

The reality of adopting IFRS in developing countries: A reading in the institutional Obstacles, Opportunities and Challenges

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Abstract:

The study aimed at revealing the nature of the relationship between the institutional factors and the quality of accounting in developing countries after converging with IFRS. **Approach:** the paper uses panel cointegration to investigate this relationship by using the Eviews.7 program. **Findings:** The results showed a long run relationship between the institutional factors and the quality of accounting, however, the institutional differences between developing countries in general remain clearly in control of convergence with IFRS. **Originality:** this paper provides new empirical evidence in developing countries for increase resource allocation efficiency.

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key words: Globalization ; International accounting convergence ; IFRS ; Quality of accounting, Institutional factors ; Developing countries.

Introduction :

The general record of IFRS is impressive, According to the IASB, at the end of March 2017, there are more than 140 countries that are formally committed to IFRS and more than 27,000 companies spread over more than 88 international and regional stock exchanges. In less than 08 years since the issuance of “the IFRS for SMEs” it has been adopted by more than 85 countries. And the developed countries are also moving steadily towards the formulation of convergence projects such as the Chinese project in 2005, the Japanese BAC/IASB project from 2008-2012, the United States signature of the Convention “Norwalk Agreement” in 2002 and 2009 (Paul Pacter, 2017, P 04) ¹.

What is interesting about these statistics is that contrary to the EU explicit adoption wave in 2005 (the adoption rate of 98%), the developing countries continue to be the world's leading countries to adopt IFRS (the DCs continue to experience strong economic growth with a GDP of \$ 27 trillion and over 80 percent of the IASB members are from developing countries). which raises significant problems about their institutional capacity to enforce IFRS within their domestic environments, while these countries recognize many of the institutional differences such as political, economic, social, demographic, ..., etc. In this study, we provide evidence on the validity of these claims by examining the macro-effects of institutional contexts on the accounting quality in 15 Developing countries from 2007 to 2018.

The reminder of the paper is organized as follows, the next section explains theoretical framework and literature review, Section 3

explains the research methodology (including sample selection as well as the development of empirical models). In section 4 us exposing the empirical results obtained, the final section provides a summary of results and conclusions.

SECTION I : Theoretical framework and literature review

Tokuga 1993 presents the hierarchical structure of the accounting system in five layers descending: (1) Environmental factors: economy, geography, sociology, (2) neighboring environmental factors: wealth, governance, law sources... (3) Institutional systems: political system, economic ..., (4) Accounting Objectives and Functions (5) Methods, Accounting Applications and Processes (Masatsugu Sanada, 2012, P 04)².

In his view, Peter Wysocki (2011) argues that the analysis of the financial reporting system within its environment must take place under five elements: (1) Institutional structure (formal and informal), (2) Level of analysis (macro and micro), (3) Causation (external institutions and self-institutions), (4) Interdependence and integration, (5) Effective results versus ineffective results (Peter Wysocki, 2011, p 309)³ (See Figure (01) in Appendix).

“Accounting quality” can be defined as the extent to which the financial statement information reflects the underlying economic situation (Huifa Chen et al, 2010, p 220)⁴. Ball et al (2003) knows it and simply: “it is transparency in the presentation of basic transactions a company” (Ray Ball et al, 2003, p 242)⁵. In this context, many questions impose themselves such as: Who sets accounting standards? Are the markets (voluntary adoption)? Or governments (mandatory adoption)?, and, what factors could significantly influence countries` decisions to adopt IFRS?, How can IFRS make a difference in accounting quality in the context of

different institutional environments?, Does IFRS compliance improve a firms information environment in a weak enforcement economy?.

As reported by the Financial Crisis Group 2009: “the standard-setting due process was set up to ensure that all voices in all geographical regions have an adequate opportunity to make their view known, Wide consultation also promotes excellence, neutrality, the identification of unintended consequences, and ultimately, broad acceptance of the legitimacy of the standards that are adopted” (Kevin Mcmeeking, Matthew Bamber, 2016, p 10) ⁶. The United Nations Conference on Trade and Development (UNCTAD) has acknowledged the need to “mobilize investment for financing economic and social development”, and the essential role of a “global set of high-quality financial reporting standards” in that development (UNCTAD, 2005, p 3). Roberts, Weetman & Gordon, 2002, Barth, Landsman & Lang 2005, believes that international Markets also benefit from adopting IFRS by: (1) forcing domestic firms to upgrade their information disclosure policies and accounting systems (Michael Yeboah et al, 2018, p 27)⁷; (2) providing investors with opportunities for portfolio diversification by the introduction of a greater variety of financial instruments; (3) increase efficiencies in the domestic financial system, which will enhance the competitiveness of the economy at large; (4) accelerating economic growth; (5) encourage international flows of capital across national boundaries; (6) enh However, IFRS do not automatically lead to higher-quality financial reporting, realistically, regional differences in all economies may not be adequately reflected in a common set of standards like IFRS, therefore, a single set of standards might not accommodate the differences in national institutional features and regional which caused divergent accounting systems to arise in the first place (Ball, 2003, 2006; Ding et al, 2007; Thomas Jeanjean, 2008;

