Investigating the Impact of IFRS Adoption in Developing Countries

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In the quest for transparent trade records, humanity has witnessed great transformation in the accounting field, from numerical engravings on tablets to the International Financial Reporting Standards (IFRS). IFRS is defined by Palmer (2022) as a set of accounting standards developed by the International Accounting Standards Board (IASB) intended to foster transparency and accuracy in the recording and reporting of financial information. According to Palmer, 168 jurisdictions have adopted IFRS, including all members of the European Union. However, the impact of IFRS adoption in developing countries remains controversial. Developing countries generally lack qualified accounting professionals and enforceable legislation regarding the application of accounting standards (Samaha & Khlif, 2016). Therefore, for the sake of increased transparency and economic growth, it is essential to understand how IFRS adoption impacts developing countries. By analyzing factors influencing IFRS adoption, as well as its costs and benefits, we can see various perspectives on the impact of its adoption in developing countries; an understanding of this topic increases our awareness of the need for accounting standards that benefit developing nations.

The two theories that most adequately explain the factors that influence IFRS adoption are the economic theory and isomorphism. According to Samaha and Khlif (2016), the economic theory states that the likelihood of a country officially adopting IFRS depends on whether its trade partners and other countries within its region have adopted, or are pursuing the adoption of, IFRS. This theory is based on the understanding that IFRS makes financial statements more comparable across countries, which drives foreign investment in business. Li et al. (2020) validate this claim in their research, stating that the increased detail IFRS introduces to financial statements drives greater disclosure quality (DQ), which corresponds to increased foreign investment. This is a positive development for developing countries because increased foreign investment drives domestic business investment and innovation. Therefore, if a developing country believes that IFRS will bring greater foreign investment than local GAAP, it will likely adopt IFRS. This theory ultimately views IFRS as a product, much like oil, gas, or a sandwich. A country's final decision to adopt ("buy") IFRS depends on its assessment of the value of IFRS, also called the "autarky value of IFRS," which measures whether adoption will bring greater value to the economy than its local Generally Accepted Accounting Principles (GAAP). A second theory described by Hassan et al. (2016) for the factors influencing IFRS adoption is isomorphism, which has three types: coercive, mimetic, and normative. Isomorphism simply refers to something being similar to another, so all of these theories discuss how worldwide trends influence domestic decisions The authors describe coercive isomorphism as a situation where an institution forces IFRS adoption in a country in exchange for some economic benefit. In developing countries, this often involves international institutions requiring a country to adopt IFRS before it will conduct trade or provide aid to that country. The second is mimetic, which the authors describe as a shift towards IFRS adoption caused by the perception that highly legitimate countries follow IFRS. Developing countries generally desire legitimacy, so adopting IFRS is a logical way to achieve this. The last is normative, which is described as a shift towards IFRS created by changes in the percentage of educated citizens in a country. Understanding the factors influencing the adoption of IFRS in developing countries advances our understanding of the perceived value of IFRS in these countries.

The main costs and perceived drawbacks of IFRS adoption in developing countries include monetary transition costs and relevance. Monetary transition costs refer to the cash companies would have to spend making sure they comply with IFRS. According to research by

Pawsey (2017), a typical conversion project for a company transitioning to compliance with IFRS costs $200,000 and lasts between nine and 20 months. Furthermore, Pawsey shows that after conversion, companies spent an average of 20% more on accounting costs. These numbers threaten the short-term profitability in countries where businesses are already tight on cash flow. Furthermore, the transition to IFRS would cause a dramatic increase in demand for accounting staff as companies seek to comply with IFRS. The issue with this increase in demand is many developing countries cannot meet this demand pre-IFRS adoption, so businesses may be forced to outsource their work to accounting firms like Deloitte and PWC, who charge significant auditing and consulting fees. Another perceived drawback of IFRS adoption is relevance. In the research of Tyrrall et al. (2007), the authors claim that the countries which developed IFRS were industrial countries, not developing countries, which means developing countries had a limited say in the development of IFRS. Developing countries naturally face different issues shaped by their cultural, economic, and political environments, and the authors claim that these issues were ignored in the development of IFRS. As a result, the authors argue that IFRS should not be viewed as a solution to accounting issues in developing countries. Rather, already-existing laws and standards must be changed to meet the nature of the needs of developing countries. If IFRS is characterized by a failure to meet the needs of developing countries, then the autarky value of IFRS discussed earlier will diminish, along with the motivations of other countries to transition to IFRS. For IFRS to be effective in developing countries, it must be adaptable and relevant to the current political, social, and economic climate so that it serves the needs of developing countries.

The most important benefits of IFRS adoption in developing countries include foreign investment produced by comparability, as well as improved transparency and disclosure quality

(DQ). Samaha and Khlif (2006) argue that IFRS adoption will help drive positive economic growth by facilitating international investment as financial statements become more comparable. For instance, the financial statements of an oil company in Saudi Arabia and Egypt will look very similar and the information presented will be comparable. This will encourage foreign investors to invest in these countries as they perceive their investments to be less risky due to available accounting data. Access to foreign investment will allow businesses in developing countries to scale production and services, as well as innovate by investing in research and development (R&D), which drives economic growth. In fact, a survey conducted by the International Federation of Accountants (IFAC) found that out of 143 world leaders, 90% of respondents stated that pursuing IFRS adoption was "very important" or "important" for economic growth in their respective countries (The CPA Letter, 2008). Furthermore, Li et al. (2020) argue that the improved transparency and DQ that IFRS offers are beneficial for developing economies. Due to the strict standards imposed by IFRS, complying businesses will have greater transparency in their financial statements, which may translate to increased business investment. This is due to a state that Li et al. describe as "information symmetry," in which investors all have access to the same financial information, resulting in boosted investor confidence. Furthermore, Li et al. describe how the increased financial statement "granularity" positively impacts the DQ of financial statements. When financial statements are more "granular" (specific), they generally produce more useful information for investors, which is important because investors perceive investments in these companies as less risky and are willing to invest more. As discussed earlier, foreign investment is an important driver of economic growth. Therefore, proponents of IFRS believe that by increasing comparability, transparency, and DQ, IFRS creates positive economic opportunities for developing countries.

As the debate on IFRS adoption continues, it is important to identify factors in its adoption, as well as potential drawbacks and benefits that researchers believe will impact developing countries. By analyzing factors in IFRS adoption, we observed how developing countries assess the value of IFRS using economic theory and isomorphism. By analyzing the drawbacks of IFRS adoption, we understood the perspective of some researchers on the monetary costs and lack of relevance that IFRS may pose. Finally, by highlighting the potential benefits of IFRS adoption, we assessed researchers' reasoning regarding improved financial statement granularity, DQ, and comparability. Although the debate on the implementation of IFRS in developing countries will continue, the best interests of developing economies must be kept in mind. By advocating for the economic health of developing countries through improved accounting standards, we can positively impact the quality of life of billions of people around the world.

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