improving the quality of financial information. However, in practice, it is unclear to what extent these reporting changes can lead to improved fraud detection and the enhancement of auditors' professional judgment. In Iran, considering institutional differences, the level of adaptation, and regulatory capacities, the relationship between IFRS adoption and auditors' performance in fraud detection requires careful examination. Therefore, the research question is: What is the impact of IFRS adoption on the ability to detect fraud and the manner of auditors' professional judgment?

2 Theoretical foundations

The adoption of International Financial Reporting Standards (IFRS) as a global movement has transformed the landscape of financial reporting. The primary objective of these standards is to enhance transparency, comparability, and the quality of financial information internationally. By emphasizing the economic substance over the legal form of transactions, and by requiring the use of professional judgment in many areas, these standards offer a different approach compared to rules-based accounting standards (such as those previously prevalent in Iran). This transformation has brought new challenges and opportunities for the auditing profession. Understanding how these paradigm shifts influence auditors' ability to detect fraud, as well as their professional judgment, is crucial, particularly in specific economic contexts like Iran, which has a unique institutional structure and level of implementation [14].

IFRS, with its focus on the economic substance over the form of transactions and its aim to provide information that reflects a true and fair view of a business entity's financial position, can potentially aid in better fraud detection. The inherent transparency of IFRS, greater disclosure of complex transactions, and requirements related to Fair Value Accounting can reduce more blind spots for fraudulent activities [3]. For instance, more precise disclosure of

complex financial instruments or revenue recognition methods in long-term contracts can increase transparency and limit opportunities for concealment or misrepresentation of information by fraudsters. However, the flexibility and judgment-oriented nature of some IFRS standards, such as those concerning management estimates and judgments (like provisions for doubtful debts or asset valuation), can create room for misuse, although this would necessitate malicious intent and deliberate misrepresentation [12]. Therefore, the relationship between IFRS and fraud detection is dual-faceted; on one hand, increased transparency and disclosure can assist detection, while on the other hand, the judgmental nature of some standards can pose challenges [2].

One of the fundamental changes brought by IFRS is the heightened emphasis on auditors' professional judgment. The principle-based nature of many IFRS standards, in contrast to the detailed, rule-based nature of previous standards, requires auditors to make decisions about how to apply standards and present information appropriately, based on a deeper understanding of the client's business, the relevant industry, and the nature of transactions. This necessitates the application of a higher level of expertise, reasoning, and judgment [12]. For example, in fair value accounting, auditors must gather sufficient evidence to support management's estimates and exercise judgment regarding the appropriateness of valuation methods. These judgments not only influence the execution of audit procedures but also impact the auditor's ultimate conclusion and opinion. In an environment like Iran, where the maturity of the capital market and auditors' practical experience with IFRS might still be developing, assessing the impact of these standards on auditors' professional judgment is particularly important. This could lead to an increase or decrease in auditors' reliance on evidence, as well as the influence of cognitive biases on their judgment [14].

Based on the theoretical foundations discussed above, this research presents a framework for examining the relationship between IFRS adoption, auditors' fraud detection capabilities, and the quality of their professional judgment. While previous studies have addressed the impact of IFRS on financial reporting quality or specific aspects of auditing, a significant research gap exists in understanding how these standards interact with key auditing elements like fraud detection and professional judgment, especially in emerging or transitioning economic contexts such as Iran. By focusing on this gap, this research aims to provide new and up-to-date empirical evidence that can assist regulators, audit firms, and auditors themselves in better understanding the practical implications of IFRS adoption. A more detailed examination of these relationships can contribute to the development of more effective strategies and training programs to enhance auditors' performance in an environment where financial reporting standards are constantly evolving.

Agency theory examines the inherent conflict of interest between managers (agents) and shareholders (principals), where managers may conceal or misrepresent information for personal gain, potentially leading to fraud. The adoption of International Financial Reporting Standards (IFRS), by establishing a unified reporting language and increasing transparency, significantly reduces information asymmetry between managers and shareholders. This enhanced transparency limits opportunities for concealment and manipulation, making fraud detection easier for auditors. Furthermore, IFRS strengthens auditors' analytical tools by providing higher quality and more comparable information, consequently boosting the accuracy and effectiveness of their professional judgment in assessing fraud risk and the validity of financial statements. Therefore, it can be argued that IFRS adoption, by mitigating agency problems and enhancing information quality, will have a significant impact on auditors' fraud detection ability and professional judgment.