Francesco Bova & Raynolde Pereira, 2011, p 01-08)⁸. Negash (2008) argues that the gains stemming from reducing international information asymmetry is of a diminishing nature. In other words, the gains cannot be limitless. The evidence so far presented in support of IFRS adoption is just short term. The long term effects of accounting integration in globalization remain unclear, and how the gains and risks (if any) are shared is even more problematic (Minga Negash, 2008, p 04)⁹.

First Requirement: Methods and Materials

Paragraph 1: the problems and Research hypotheses

In accordance with the above literature review, the study considers the impact of several institutional factors in improving financial reporting quality in the developing countries in the context of adoption IFRS as illustrated in Figure (02) (See Appendix). Our paper intends to answer the following research question:-

Is there any statistical impact to enhance the institutional factors on the quality of the financial reporting environment in the developing countries after adopting IFRS during the period 2007 - 2018?

H0: Is there a long-term dynamic relationship between the strength of auditing and reporting standards in the developing countries and the macroeconomic environment and/or the development of financial markets and/or the tax systems and/or the strength of political systems and legal and/or the quality of higher education systems and/or Infrastructure and/or the business environment and/or Technological readiness during the period 2007-2018?.

Based on the previous figure, the main Hypothesis is:-

There is a statistically significant relationship between enhancing the quality of the financial reporting environment and the

institutional factors in the developing countries during the period 2007 - 2018.

H1: There is a long-term dynamic relationship between the strength of auditing and reporting standards in the developing countries and the macroeconomic environment and/or the development of financial markets and/or the tax systems and/or the strength of political systems and/or the quality of higher education systems and/or Infrastructure and/or the business environment and/or Technological readiness during the period 2007-2018.

Paragraph 2: Empirical models and variables involved

We use the degree of causal relationships between the quality of accounting and Institutional factors variables of interest in the long-run starting with 2007, by using the traditional Johansen-Fisher panel cointegration model proposed by Johansen (1988) and Johansen and Juselius (1990), therefore, in order to empirically test the research hypotheses, the general model is:-

**Quality of accounting = Economic Reform + Financial
Reform + Tax Reform + Political and Legal reform + Educational
reform + infrastructure reform + business environment reform +
technological reform + Social and cultural reform + Reform of the
accounting profession + Quality IFRS + ϵ_i**

$$\text{SARS}_i = B_0 + B_1 \text{ECO}_i + B_2 \text{FIN}_i + B_3 \text{TAX}_i + B_4 \text{POL}_i + B_5 \text{EDU}_i + B_6 \text{INFRA}_i + B_7 \text{BUS}_i + B_8 \text{TEC}_i + \epsilon_i$$

The variables are defined as follows:-

First: the independent variables used are: (1) the macroeconomic environment ECO: this indicator reflects the degree of development of macroeconomic environment in the developing countries; (2) the financial markets FIN: this indicator reflects the degree of development of financial markets during 2007-2018; (3) the tax systems TAX: this

indicator reflects the degree of development of tax systems in the developing countries; (4) political systems POL: the index reflects the degree of development of the strength of political systems and legal in Developing countries; (5) Education systems EDU: the indicator shows the degree of development of higher education systems; (6) Infrastructure INFR: this indicator reflects the degree of development of infrastructure during 2007-2018; (7) the business environment BUS: the indicator reflects the degree of development of business environment in the developing countries; (8) technological readiness TEC: the indicator reflects the degree of development of technological readiness in during 2007-2018.

Secondly: the dependent variable used is the quality of accounting by using the indicator Strength of auditing and reporting standards SARS: this indicator shows the development of the national accounting standards in the developing countries after adoption of IFRS during 2007-2018.

