



International Accounting Standards in Developing Countries “Issues and Challenges”

معايير المحاسبة الدولية في الدول النامية "القضايا والتحديات"

^{1*} Yassine Salmi, y.salmi@mail.univ-djelfa.dz

¹ Lecturer B, Ziane Achour University of Djelfa, (Algeria)

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Abstract

Keywords

This paper proposes an in-depth analysis to the question of whether a single set of high-quality written accounting standards can be relevant and applied to both developed and developing countries, or developing countries should have their own standards which reflect their own contextual environments and serve their precise needs.

international accounting standards;
Globalisation;
Financial markets;
Developing countries;
International financial reporting;
financial information.

JEL Classification Codes : M40 ; F02 ; D53 ; F38

الكلمات المفتاحية

الملخص

معايير المحاسبة الدولية؛
العولمة؛ الأسواق المالية؛
الدول النامية؛ التقارير المالية
الدولية؛ معلومات مالية.

تقدم هذه الورقة تحليلاً عميقاً لمسألة ما إذا كانت مجموعة واحدة من معايير المحاسبة الدولية عالية الجودة يمكن أن تكون ذات صلة ومطبقة على البلدان المتقدمة والنامية على حد سواء، أو ينبغي أن يكون للبلدان النامية معاييرها الخاصة التي تعكس بيئتها السياقية الخاصة وخدمة احتياجاتهم الدقيقة.

تصنيف JEL: F38 ؛ D53 ؛ F02 ؛ K40

* corresponding author : full name, email : yassinoira@gmail.com

I.INTRODUCTION:

Accounting in developing countries has been the subject of controversy in academic and professional accounting literature over the last years. Two schools of thought mainly comprise the vast majority of existed literature. The first school of thought insists that with the increasing globalisation of financial markets, developing countries face a pressing need to adopt a coherent set of international financial reporting standards such as IFRS or U.S. GAAP. This argument is essentially based on the fact that financial information prepared according to different national accounting systems no longer satisfies the needs of users whose decisions have become more international in scope (Zeghal and Mhedhbi, 2006). Investors have increasingly broadened their horizons beyond national boundaries. Confusion, uncertainty, inefficiency, and a more cost of capital might, therefore, be avoided if the financial information under consideration is presented using coherent set of better-prepared international standards similar to those in any investor's country.

By contrast, the second school of thought contends that adopting a common set of enhanced international accounting standards does not necessarily translate into better quality of financial information (Ball, 2006). The quality of financial information is, arguably, influenced not only by accounting standards, but also by the political, cultural and economic factors present in each country (Doupnik and Salter, 1995; Nurunnabi, 2015). Given the different circumstances prevailing in every country, it would, therefore, be overwhelming to effectively establish a single set of standards that meets the financial reporting needs of all countries, particularly the developing ones (Chand and White, 2007).

The rest of this paper is organised as follows: The second section sheds the light on a new proposed premise that should be utilised in defining developing countries for accounting purposes. This is followed by a brief section outlining the factors affecting IFRS adoption in developing countries. The fourth section critically evaluates and problematises the process and rationale for the adoption of international standards by developing countries. The last sections present the conclusion and some suggestions.

II. THEORETICAL FRAMEWORK:

1-New premise to indicators of nations development: from economics to accounting:

