

IFRS Harmonization and Foreign Direct Investment

Javier Vidal-García

Universidad de Valladolid, Spain

Marta Vidal

Universidad Complutense de Madrid, Spain

ABSTRACT

IFRS refers to International Financial Reporting Standards, which are the guidelines that provide the framework for accounting works. The principles are also known as the International Accounting Standards (IAS). This global financial concept was first introduced in 2001 to equip investors with analyzed accounting statements. In this Chapter we review the relation between IFRS and Foreign Direct Investments (FDIs). We review the relevant literature that analyses the effects on IFRS on FDIs and cross-border acquisitions. The economic literature states that the introduction of IFRS has presented an important increase in FDIs. The evidence shows that IFRS adopting countries attract investments from countries that implemented IFRS and non-IFRS implementing countries.

INTRODUCTION

IFRS refers to International Financial Reporting Standards, which are the guidelines that provide the framework for accounting works. The principles are also known as the International Accounting Standards (IAS). This global financial concept was first introduced in 2001 to equip investors with analyzed accounting statements. In this Chapter we review the relation between IFRS and Foreign Direct Investments (FDIs). We review the relevant literature that analyses the effects on IFRS on FDIs and cross-border acquisitions. The economic literature states that the introduction of IFRS has presented an important increase in FDIs. The evidence shows that IFRS adopting countries attract investments from countries that implemented IFRS and non-IFRS implementing countries.

BACKGROUND AND LITERATURE REVIEW

The notion of unifying accounting principles dates back to the early 19th century. It is at this time that the concept of international financial standards originated, specifically during the first Global Congress of Accountants held at St. Louis in 1904 (Fritz & Lammler, 2003, p. 3). At the conference, the need for harmonization and cooperation in the accounting field was emphasized. Despite the initiative, differences in the accounting principles still abound, mainly because the dissimilarities in legal systems, the manner in which providers of capital operate, taxation systems, national cultures, and general accounting practices. The differences hindered investors from obtaining clear financial information, which is vital for strategic planning. Thus, international trade was constrained; countries experienced unequal opportunities as a result of the dissimilarities. In this regard, the inequalities and unclear financial statements were the main reasons behind the call for financial standardization.

1. The Accounting Harmonization Process

In harmonizing the accounting standards, different approaches were and still are being employed (Fritz & Lammler, 2003, p. 3). To enable accurate depiction of the process, harmonization can be viewed from different angles. First the process can be shown as a timeline and then depicted as a series of trait junctions. The timeline follows the steps and achievements made by the International Accounting Standards Committee (IASC) since the early 1960s.

1.1 Pre-Stage of the Harmonization Process

Jacob Kraanyehorf was the pioneer of financial unification. He released his first concept paper on the subject in 1959; through the document, Kraanyehorf campaigned for the international acceptance of economic unification (Fritz and Lammler, 2003, p. 21). To strengthen his proposal, he noted the advantages of a unified financial front such as elevated global loaning and easy trading that come with identification and appreciation of differences among countries. As a result of Kraanyehorf efforts, the International Accounts Study Group (IASG) was formulated in 1966 to help analyze and eliminate the differences in financial documentation between Canada and the United Kingdom. The Americans were not as enthusiastic about harmonization in the early 1960s, but changed their viewpoint in 1972 after one of their professional accounting bodies held discussions with six other nations, including Germany, Japan, China, the United Kingdom, and Canada (Fritz and Lammler, 2003, p. 21).

1.2 Harmonization between 1973 and 1987

The International Accounting Standards Committee (IASC) was slowly developed between 1973 and 1987. This body was responsible for a considerable number of the standards set during the 14-year period. Particularly, the institution dealt with the problem of inventory recording. In this case, the main objective of the IASC was to ascertain compatibility between the new set guidelines and those established by the IASG (Fritz & Lammler, 2003, p. 23). Besides that, during the period, the unpopular global measurement methods, such as the austerity metrics, were eliminated. All standards were incorporated through

a democratic process; if the set quorum was not achieved, the member states had the right to use any other desired algorithm to enact changes to the accounting principles. Unfortunately, the IASC actually ended up endorsing only mainstream financial procedures, instead of performing actual harmonization.

1.3 Harmonization between 1987 and 1993

This period marked the second generation of the IASC's developments. In 1987, the harmonizing group initiated membership with the International Organization of Security Commissions (IOSCO). A year later, the Financial Accounting Standards Board (FASB) joined the membership committee. The more other regulatory organizations acceded to the principles promoted, the further procedural standardization advanced. The member bodies dealt with financial matters in the same manner and thus the second harmonization process was characterized by further reduction of the set IASC options. That said, the IASC financial recording principles of 1989 were employed on a trial basis, hence the union of guidelines was rarely implemented. In this respect, the existence of comparability and a right to choose constrained the unification process; member organizations basically operated independently (Fritz & Lammler 24).