Paragraph 3: Sample selection, and database

Data used in this study is a quantitative data. Samples collected in this study were 180 observations during the period 2007-2018 (12 years). Data source of 15 Developing countries such as: China, India, Bangladesh, Denmark, Spain, Belgium, Georgia, Chile, Argentina, Costa Rica, Croatia, Brazil, Ethiopia, Nigeria, Cameroon, was taken from the Global Competitiveness Reports issued by the World Economic Forum: <http://reports.weforum.org/global-competitiveness-index2017-2018/downloads/>, For years: 2007, 2008,, 2018¹⁰. Subsequently, comparative data which are referred to the research were collected "by hand" and were transferred to spreadsheets for processing in the EvIEWS.7 program.

Second Requirement: Results and discussion :

Paragraph 1: Panel Unit Root Test

Here we shall detect whether $SARS_t$, ECO_t , FIN_t , TAX_t , POL_t , EDU_t , $INFRA_t$, BUS_t , TEC_t has unit root or not. Based on table A, we observe that all-time series are not stationary in level because the P-value is large than 5 % (the majority $Prob > 5\%$), the majority of the methods are telling that $SARS_t$, ECO_t , FIN_t , TAX_t , POL_t , EDU_t , $INFRA_t$, BUS_t , TEC_t she become stationary after first differenced.

Paragraph 2: Cointegration Test

Based on table B the cointegration test is aims to accept at least one causal relationship between: $SARS_t$ and the variables ECO_t , FIN_t , TAX_t , POL_t , EDU_t , $INFRA_t$, BUS_t , TEC_t , because the P-value less than 5%: $Prob = (0.0046) \leq 5\%$, therefore we refuse H_0 (H_0 : No Cointegration) and accepted H_1 , in other words, there is a long term dynamic relationship between $SARS_t$ and ECO_t , FIN_t , TAX_t , POL_t , EDU_t , $INFRA_t$, BUS_t , TEC_t in during the period 2007 - 2018.

Paragraph 3: Empirical Models

Based on table C (See Appendix), we can representation the results of relationship between the quality of the financial reporting environment and Institutional factors in the developing countries as follows: -

Long run :-

$$e_{t-1} = SARS_{t-1} - 0.073 ECO_{t-1} + 0.069 FIN_{t-1} - 0.014 TAX_{t-1} - 1.2786 POL_{t-1} + 0.891 EDU_{t-1} + 0.1479 INFRA_{t-1} + 0.02726 BUS_{t-1} - 0.462 TEC_{t-1} - 0.2294$$

Short run :-

$$\begin{aligned} \Delta SARS_t = & -0.05377 e_{t-1} + 0.0833 \Delta SARS_{t-1} - 0.4544 \Delta SARS_{t-2} + 0.038 \\ & \Delta ECO_{t-1} + 0.0247 \Delta ECO_{t-2} - 0.0948 \Delta FIN_{t-1} + 0.128 \Delta FIN_{t-2} + 0.002 \\ & \Delta TAS_{t-1} + 0.0016 \Delta TAX_{t-2} + 0.1269 \Delta POL_{t-1} + 0.015 \Delta POL_{t-2} + \\ & 0.0685 \Delta EDU_{t-1} + 0.0916 \Delta EDU_{t-2} + 0.02 \end{aligned}$$

$$\Delta \text{INFRA}_{t-1} + 0.1177 \Delta \text{INFRA}_{t-2} + 0.0528 \Delta \text{BUS}_{t-1} + 0.096 \Delta \text{BUS}_{t-2} + 0.0002 \Delta \text{TEC}_{t-1} + 0.1362 \Delta \text{TEC}_{t-2} - 0.054246.$$

From this model we can see that the Speed of adjustments towards long run equilibrium is negative and significant: $C(1) = -0.05377$ & $P\text{-value} = 0.0015 < 5\%$, for that, we can confirm the long causality from the three independent variables such as ECO_t , FIN_t , TAX_t , POL_t , EDU_t , INFRA_t , BUS_t , TEC_t to SARS_t , meaning that, ECO_t , FIN_t , TAX_t , POL_t , EDU_t , INFRA_t , BUS_t , TEC_t have influence on SARS_t in the long run. In the long term the developing countries need 18.598 years ($1 \div 0.05377 = 18.598$) to return of the point equilibrium, therefor, the first correction of this model in the year 2025 and the second correction in 2044, and the speed of the logarithmic convergence is:

$$\mu = \frac{\ln(1-TB)}{T} = \frac{LN(1-12(-0.05377))}{12} = 0.04149 = 4.149\%, \text{ this means that the quality}$$