Before examining the different accounting environments of developing countries in detail, it is crucial for the purpose of this discussion to explain the meaning given to the term ‘developing countries’ as it is capable of being defined in different ways. The more cited definition of developing countries which most researchers would probably consent to is that of The World Bank. Based on the gross national income (GNI) per capita, countries have been classified into four income groups: low income, lower middle income, higher middle income and high income¹. The World Bank classifies all low- and middle-income countries as developing countries. Similarly and referring to an amorphous and heterogeneous group of countries mostly found in Africa, Asia, Latin America, the Middle East and the Oceanic, Wallace (1990) defines developing countries as those placed in the mid-stream of economic development. This definition, in fact, ties in reasonably well to that used in the statistical analysis of economic development by The World Bank. However, using economic indicators to classify countries between developed and developing ones do not precisely determine the status of accounting development of these countries. Boolaky (2004) argues that using the economist’s definition of developing countries to assess their accounting needs is the wrong premise since it does not reflect the most relevant factors in the specific context of accounting. For example, using the level of GDP in developing countries for determining their accounting system is problematic in the context of accounting owing to the fact that it does not provide any basis of information to determine the accounting system of a country. Consistently, Nobes (1998b) argues that using relevant accounting indicators to define a developing country would be more useful in determining the status of accounting development of a country and its accounting needs. Such indicators can include: the number of public companies; the number of trained accountants and independent auditors per million of population; and the degree to which the business tax system is efficient. Apparently, these are important indicators for the financial reporting development of a country. Boolaky (2004) contends that in the absence of these indicators, any debate on the relevance of accounting system of developing countries will stay vague and futile. Nobes (1998b) points out that the number of public companies, for example, is a matter of importance because of its ability to determine users of the financial reporting and their needs. For instance, if a country has a large number of public companies in relation to its size, this is one signal that it may be a developed country for accounting purposes. On the contrary, if there is no public company in a country, external financial reporting to investors for financial decision-making purpose is not important. In a study covered 15 African countries and 14 developed countries, and using the index of the number of listed companies in a country, Boolaky (2004) report that there are few

¹ Economies were divided according to 2008 GNI per capita using the following ranges of income: Low-income economies are those with a GNI per capita of \$975 or less in 2008. Middle-income economies are those with a GNI

countries which are classified as developing countries from the economic indicators but are under this index ranked before the developed countries. It may, therefore, be argued that the number of listed companies in a country is more relevant to determine the accounting system than the GDP.

Furthermore, the number of trained accountants gives a clear clue to a kind of accounting and auditing systems which can be afforded. Nobes (1998b) maintains that countries with few qualified accountants and given the absence of effective external audit, adoption of IFRS will more likely to be unfeasible. It is, therefore, more relevant to consider accounting indicators when determining, whether a country is classified as developing or developed for the purpose of designing, developing and even harmonising accounting and reporting systems and practices.

2- Cultural, economic and political factors, and accounting change:

There is a general agreement that accounting diversity exists because accounting is a product of its unique environment (Saudagaran, 2001). Belkaoui (1985) claims that accounting does not develop in a vacuum but rather reflects the underlying environment in which it is developed. Given that environments differ from country to country, accounting systems and practices would necessarily be expected to differ from one country to another (Adhikari and Tondkar, 1992; Choi and Mueller, 1992). Therefore, a fundamental understanding of the underlying environmental factors that affect accounting practices in different countries would be essential in terms of both formulating any strategy and policy to harmonise international accounting systems and illustrating the limits of this endeavour.

It is generally agreed that the environmental factors that influence the accounting environment include: culture, economic development, political system, capital market, inflation levels, tax laws, legal system, and level of education, among others (Meek and Saudagaran 1990; Mueller 1968). Gallhofer and Haslam (2007) argue that the most important factors influencing the accounting policy within developing countries are culture-based societal values, economic forces, and the political system. This section sheds the light on these three factors.

A. Accounting and culture-based societal values:

The importance of cultural dimension of accounting and its historical roots has attracted a great deal of attention in recent years (Harrison & Mckinnon, 1986; Gray, 1988; Hamid et al., 1993, Nurunnabi, 2015). Culture-based societal values are a crucial element for understanding how accounting systems change since it influences norms, values and group behaviour within and across systems. Such values, in fact, tend to be significantly different from one country to another where accounting practices evolve to suit the circumstances of a particular society at a particular

per capita of more than \$975 but less than \$11,906. Lower middle-income and upper middle-income economies are separated at a GNI per capita of \$3,855. High-income economies are those with a GNI per capita of \$11,906 or more.

time. Apparently, it is overwhelming to judge the validity of such an argument directly. The main theoretical paradigm that address the question of cultural relevance of Western accounting systems to developing countries is due to Gray (1988). Based on the societal values² identified by Hofstede (1980), Gray (1988) identifies four dimensions related to societal accounting values. These values are professionalism versus statutory control, uniformity versus flexibility, conservatism versus optimism and secrecy versus transparency. This first dimension distinguishes between preference for the exercise of individual professional judgment and maintenance of professional self-regulation, as opposed to compliance with prescriptive legal requirements and statutory control. The second dimension refers to the enforcement of uniform accounting practices as opposed to flexibility in accordance with the perceived circumstances of individual companies. The third one refers to a cautious approach to accounting measurement as opposed to a more optimistic and risk-taking approach. The last dimension refers to confidentiality and the restriction of disclosure as opposed to a more transparent, open and publicly accountable approach.

