

The diffusion of International Financial Reporting Standards (IFRS)

Andrea Dunhill

Early stages of scoping literature review

Background

Many academics have written that accounting and reporting evolves from cultural and legal and institutional structures in a country (Hopwood 2007, Hayek (1944,1948,1979) quoted in North (2005) Chapman et al (2009)). Notwithstanding this widely agreed observation a single accounting system – International Financial Reporting Standards (IFRS) – has spread around the world so that over 120 countries now require or permit the use of IFRS.

In 2005 reporting under IFRS became mandatory for EU countries

At the time there was much concern about volatility and other adverse impacts on performance and position

There was political interference in specific standards

Subsequently there has been criticism that IFRS did not warn of the emerging financial crisis Nevertheless there has been very little resistance to continued take up.

My interest is what are the motivations or drivers for countries to abandon their own accounting systems and replace with a system that is largely based on that of another country (UK).

Definitions

IFRS – International Financial Reporting Standards – the regulatory framework that prescribes the recognition and disclosure requirements of financial statements. This system of reporting is mandatory for listed plc's in the European Union.

IASB – International Accounting Standards Board – the body that authors each new IFRS

Adoption of IFRS – the exact official IASB standards are followed with no deviation to local practice, ie local Generally Accepted Accounting Principles (GAAP)

IFRS diffusion refers to the adoption or adaption with local variants of the IFRS reporting system by a country

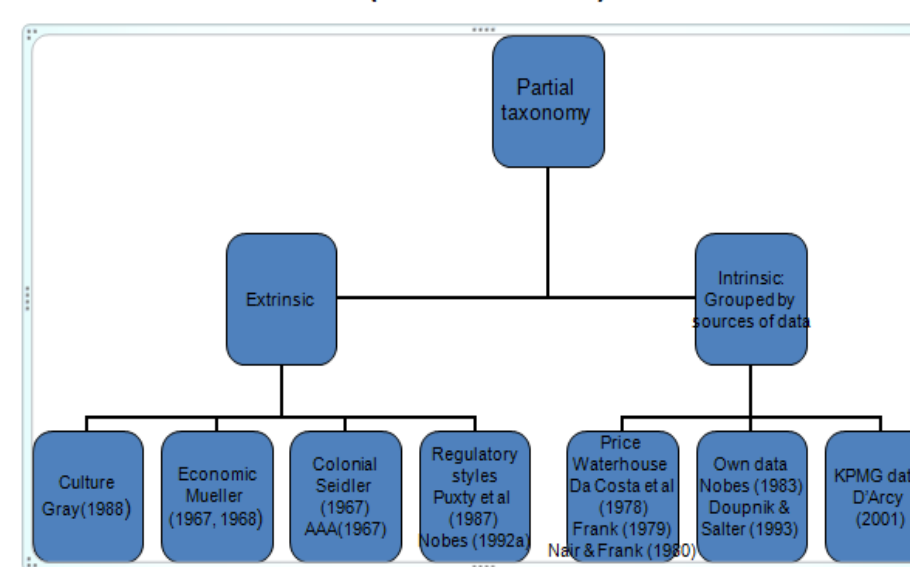
Research question

What are the drivers of IFRS diffusion?

Literature Review

Nobes (2010) argues the importance of classification – it enables prediction of what might happen in the future. Nobes has produced his own and critiqued other variants of taxonomies of the clusters of IFRS adaptors. Nobes (2010) found that in fact only 2 countries Israel and South Africa have adopted IFRS, the rest have adapted IFRS.

