Chapter 4

Determinants of and Obstacles to the Adoption of International Financial Reporting Standards in Africa

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ABSTRACT

This chapter investigates the determinants of and obstacles to the adoption of International Financial Reporting Standards (IFRSs) in Africa. Specifically we investigate whether English as an official language, educational levels, existence of a capital market, economic openness and economic growth are associated with the probability of a country adopting IFRSs with a sample of 46 African countries. Binary logistics regression was used to analyze the data. The results suggest that only English as one of the official languages was associated with the likelihood of a country adopting IFRSs. Through an examination of the Reports on the Observance of Standards and Codes of the World Bank, we document that the major obstacles to adopting IFRSs are the lack of enabling legislation for its adoption and a lack of capacity in all aspects of the accounting supply chain. The chapter concludes that more research is needed at a continent level given that most of the determinants we investigated are not associated with the likelihood of a country adopting IFRSs.

INTRODUCTION

The benefits of adoption of International Financial Reporting Standards (IFRSs) have been well documented. For example, Barth, Landsman and Lang (2008) investigated whether the adoption of IFRSs is associated with higher earnings quality. They found that firms applying international accounting standards in 21 countries generally evidenced less earnings management, more timely loss recognition,
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and more value relevance accounting amounts than do matched firms applying non-United States (US) domestic standards. Armstrong, Barth, Jagolinzer and Riedl (2010) investigated the market reaction to the adoption of IFRSs in Europe. They suggest that markets in Europe would react positively to movement toward IFRSs adoption if, for example, investors expected application of IFRSs to result in higher quality financial reporting information. The study found that the markets reacted positively to firms with lower quality pre-adoption information and with higher pre-adoption information asymmetry, consistent with investors expecting net information quality benefits from IFRSs adoption. Another study by Daske, Hail, Leuz and Verdi (2008) examined the economic consequences of mandatory IFRSs reporting around the world by analyzing the effects on market liquidity, cost of capital and Tobin’s q in 26 countries. Their findings suggest that on average, market liquidity increases around the time of introduction of IFRSs and that the cost of the firms’ capital decreases and the equity valuations increases.

However, while the benefits of adoption of IFRSs in developed countries are undisputed, IFRSs adoption and use in developing countries has been subject of much debate. For example, some academics have suggested that the international accounting standards may not be applicable to developing countries (e.g., Briston, 1978; Hove, 1986; Perera, 1989). Such questioning of the relevance of international accounting standards has come both from a general perspective, analysis of a group of developing countries and examination of specific developing countries (Cairns, 1990; Hove, 1986; Samuels and Oliga, 1982; Perera, 1985). However, Chamisa (2000) cogently argues the case for applicability of international standards to developing nations using Zimbabwe as an example. Chamisa (2000, p. 274) suggests that ‘.. developing countries (such as Zimbabwe and many others) in which the private sector dominates the economy (resembling the sector ownership patterns found in the UK and US), the IASC standards (which are oriented towards information needs of the private sector) are judged to be relevant’. Tyrall, Woodward and Rakhimbekova (2007) who examined the relevance and implementation of IFRSs between 1991 and 2006 in Kazakhstan, however, concluded that although a strong case for IFRSs cannot be made, even by 2006, Kazakhstan had little choice but to proceed with IFRSs.

Despite the controversy discussed above as to whether IFRSs are relevant to developing countries, some developing countries have adopted IFRSs while others have not. The pertinent question therefore is why some developing countries have opted to adopt and what are the obstacles for those that may want to adopt but have not done so. There are a few studies that have investigated the determinants of IFRSs adoption (e.g. Ding, Jeanjean & Stolowy, 2005; Zeghal & Mhedhbi, 2006; Hope, Jin & Kang, 2006; Ramanna & Sletten, 2009; Judge, Li & Pinskyer, 2010). However, all these studies except Stainbank (2014) are not continent specific. For example, Zeghal and Mhedhbi (2006) included 21 African countries in their sample of 64 countries. Ramanna and Sletten (2009) included 24 African countries in their final sample of 102 non-European Union countries. Judge et al. (2010) included 22 African countries in their end sample of 109 countries. These studies did not attempt to isolate factors that may be more significant in one particular continent. Other empirical research usually includes only the larger more developed African countries, such as South Africa and Kenya, in their data sets. The purpose of this research is to focus only on African countries and identify factors influencing the adoption of IFRSs in African countries.

The contribution of this study is that it extends the work by Stainbank (2014) who investigated the determinants of adoption of IFRSs by 32 countries (or 59% of all African countries) due to limited data set. We extend that study by investigating the determinants of adoption by a larger data set of 46 (or 85%) of all African countries. We also contribute by including two new variables that were not part of the study by Stainbank (2014). In addition to investigating the determinants, we also investigate the
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