of accounting in developing countries returns to balance point after any external shock or crisis in the institutional factors at a rate of 04.149 % in the year, and the time required for developing countries to complete half of the gap that separates them from the stable situation in the long term are: $\mu = \frac{\ln(2)}{\mu} = \frac{LN(2)}{0.04149} = 16.71$, this means that

the achievement of half the distance of accounting convergence between the developing countries requires about 16.71 years. For study the short-term causal relationship we using Wald test Statistics, Based on the Wald test results we can accept H_0 in all cases, because $P\text{-value}$ is large than 5 %: (0.6003, 0.0973, 0.6183, 0.5805, 0.6268, 0.2773, 0.2571, 0.2413) $> 5\%$, meaning that there is no short run causality running from ECO_t , FIN_t , TAX_t , POL_t , EDU_t , INFRA_t , BUS_t , TEC_t to SARS_t .

Conclusion:

Based on the results of the test statistic using panel data, there is evidence that the main hypothesis are supported, from these findings we can confirm the main hypothesis of the study that the increase in the quality of the financial reporting environment in the developing economies is driven in part a enhance of institutional factors in the context of adoption IFRS during 2007-2018, where we can use the model to predict future changes in Accounting Quality.

As any other study of this kind of research, it is subject to a number of limitations, this study was conducted in the developing Economies, therefore, caution is required in generalizing the results to other countries, and more research should be undertaken in other developing countries. Future research could expand the framework of this study, as more data becomes available in future to raise further explanation of the models and to reveal more generalized findings in developing countries or other.

Notes:

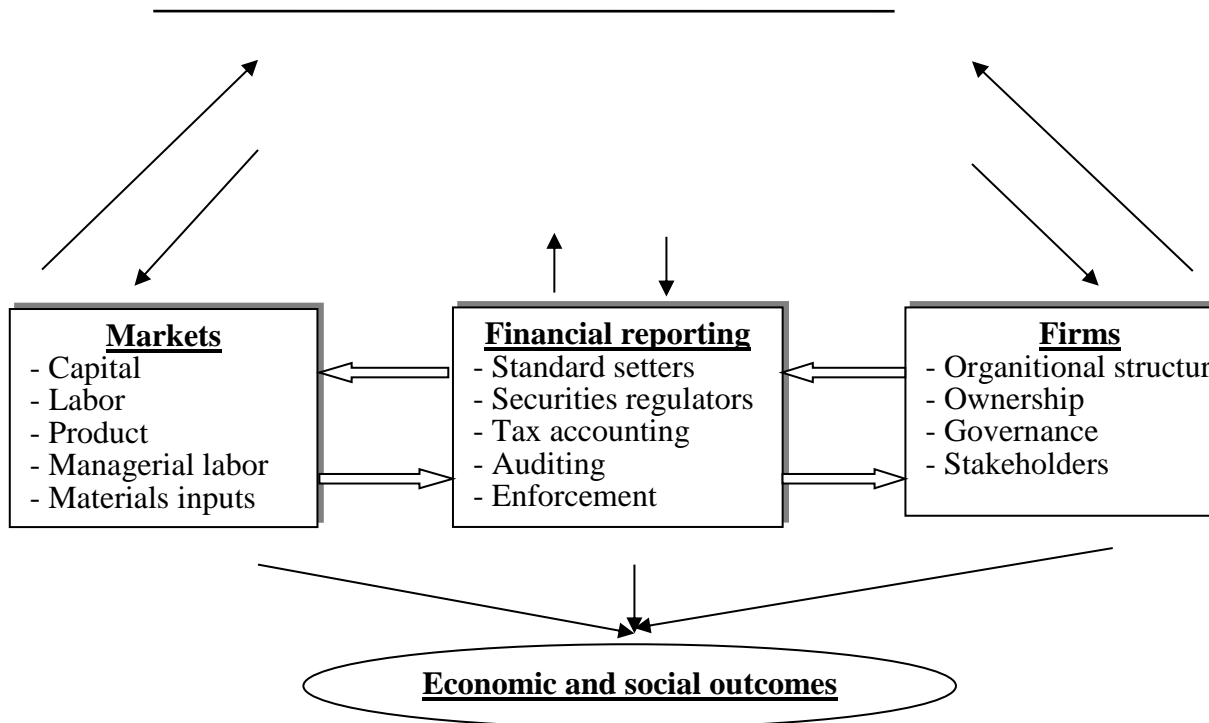
1- For simplicity, this study uses the term IFRS to refer to both IFRS issued by the International Accounting Standards Board (IASB) and International Accounting Standards (IAS) issued by IASC.