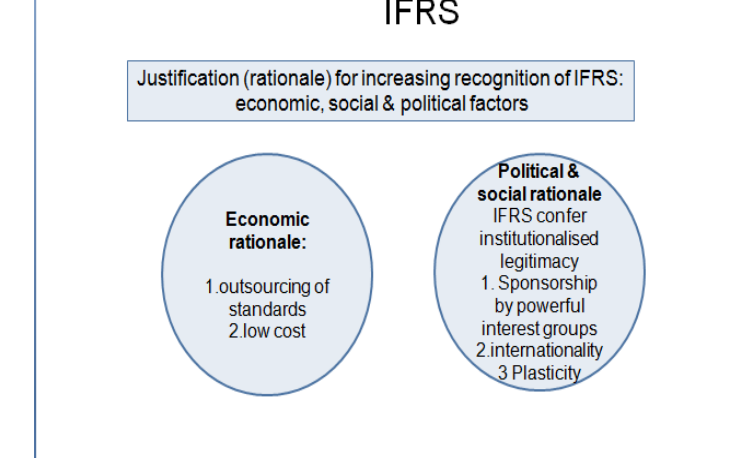
A taxonomy of some accounting classifications (Nobes 2010)



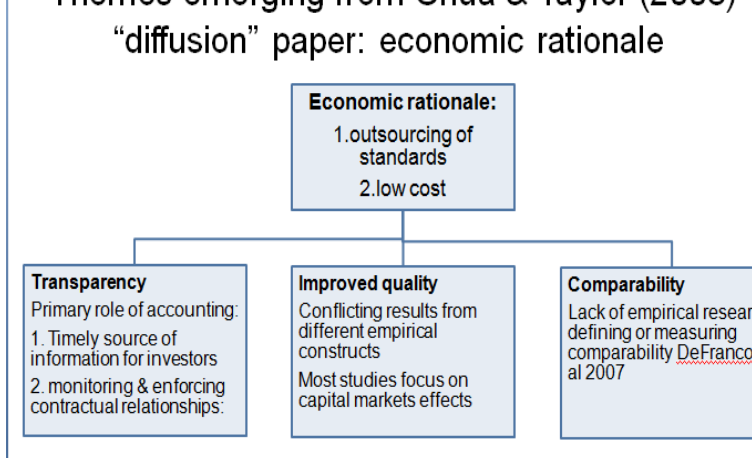
Chua and Taylor (2008) have produced a knowledge gap paper on the justification for the increasing recognition of IFRS. The paper divides the rationale into Economic rationale – outsourcing standards is rational and low cost if decision rights are retained but there is an absence of strong substantive empirical support for this as main cause of rise of IFRS

Political & social rationale – these dimensions are more important according to Chua and Taylor.

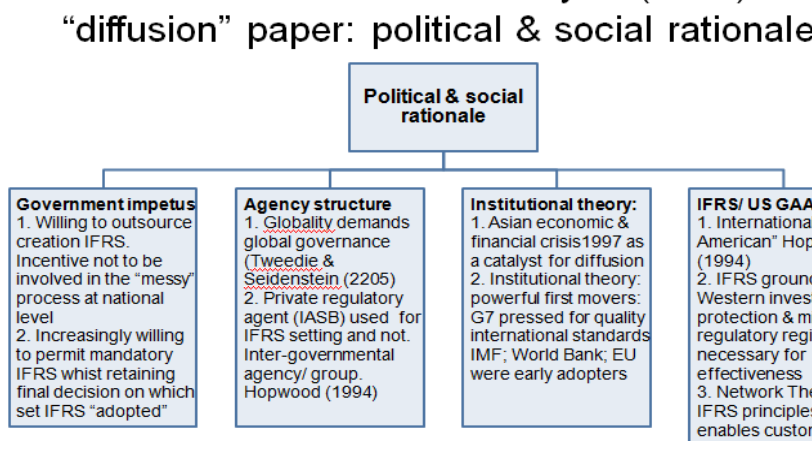
Chua & Taylor (2008) model of "diffusion" of IFRS