In fact, statutory control is the first and more important accounting value required to adopt a global set of accounting standards. The practical adherence to standardised accounting standards by individuals with various backgrounds needs to impose prescriptive rules and regulations to account for a wide range of transactions. Put differently, the cultural orientation of many developing countries, arguably, tends to favour legislative control over accounting (Perera, 1986). Professional managers are likely to disclose more information than the non-professional ones, where the former group is relatively more aware of its social responsibility than the latter. Such a non-professional orientation of managers is likely to affect their general attitude toward the disclosure of financial information, resulting in relatively less reliable accounting information. However, in many developing countries, business managers are less likely to be professionals, educated and trained in management compared to those in developed countries. Therefore, an active role of governmental legal authority in developing accounting standards is likely to take place to result in a higher reliability of accounting information that is essential for creating public confidence in companies, and ensuring a high level of industrialisation progress. For example, in some Arab countries such as, Saudi Arabia and Morocco, the accounting profession's role in standard setting has been relatively minor compared to that of the USA and the UK (Dima, et al., 2010; Abd El Razik, 2009). Thus, new institutions have only recently been established which incorporate significant professional input to standard setting in a way that harmonises with IASB standards.

² There are four major societal values identified by Hofstede (1980): 1-individualism versus collectivism: describes individualistic societies as communities where there are few ties beyond those of the nuclear family, while the opposite societies - collectivism - are characterized by stronger cohesive in-group ties; 2-Large versus small power distance: represents the extent to which the less powerful members of a society accept that power is unequally distributed; 3-Strong versus weak uncertainty avoidance: deals with a society's tolerance for uncertainty and ambiguity; it ultimately refers to man's search for Truth. It indicates to what extent a culture programs its members to feel either uncomfortable or comfortable in unstructured situations; 4- Masculinity versus femininity: relates to the social implications of being born as a male or a female.

B. Accounting and political-based factors:

The political environment plays a key role in the development of accounting both directly and indirectly. Belkaoui (1985) argues that the political environment, in general, and political rights and civil liberties³, in particular, have significant and direct effect on the development of accounting practices. Consistent with this argument, Pourjalali and Meek (1995) report that the Iranian accounting environment changed following the 1979 revolution in Iran. Baker et. al (2010) also add that actions of standard setters in some countries are mainly based on political factors. For example, in 2006, the Chinese, Japanese and Korean standards setters joined together in an initiative which allows the continued use of pooling of interests method. The main reason that stands behind this initiative is to reflect the circumstance of large scale industrial reorganization⁴.

Moreover, the political environment affect accounting in an indirect way through its effect on the national culture and the economy. Larson and Kenny (1995) argue that the form of government, dictatorship or democracy, influences the economic environment, which in turn affects the accounting environment. Factors in the political environment, such as stable governments and a stable currency can significantly affect the economic environment, which in turn, may have an impact on the accounting environment. Considering political freedom and democracy as the main components of the political environment HassabElnaby et al. (2003) report that in periods of democracy there is more development in accounting in Egypt.

Indeed, in developed countries, political attributes that are based on high levels of democracy, political stability and a culture of accountability are reflected in their business systems including their accounting systems. However, Nobes (1998a) warns that in developing countries if these political attributes exist, their political systems are often exposed to vary. That is, political systems do not have significant impacts on accounting in developed countries as they are most likely adequately homogeneous in such countries, but they may affect it in developing countries.

This, however, is not a totally new idea. Currently, developing countries are increasingly facing a pressing need to adopt IFRSs where these countries are significantly dependent on foreign capital and such an adoption evidently found to lower the cost of information processing and auditing to capital market participants (Barth, 2008). Ramanna and Sletten (2009) argue that under this situation and to do so, developing countries must either engage in the political process to try to shape the nature of the international standards, or cede the standard setting role to other

³ Political rights are the ability to participate in the political process through such means as voting. Civil liberties represent individual freedom from state control.