2- The World Bank assigns the world's economies into four income groups — high, upper-middle, lower-middle, and low based on GNI per capita calculated using the Atlas method : Low-income < 1,005 \$, Lower-middle income [1,006 - 3,955], Upper-middle income [3,956 - 12,235]; High-income > 12,235 \$.

Appendices

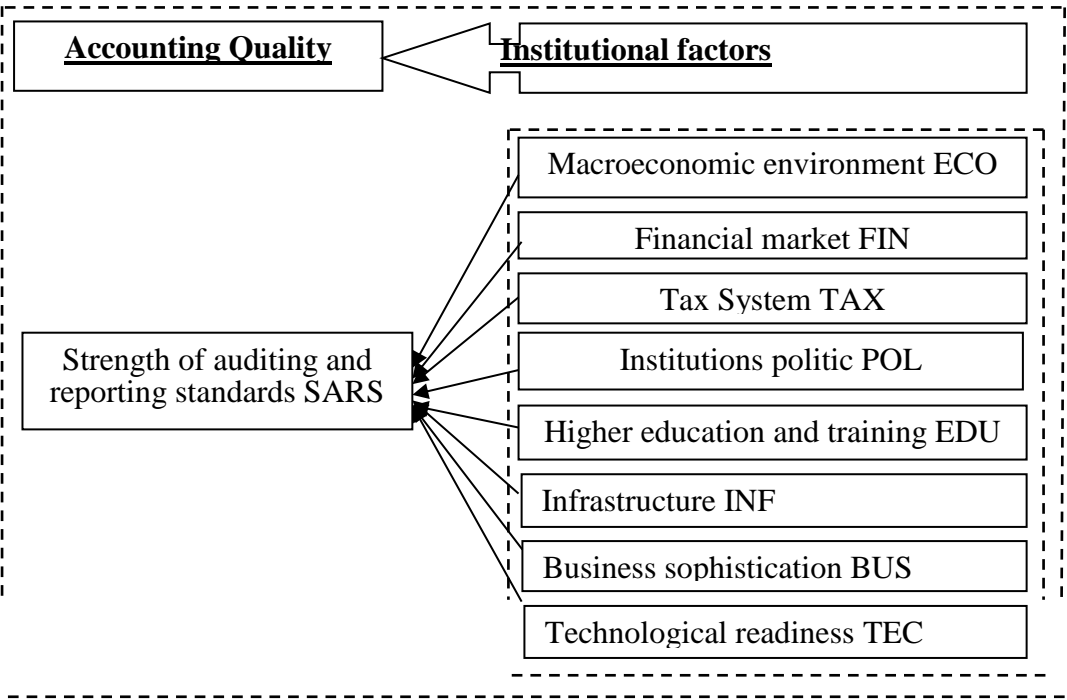
Fig N° 1 : Impact of the institutional environment on the establishment and functioning of financial reporting system

<u>Supra-national and country institutions</u>		
<u>Legal system</u>	<u>Government</u>	<u>Societal norms</u>
- Law	- Regulation	- Religion
- Courts	- Public sector	- Corruption
- Self-regulation	- Political ideology	- Trust



Source : Stuart McLeay, Peter F. Pope (2011), The European IFRS Experiment: Objectives, Research Challenges and Some Early Evidence, Accounting and Business Research, Vol 41, n° 03, p 247.

Fig N° 2 : Suggest the factors and variables of the study



source: Prepared by the researcher.

Table N°1 : Summary Results of Unit Root Test

	In level			First differences		
	Levin	ADF	PP	Levin	ADF	PP
SARS	0.0427	0.177	0.4435	0.0000	0.0000	0.0000
ECO	0.0896	0.3255	0.752	0.0000	0.0000	0.0000
FIN	0.2702	0.2765	0.6985	0.0000	0.0000	0.0000
TAX	0.1115	0.1683	0.5261	0.0000	0.0000	0.0000

POL	0.1205	0.3639	0.7006	0.0000	0.0000	0.0000
EDU	0.3256	0.3453	0.6890	0.0000	0.0000	0.0000
INFR	0.1124	0.1845	0.6542	0.0000	0.0000	0.0000
BUS	0.2548	0.3571	0.5562	0.0000	0.0000	0.0000
TEC	0.0756	0.1758	0.6845	0.0000	0.0000	0.0000

source : Based on Eview.7 program outputs.