Themes emerging from Chua & Taylor (2008) "diffusion" paper: economic rationale

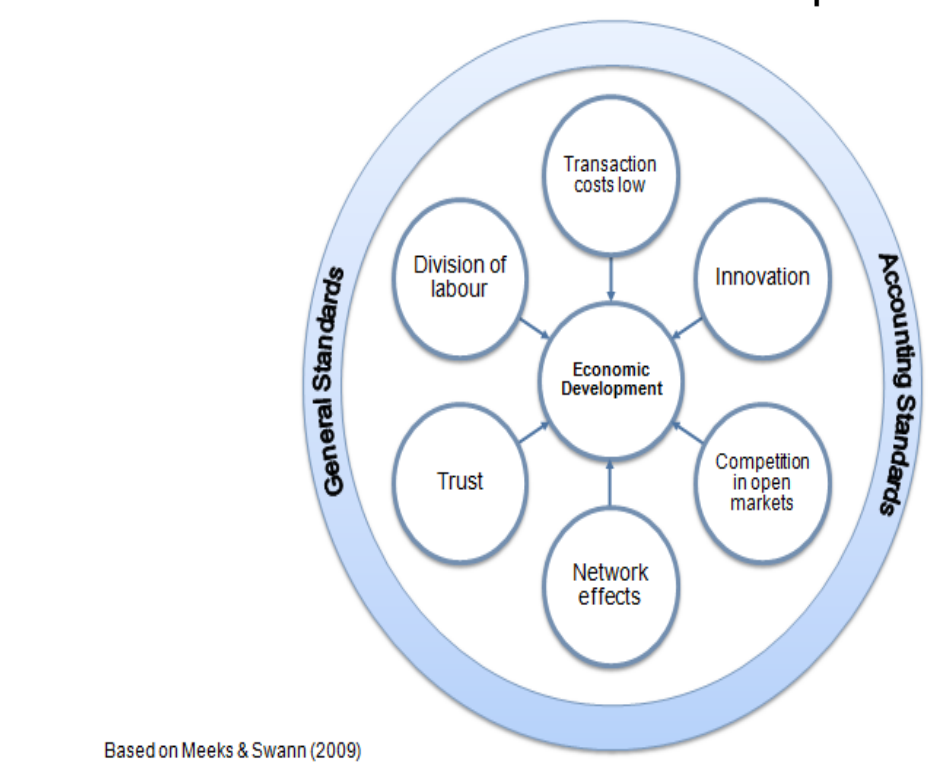


Themes from Chua & Taylor (2008) "diffusion" paper: political & social rationale

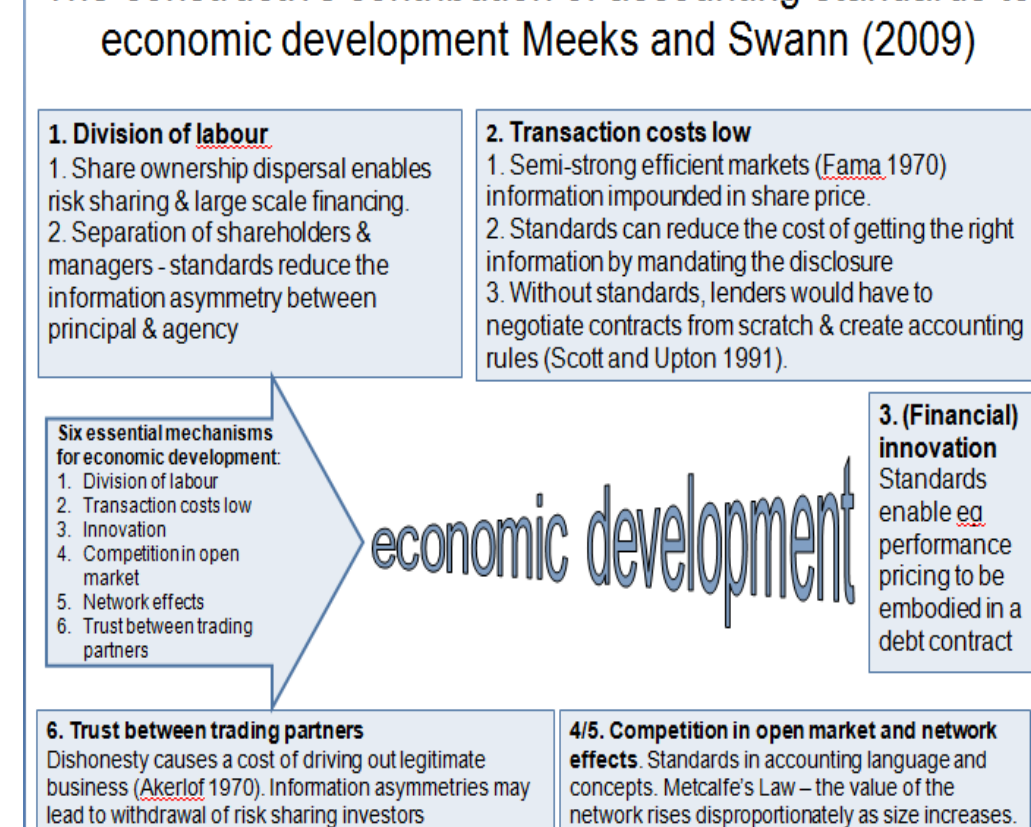


Meeks and Swann (2009) used economic theory to present a rationale to show that standardisation of products and processes in general will lead to economic development because it supports the key drivers. The general economic model is applied to the standardisation of accounting systems