Institutional theory explains how organizations are influenced by environmental pressures and adapt their behaviors to institutional norms and expectations to gain legitimacy and survival. The adoption of International Financial Reporting Standards (IFRS) represents a powerful global institutional pressure that encourages firms to adopt uniform and standardized financial reporting practices. This compliance with IFRS is not merely a technical measure but a response to institutional expectations for increased transparency, comparability, and reporting quality. This change in the financial reporting infrastructure, in turn, alters how auditors operate and what is expected of them; auditors now face a new set of standards and expectations, requiring them to pay closer attention to detail, conduct deeper analysis, and exercise more precise professional judgment in the process of fraud detection and assurance. Consequently, adherence to the institutional requirements of IFRS will have a significant impact on auditors' functioning in fraud detection and the application of their professional judgment.

3 Research methodology

3.1 Research method

This current research is practical in terms of results; In terms of purpose and time period, it was analytical and cross-sectional respectively.

3.2 Research variables

3.2.1 Dependent variable

Professional judgment: The International Auditing and Assurance Standards Board defines professional judgment as "the application of learning, experience and knowledge gained about auditing and accounting standards and the requirements of the code of professional conduct to adopt appropriate decisions according to the conditions of audit work. The questionnaire related to the auditor's judgment is adapted from the research of Espinosa-Pike and Barrainkua [10] and Barrainkua and Espinosa-Pike [6]. This localized questionnaire consists of 6 questions and the respondents were asked how effective each of the following factors is in the auditor's judgment: conducting an audit in conditions of lack of independence; prioritizing personal interests over public interests; Judgment influenced by customer familiarity and trust; auditing without having the necessary technical qualification and individual competence; superior pressure to change conclusions or opinions; Not reporting actual work hours.

Fraud detection: In this study, the questionnaire on fraud detection developed by Fullerton and Durstchi [11] was adapted. The localized questionnaire consists of 42 items measured on a five-point Likert scale, ranging from "Strongly Disagree" to "Strongly Agree." This questionnaire consists of 10 subscales as described in the following table:

Table 1: Fraud detection questionnaire sub-scales

Subscale	**Questions**	**Number of questions**
Organizational culture prone to fraud	1-4	4
Suspicious relationships with people outside the organization	5-7	3
Financial pressure	8-12	5
Opportunity to cheat	13-15	3
Suspicious symptoms of employees	16-19	4
Transparency	20-26	7
Individual symptoms	27-30	4
Accounting signs	31-34	4
Signs in financial statements	35-38	4
Neutral cheat position	39-42	4

3.2.2 Independent variable

International financial reporting standards: The questionnaire on the adoption of International Financial Reporting Standards (IFRS) was adapted from the Madawaki [16] questionnaire. Since this questionnaire was initially designed for a non-Iranian environment, an adaptation process was undertaken to ensure cultural and conceptual compatibility within the Iranian context. First, the questionnaire was meticulously translated into Persian by two experts in both English language and accounting (using the Back-Translation method). Subsequently, to ensure face and content validity, the questionnaire was reviewed by 7 accounting professors and 7 financial managers from publicly listed companies. After implementing minor modifications suggested by the specialists, the final version of the questionnaire was administered to a Pilot Study sample of 30 respondents. Reliability analysis results showed that the Cronbach's Alpha coefficient for the entire construct was 0.81, which is above the acceptable threshold of 0.70. These results confirm the reliability and suitability of the measurement instrument within the context of the present study. The localized questionnaire includes 15 items designed to measure the impact of IFRS, assessed using a five-point Likert scale, measuring respondents' agreement or disagreement from "Strongly Disagree" to "Strongly Agree."

3.3 Population and statistical sample

The statistical population of this research was formed by the audit organization and audit institutions, members of the public accountants community, in 2023, and the sample size was determined by using Cochran's formula of 196 people. The sampling method in this research is simple random.

3.4 Data analysis method

Considering that in the current study, the relationships between variables were studied in the framework of a causal model, inferential statistics of the structural equation modeling type were analyzed using Lisrel software version 8.80. Structural equation modeling (SEM) is a multivariate, hypothesis-driven technique that is based on a structural model representing a hypothesis about the causal relations among several variables.

4 Research findings

In this research, the Kolmogorov-Smirnov test was used to test the normality of the data. The Kolmogorov-Smirnov test is used to evaluate the similarity between the distribution of data and a theoretical distribution, or to compare two datasets with each other.

Table 2: Normality test for data

Variable	K-S	SIG	Test result
IFRS	3.83	0.553	Normal
Professional judgment	3.71	0.614	Normal
detection of fraud	4.06	0.449	Normal

Considering that the p-value of the variables is greater than 5%, the assumption of normality for all research variables is confirmed.

Before testing the relationship between research variables, the validity and reliability of the questionnaires were first performed. Convergent validity is a quantitative measure that indicates the degree of internal correlation and alignment of the measurement items for a category. For convergent validity, the average variance extracted (AVE) must be calculated.