⁴ The pooling method provides more flexibility to lending institutions and large industrial agencies when reorganizing their transactions without the need to refer to unreliable fair market value measures as required by IFRS 3 (Business Combinations).

political players. It is unlikely that developing countries, generally classified as less powerful countries, will adopt the former route because, they will likely have to enter into costly political wrangling with the EU, the IASB's largest sponsor. Faced with this choice, it is reasonable to expect that less powerful countries in general, and developing countries in particular are more likely to adopt IFRS since there is little political face lost in adopting EU-centric standards.

C. Accounting and economic-based factors:

The economic system is also a key determinant in the choice of a developing country's accounting system. Evidently, it has been recognised by many researchers (See Larson, 1993; Adhikari and Tondkar, 1992) that there is a positive association between a country's level of economic growth and the development of accounting systems. Larson (1993) studied if there is a difference between the economic growth rates of African countries that adopt IFRSs, with or without modification, and those that do not adopt these standards. The results indicate that adoption of IFRSs, particularly when they are modified to suite a country's local conditions, contributed to better economic growth. It is obvious that in countries that seek to achieve a relatively high level of economic growth, the socio-economic role of accounting will be of substantial importance. Business activities will reach a certain level of complexity that necessitate a high-quality accounting system. Nobes (1998a) predicts that under these circumstances, the accounting system will undergo significant changes in response to demands of the changing economic conditions for a more dynamic business environment. Put another way, the decision by developing countries to adopt IFRS will increasingly come out as a response to tackle a relatively high level of economic development. However, some critics argue that the differences in levels and targets of economic development between developed and developing countries impede the relevance of the IFRS to developing countries (Chamisa, 2000). This is, however, not an overwhelming issue bearing in mind that the majority of the IFRSs are essential and designed to measure financial performance of corporations, regardless of whether corporations are located in a developed or developing country. Zeghal and Mhedhbi (2006) found that a decision to develop a stock market and attract international investment has significantly triggered the restructuring of the accounting system and strongly motivated the adoption of IFRS among the countries that adopted IFRSs.

Having assumed convergence of accounting standards increases the accessibility of foreign capital, some warn that standards principally designed to serve investors in organised capital markets (developed countries) might not be the best choice for market participants in developing markets (Hove, 1986). Nair (1982) argues that IFRS or US GAAP were developed and heavily influenced by developed countries for market participants on developed and organised stock exchanges. That is, financial reports prepared under IFRSs are prepared for investors in organized capital markets, whereas financial reports in developing countries should serve not only investors but also other users, such as government agencies, creditors, among others. Hence, IFRSs with the investor as the main intended subject may not be useful for developing countries

with divergent interested groups and market participants. This, in fact, can be one reason that stands behind the resistance of some developing countries to adopt the IFRSs.

Nevertheless, financial reporting in developing countries produced under their local standards is still difficult to trust, despite the urgent need for these countries to attract foreign capital on the one hand, and the demands from individual and institutional investors, and international lending institutions, on the other hand. Therefore, the adoption of IFRSs in this respect is important for developing countries, particularly those with an emerging financial market.

3.The logic for the adoption of IFRSs in developing countries:

As mentioned earlier, the choice of accounting systems in developing countries is, to some extent, embedded in the workings of the overall political and socio-economic network. Belkaoui (1988) claims that the world-wide diffusion of Anglo-American accounting practices is merely legitimising certain values. This process, therefore, could result in a lack of serious efforts to meet the special needs of host (developing) countries which are noticeably pursuing diverse socio-economic development policies. In fact, the IASB has given a great deal of attention for external reporting and investors as main users in comparison with public sector accounting. Public sector accounting in developing countries is a vitally important field. To overcome such deficiency, Wallace and Briston (1993) suggest that IASB should collaborate more closely with developing countries. In this way, the IASB guarantees that its assistance is delivered in accordance with national accounting development policy.