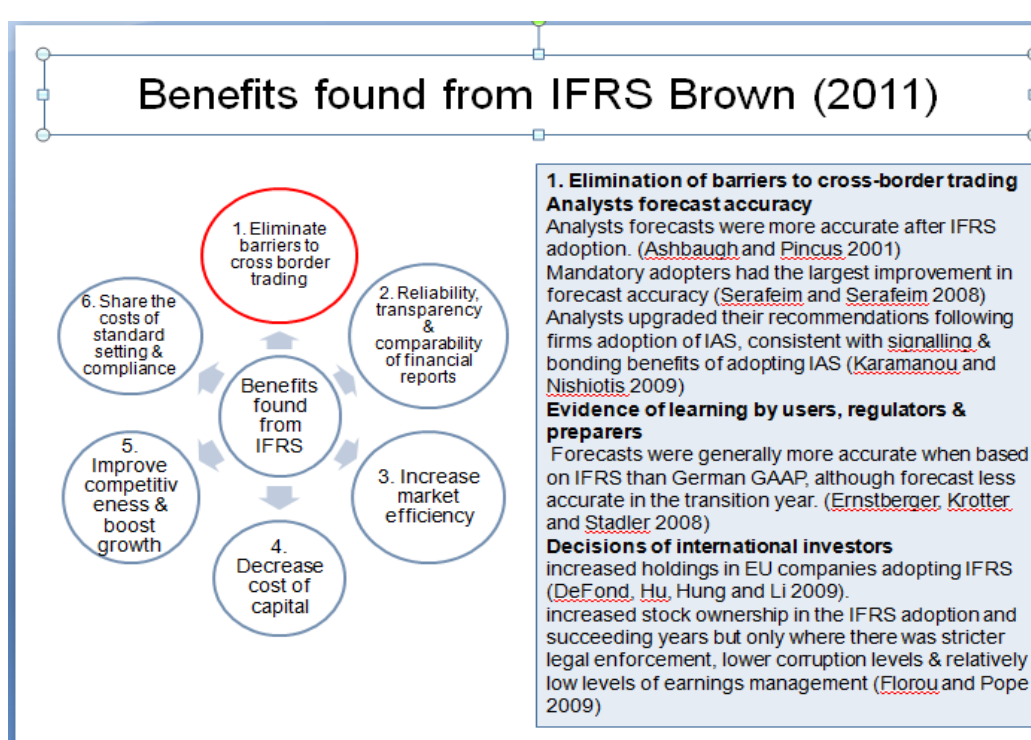
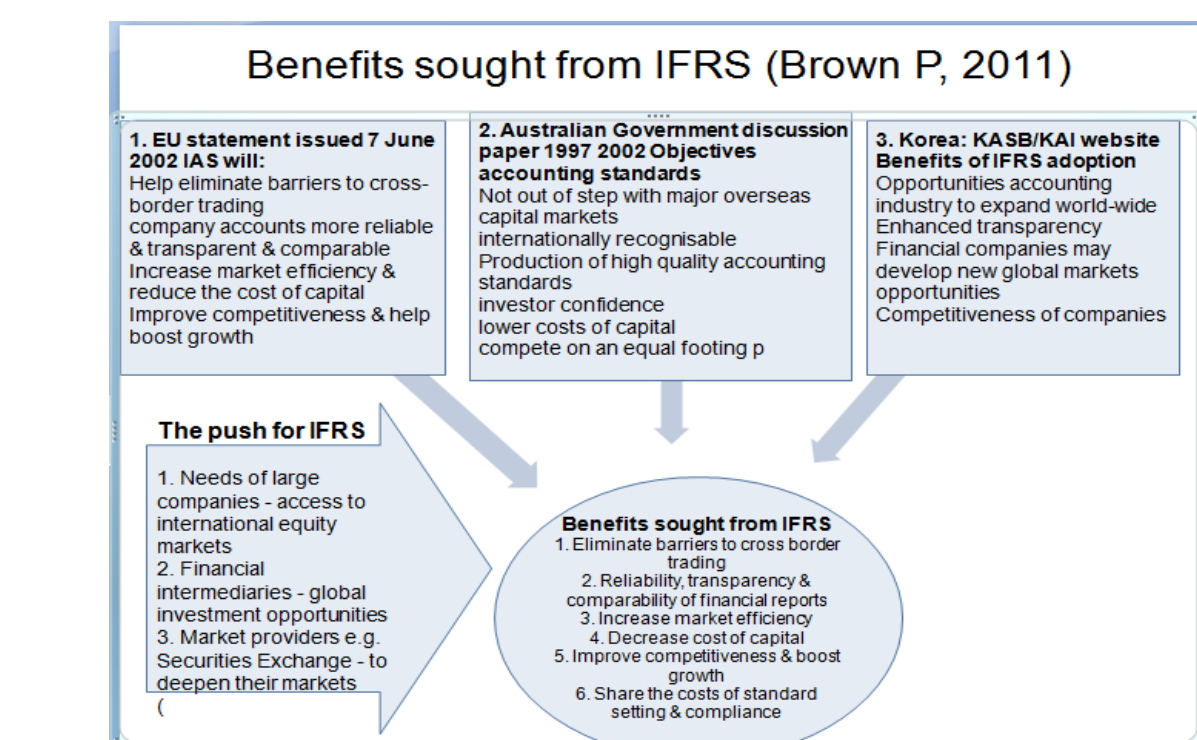
Drivers of economic development



The constructive contribution of accounting standards to economic development Meeks and Swann (2009)



Brown (2011) has produced a literature review paper which identifies the benefits sought by countries adopting or adapting IFRS and then examines 100 research papers to identify the extent to which the benefits have been validated through empirical evidence. Part of his summary of the first benefit circled in red in shown below:



Brown, P. (2011) International Financial Reporting Standards: What are the benefits. Accounting & Business Research Vol 41 No 3 2011

Concerns about IFRS

Brown (2011) Benefits of adoption depend upon:

Nature of standards before IFRS

Extent that IASB Issued standards are not adapted for local conditions

Quality of IFRS education & training and especially guidance of preparers, users, auditors, regulators