Table 3: Convergent validity (AVE)

Variable	AVE
IFRS	0.836
Professional judgment	0.794
detection of fraud	0.809

AVE values above 0.5 indicate acceptable convergent validity, and as shown in the table above, the conceptual model of the research has acceptable convergent validity.

To better assess reliability, both Cronbach's alpha and composite reliability methods have been used. If the Cronbach's alpha and composite reliability values for each construct (variable) are above 0.7, it indicates good internal consistency for the measurement models.

Table 4: Cronbach's alpha and composite reliability coefficients

Variable	Cronbach's alpha	Composite reliability
IFRS	0.924	0.938
Professional judgment	0.912	0.946
detection of fraud	0.906	0.931

Given that the Cronbach's alpha and composite reliability values are higher than 0.7, the reliability of the research is acceptable.

In order to analyze the statistical analysis of the research, the relationship between the adoption of international financial reporting standards and the detection of fraud and professional judgment of auditors has been examined, and the coefficients of the path and its significance level are presented in figures 1 and 2.

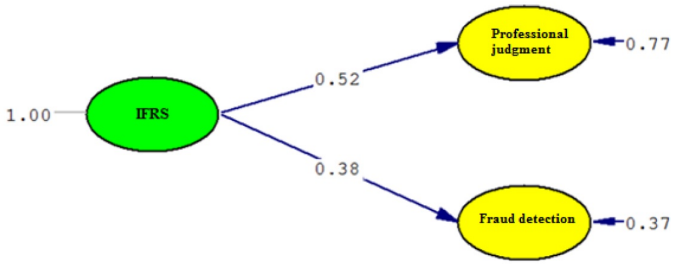


Figure 1: Model in path coefficient measurement mode

To check whether or not to reject the research hypotheses, the significance test of each of the standardized path coefficients of the structural model (Student's t-test) was used. If the value of Student's T-statistic is more than 1.95 or less than 1.96, the corresponding coefficients are significant.

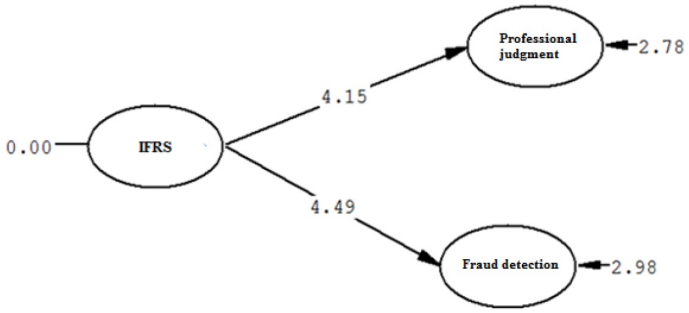


Figure 2: The model in the path significance measurement mode

Table 5: Investigating the relationship between the adoption of international financial reporting standards and fraud detection and auditors' professional judgment

Direction	Coefficient	t	SD	Result
IFRS >>> Professional judgment	0.52	4.15	0.125	Confirmation
IFRS >>> detection of fraud	0.38	4.49	0.085	Confirmation

Considering that the value of T-Student's statistic is more than 1.96, acceptance of international financial reporting standards has a significant relationship with professional judgment and fraud detection. In such a way that the adoption of international financial reporting standards has an effect of 0.52 and 0.38 on the detection of fraud in the professional judgment of auditors. IFRS adoption may more directly and strongly increase the need for professional judgment among auditors, as they must interpret standards, make decisions in complex cases, and ensure compliance with best practices. In contrast, its impact on fraud detection might be more indirect. Greater transparency can help reveal suspicious patterns, but actual fraud detection requires more specialized auditing techniques and a deeper understanding of perpetrators' motives and methods, which are not solely achieved through IFRS adoption.

Table 6: Goodness indices of structural model fit

χ^2	χ^2/DF	CFI	GFI	AGFI	RMSEA	NFI
164.39	1.63	0.976	0.961	0.95	0.045	0.923

According to table 6, the ratio of chi-square to the degree of freedom is less than 3 and the RMSEA value is close to zero. Also, the values of AGFI, GFI, NFI and CFI are close to 1; As a result, the presented model has a good fit. The Chi-square value ($\chi^2 = 164.39, p < 0.001$) is statistically significant, which at first glance may suggest a lack of model fit. However, it should be noted that the Chi-square test is highly sensitive to sample size. In relatively large samples, even very slight discrepancies between the observed data and the theoretical model can lead to it becoming statistically significant. For this reason, in the analysis of structural equation modeling (SEM), researchers recommend using supplementary fit indices such as CFI, GFI, AGFI, and RMSEA, in addition to χ^2 [15].