Chamisa (2000) went much further and found that IFRS adoption by some developing countries is mainly a legitimacy-seeking process which comes under pressures from global agencies. In fact, some agencies, such as the World Bank, have been urging upon loan or aid receiving countries to adopt IFRSs. For example, the financial aid granted to Kazakhstan by the World Bank was conditional upon Kazakh acceptance of IFRS-based accounting standards (Tyrrall et al, 2007). Therefore, this country had little choice but to adopt IFRS.

However, having said IFRS adoption could be an institutional legitimacy-seeking process, developing countries gain key benefits for their economies. Many developing countries, particularly those without their own accounting standards are seeking to adopt all applicable international standards in response to many advantageous reasons. Nobes and Parker (2010) argue that the adoption of IFRS is beneficial for developing countries in terms of providing them with better-prepared standards and best quality accounting framework and principles that are crucial for their economic growth. Chamisa (2000) studied the “usefulness of IAS” for Zimbabwe and found that these standards have a positive impact on the emerging financial market in this country.

Besides, developing countries that usually do not have adequate or effective professional accounting bodies and unable to formulate their indigenous accounting standards can adopt IFRS

at relatively lower costs (Hossain , 2010). Peasnell (1993) argues that given the relative lack of financial resources in developing countries, IFRS adoption will lower the setup cost of accounting standards and save the time and efforts.

De Lima et al., (2010) raise doubt about this point and argue that where there is an undersupply of accountants with the required knowledge in developing countries, a relatively high cost for training courses is the only solution to overcome this issue. Otherwise, their ability to work under complex IFRS and generate timely and reliable information will be unsuccessful. However, given the relative lack of financial resources in developing countries, the counterpoint to this argument is straightforward and simple. It can be overcome by developing a proper training policy and financial aids by some international agencies, such as the World Bank and IASB to facilitate the information dissemination about such international standards.

Given the aforementioned arguments, IFRS adoption by developing countries, however, should not depend only on the substance of the individual accounting standards. Such an adoption should also focus on the procedures through which these standards are adopted in a sense that IFRS adoption could be considered as a short-term remedy to the current lack or deficiency of local accounting standards (Mir and Rahaman, 2005). Yet, in the long-term, the substance of these standards should be carefully examined and restructured, if there is a need, in order to reflect the contextual factors of developing countries. In doing so, the global harmonisation of accounting standards across nations would be effectively implemented with lower cost and less time constraints for developing countries. That is, adjusting the IFRS to reflect socio-economic environment of developing countries should be less burdensome, particularly in the short term. Having said that, adjusting either of these standards to country-specific needs, in the long term, might be applied based on comprehensive research.

III.CONCLUSION:

Differences in accounting standards used in different developing countries have been questioned by many academics and professionals. This paper addresses a debatable question related to the relevance of adoption of one single set of accounting standards for developing and developed countries. On the one hand, different contextual variables in developing countries raise doubt about the relevance of IFRS developed mainly by and for the West. In particular, these countries need specific accounting standards that serve their precise needs. On the other hand, IFRS adoption in developing countries would improve the comparability of accounting information in the international milieu (Bradshaw and Miller, 2007), facilitate financial operations on an international scale, and strengthen their competitiveness in global financial markets. This paper suggests that the suitability of IFRS to developing countries depends eventually on a number of nation-specific environmental factors such as cultural, economical, and political, factors, However, adoption of IFRS should be considered as a short-term remedy to comparability problems and the current lack of local accounting standards in developing countries. That is, modification of the IFRS to reflect socio-economic environment of developing countries should be less burdensome, at least in the short term. This suggestion, yet, does not mean that IFRS are totally relevant to developing countries. The substance of these standards should be carefully examined and modified, in the long term if there is a need for such modifications, to meet local environmental factors of these countries.

Besides, if a country has special contextual factors that are not well covered by IFRS, such as accounting needs of Islamic countries, then specialised standards reflecting its particular accounting needs also would be helpful. Finally, an important issue worth mentioning in this respect is that the adoption course could be made less controversial through greater involvement by all concerned parties, particularly from developing countries. In doing so, the IASB can enhance the relevance of IFRS to reflect the various contextual factors in developing countries.

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