Legal or regulatory backing

Compliance monitoring & enforcement

(Brown 2011) Diversity of Standards

According to Brown and Clinch (1998) quoted in Brown, P (2010) "Much of the diversity in countries accounting standards results from deeply entrenched differences in..." :

Legal systems

Relationship between firms and suppliers of finance

Tax systems

Political and economic historical ties

Extent of economic development

Level of community education

Inflation rates

These differences will not disappear quickly after commitment to IFRS adoption

Walker (2010) Objections to IFRS

1. Adopting one single system may restrict the development of future capital systems
2. Global systems are created with fragile global governance
3. IFRS accounting systems did not alert investors to the risks they faced prior to the global credit crunch
4. There are disagreements amongst Academics, standard setters, professional accountants and users about concepts such as stewardship, fair value, conservatism
5. There is a worldwide variation in organisational and institutional forms of financial systems.
6. The variation may be an accident of history but mostly reflects the adaptation to the needs of a particular economy
7. Financial systems are complex and highly inter-dependent – the components have been adapted to each other over time.
8. Importing a component from another financial system may not be a good fit
9. The demands for value relevant and stewardship information differ considerably between financial systems.
10. The role of information in the economy goes far beyond NPV. Far more important is the ability of an economy to share risks and ameliorate the destructive effects of moral hazard and adverse selection on the functioning of markets and firms. Facilitating the secondary role of corporate securities is a minor role yet IASB/FASB focuses on the needs of secondary traders.

Pope & McLeay (2011) concerns about IFRS

1. IFRS was an experiment – implemented without prior research
 2. European Commission claims about the potential benefits of IFRS were not explained
 3. IFRS is centred on capital market participants
 4. Enforcement is missing from the objectives of IASB
 5. Benefits are lost if there is no enforcement
 6. Low quality adoption may occur if there is no enforcement
- Pope & McLeay (2010) suggest that there is an apparent fault line centred on the effectiveness and transparency of the enforcement framework. The absence of reference to the regulatory environment in IASB objectives (2001) is a concern

Sunder (2011) concerns about a monopoly set of accounting standards

Sunder criticises the global adoption of a single accounting standard because of the danger of locking into to a bad or sub-optimal system which will prevent the search for a better and improved system. Sunder argues that it is not known which set of standards will increase the welfare of the world and a monopoly removes the opportunity to compare with other systems. A single global standard may not be sufficiently robust to withstand Manipulation and a top down design that ignores the legal, economic and business systems is not good. He criticises IFRS in particular for it's length and complexity and questions how it is possible to have 2,700 pages of principles. He has concerns about errors in translation of words and their meanings.

References

Brown (2011) *International Financial Reporting Standards: What are the benefits.* Accounting & Business Research Vol 41 No 3 2011
 Chapman, C.S., Cooper, D.J., & Miller, P (Eds). (2009). *Accounting, organizations, and institutions: Essays in honour of Anthony Hopwood.* Oxford: Oxford University Press. Quoted in Walker, M., (2010)
 Chua, W.F., & Taylor, S. L. (2008). *The rise and rise of IFRS: An examination of IFRS diffusion.* Journal of Accounting and public Policy 27 (2008) 462-473
 Meeks, G., Swann, G.M.P. (2009) *Accounting standards and the economics of standards.* Accounting and Business Research, International Accounting Policy Forum, Vol 39, No 3 2009
 Nobes, C. Parker, R (2010) *Comparative International Accounting.* FT Prentice Hall. 11th ed Chap 3 pp 55-77
 Pope, P.F. McLeay, S.J. (2011). *The European IFRS Experiment: Objectives, Research Challenges and Some Early Evidence.* Accounting and Business Research, Vol 41, No 3
 Sunder, S., (2011) *IFRS Monopoly: Pried Piper of Financial Reporting.* Accounting and Business Research, Vol 41, No 3
 Walker, M. (2010). *Accounting for varieties of capitalism: the case against a single set of standards,* The British Accounting Review Volume 42 (3) 137-152