5 Conclusion

Using the opinions of 196 audit organizations and audit institutions that are members of the public accountants community, this research examined the effect of adopting international financial reporting standards on the detection of fraud and the professional judgment of auditors. The results of the research showed that the adoption of international financial reporting standards has a significant relationship with professional judgment and detection of fraud. In such a way that the adoption of international financial reporting standards has an effect of 0.52 and 0.38 on fraud detection and auditors' professional judgment. The adoption of IFRS strengthens the foundation of auditors' professional judgment by providing a standard and transparent framework. These standards, with greater detail on fair value measurement, revenue recognition, and financial instrument reporting, require auditors to interpret accurately and apply judgment in complex situations. IFRS's focus on the economic substance of transactions compels auditors to look beyond the superficial form to the economic reality. This approach, coupled with the need for continuous training to understand the intricacies of the standards, significantly enhances auditors' analytical and judgment skills. Furthermore, the international comparability of information helps auditors more easily identify deviations and anomalies, leading to more well-founded judgments and ultimately improving audit quality. on the other hand, IFRS reduces opportunities for management to conceal fraud by increasing transparency in financial reporting. Disclosed details about complex

transactions and the measurement of assets and liabilities make the trail of fraud more apparent to auditors. The greater reliability of financial information resulting from standardization allows auditors to rely more confidently on data and conduct their analyses, which in turn makes suspicious cases and fraud-related deviations easier to identify. The focus on the economic substance of transactions assists auditors in detecting unusual and structured transactions that may be designed to conceal fraud. Overall, by providing more accurate and reliable information, IFRS indirectly but effectively equips auditors with the necessary tools for fraud detection.

The findings of this research offer important insights for the accounting profession and the committees responsible for formulating professional ethical codes. Firstly, this research emphasizes Iran's convergence in adopting and utilizing International Financial Reporting Standards (IFRS). Given the current political and economic sensitivities facing the country, attracting maximum foreign investment and fostering macro-economic development necessitates creating suitable platforms for reporting harmonization, comparability, transparency, and the use of a common reporting language compared to previous periods, requiring greater attention and consideration. Secondly, based on the obtained results, it is recommended to provide education on these international financial reporting standards in universities and professional accounting bodies to create a suitable environment for their adoption and use, as greater education and understanding of these standards facilitate their dissemination to other sectors. Considering the positive impact of adopting International Financial Reporting Standards (IFRS) on fraud detection and auditors' professional judgment, the following practical suggestions are presented:

1. Enhanced Auditor Training Programs:
    - Focus on IFRS Nuances: Training programs for auditors should include in-depth modules on complex IFRS areas that require significant professional judgment (e.g., fair value accounting, impairment testing, revenue recognition under IFRS 15).
    - Scenario-Based Learning: Incorporate case studies and simulations that highlight how specific IFRS applications can either facilitate or hinder fraud detection. Include examples where professional judgment was critical in identifying red flags.
    - Cross-Border Harmonization: For auditors working with multinational clients, training should emphasize the comparative aspects of IFRS across different jurisdictions and how variations might be exploited for fraudulent purposes.
2. Development of Audit Methodologies:
    - IFRS-Specific Risk Assessment: Audit firms should develop or refine risk assessment procedures that specifically consider the risks of material misstatement due to fraud or error arising from the application of IFRS. This includes understanding management's incentives and opportunities to manipulate IFRS-based financial statements.
    - Data Analytics Integration: Leverage data analytics tools to identify patterns, anomalies, and outliers in IFRS-reported financial data. This can help in detecting potential fraud indicators that might be masked by the complexity of IFRS. For example, analyzing unusual fluctuations in fair value adjustments or complex revenue recognition patterns.
    - Skeptical Mindset Emphasis: Audit methodologies should consistently reinforce the importance of professional skepticism, particularly when dealing with estimates and judgments made by management under IFRS. Auditors should be encouraged to critically evaluate management's assumptions and justifications.
3. Collaboration and Information Sharing:
    - Industry Best Practices: Encourage professional accounting bodies and audit firms to share best practices and insights on applying IFRS and detecting fraud. This could be through conferences, workshops, or shared knowledge platforms.
    - Regulatory Guidance: Work with regulators to provide clear guidance on the application of IFRS in areas prone to fraud, and how auditors should exercise their professional judgment in these contexts.
4. Technology Adoption:
    - Artificial Intelligence (AI) and Machine Learning: Explore the use of AI and machine learning tools to analyze large datasets of IFRS-compliant financial information, identifying complex fraudulent schemes that may be hidden within sophisticated financial structures.
    - Audit Software Enhancements: Ensure audit software is updated to effectively handle and analyze IFRS-specific data points and complexities.

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