Table N°2 : Summary Results of Regression Models

Long run CointEq1										
	SA RS (-1)	EC O (- 1)	FIN (-1)	TA X (-1)	POL (-1)	ED U (- 1)	INF R (- 1)	BUS (-1)	TEC (-1)	C
Coeffic ient	1.0 00	- 0.07 3	0.06 94	- 0.01 41	- 1.278	0.89 1	0.14 8	0.027 3	- 0.46 2	- 0.2 29
Std. Error	-	0.14 7	0.26 9	0.00 6	0.273	0.36 7	0.20 5	0.34	0.28 56	0.8 02
t- statisti c	-	- 0.49 6	0.25 8	- 2.30 6	- 4.684	2.42 9	0.72 3	0.08	- 1.61 8	- 0.2 86
Error Correction (Short run)										
			Coefficient	Std. Error		t- statis tic	Prob (t)	R- squer ed	F- statis tic	
CointEq1			-0.053772	0.0168 5		- 3.190 5	0.001 5	23.74	13.25 3	
D(SARS (-1))			0.083363	0.0926 8		0.9	0.368 5			
D(SARS (-2))			-0.454362	0.093		- 4.886 5	0.000 0			
D(ECO (-1))			0.037807	0.0414 6		0.911 9	0.361 9			
D(ECO (-2))			0.024719	0.0396		0.624 1	0.532 6			

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D(FIN (-1))	-0.094842	0.0815 1	- 1.163 5	0.244 8		
D(FIN (-2))	0.128188	0.0745 5	1.719 5	0.085 7		
D(TAX (-1))	0.002022	0.0026 1	0.774 8	0.438 6		
D(TAX (-2))	0.001626	0.0024 7	0.658	0.510 6		
D(POL (-1))	0.126905	0.1247 3	1.017 45	0.309 1		
D(POL (-2))	0.015247	0.1188 7	0.128 27	0.898		
D(EDU (-1))	0.06851	0.1062 6	0.644 74	0.519 2		
D(EDU (-2))	0.09161	0.0994 8	0.920 9	0.357 3		
D(INFR (-1))	0.020026	0.0784 1	0.255 4	0.798 4		
D(INFR (-2))	0.117687	0.0743 6	1.582 66	0.113 7		
D(BUS (-1))	0.052833	0.0599 6	0.881 16	0.378 4		
D(BUS (-2))	0.095917	0.0589 4	1.627 44	0.103 9		
D(TEC (-1))	0.00025	0.0812 1	0.003 1	0.997 5		
D(TEC (-2))	0.136198	0.0831 1	1.638 68	0.101 5		
C	-0.054246	0.0576 2	- 0.941 4	0.355 4		
Wald test						
Test Statistic	Value	Df	Prob	H₀		
Chi-square C(4)=C(5)	1.020724	2	0.6003	C(4)=C(5)=0		
Chi-square C(6)=C(7)	4.660352	2	0.0973	C(6)=C(7)=0		
Chi-square C(8)=C(9)	0.961664	2	0.6183	C(8)=C(9)=0		
Chi-square C(10)=C(11)	1.08766	2	0.5805	C(10)=C(11)=0		

Chi-square C(12)=C(13)	0.934145	2	0.6268	C(12)=C(13)=0
Chi-square C(14)=C(15)	2.565198	2	0.2773	C(14)=C(15)=0
Chi-square C(16)=C(17)	2.716432	2	0.2571	C(16)=C(17)=0
Chi-square C(18)=C(19)	2.843658	2	0.2413	C(18)=C(19)=0

source : Based on Eview.7 program outputs.

Table N°3 : Summary Results of Cointegration Test

Test Summary	t-statistic	Residual variance	HAC variance	Prob
ADF(SARS)	-2.60633	0.019845	0.017444	0.0046
H0 : No Cointegration				
H1 : It is Cointegration				

source : Based on Eview.7 program outputs.

ancing the integration of emerging markets into world capital markets (Ole-Kristian Hope et al, 2006, p 01-06) ¹¹.

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⁹ - Minga Negash (2008), **The effects of IFRS adoption: A review of the early evidence**, p 04, Visited: 25/12/2018, SSRN Electronic Journal: <http://ssrn.com/abstract=1154504>.

¹⁰ - World Economic Forum, The Global Competitiveness Report, of years: 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018, pp: 70, 65, 93, 91, 85, 99, 103, 91, 93, 41, 45, 48, Visited: 14/12/2018, website: <https://www.weforum.org/reports>.

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