1.4 Harmonization between 1993 and 1998

The third IASC harmonization process began in 1993 after the agency and IOSCO agreed on a specific catalog of core guidelines for integration of financial statements (Fritz & Lammler, 2003, p. 25). By the end of 1994, the IOSCO had initiated and completed an analysis on all standards set by the IASC. By doing that, the body identified several niches and standards that required modifications to increase the openness, truthfulness, and accuracy of reporting. In 1995, both agencies jointly went through the reviews to create a joint list of unified principles. It is also at this time that the European Union (EU) decided to support the unification process. In addition, the EU decided not to segregate itself and thus eliminated its independent accounting standards. Finally, the harmonization process came to an end in 1998.

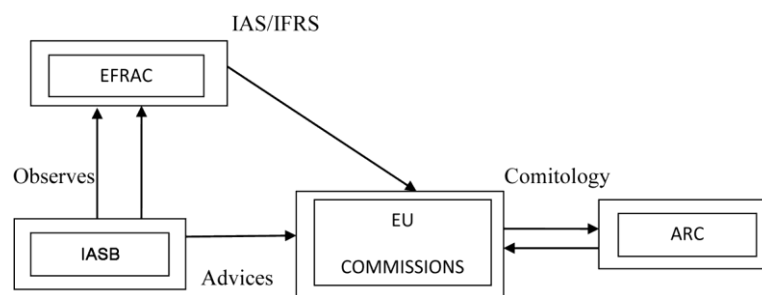
1.5 Harmonization 1998 Onwards

The current harmonization process began mainly in the new millennium. In May 2000, the IOSCO instructed its member states to permit the IASC to prepare for them international listings and offerings. The body also created a 26-question questionnaire that examined the acceptability of the financial documentation process under harmonization. The creation of the Euro – the EU's currency – in 1999 also increased the push for global accounting standards and thus more reviews and changes were made. Examples of the changes include the formulation of an inclusive body of accounting, emphasis on high levels of transparency and comparability as well as rigorous interpretations of financial statements (Fritz and Lammler, 2003, p. 27). The changes facilitated complete statement analysis in different languages and through multiple algorithms. The standard enforcement is now structured as shown below (see Figure 1).

1.6 Harmonization through Socio-Economic Aspects

In relation to trait junctions, the harmonization process has to be analyzed through socio-economic aspects. In this respect, the harmonization process can be broken down into material and formal harmonization, mutual recognition, reconciliation, and standardization. Material harmonization refers to the

Figure 1. Standard enforcement of accounting principles



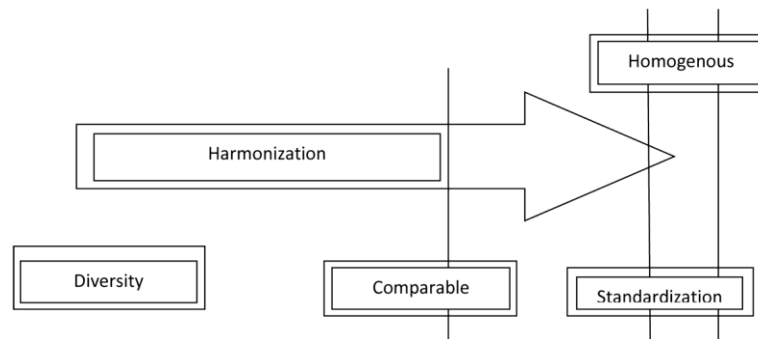
use of standard materials, such as tick marks and opinion letters, to ensure financial research follows a common theoretical and practical angle (Fritz & Lammle, 2003, p. 31). Formal harmonization refers to the broad acceptance and analysis of domestic or independent rules and regulations used by different states (Fritz & Lammle, 2003, p. 31). In the process of conducting formal harmonization, divergence and similarities were considered in the interpretation process, hence allowing statistical data to have similar conclusions irrespective of the rules and regulations applied.

Mutual recognition is the acceptability of statements across borders despite the fact that preparation of the documents may not have been done in accordance with accounting guidelines of the destination state. For instance, Canada and the United States employ different accounting principles domestically, but a document prepared by either country would be accepted by the stockbrokers of both nations. In this respect, mutual recognition curtails the harmonization process to some extent because it negates the need for similar core principles.

The reconciliation guidelines state that an expanding or foreign enterprise has the right to prepare documents in accordance with its local accounting standards so long as it additionally prepares records for use in the accounting of critical principles in the destination state (Fritz & Lammle, 2003, p. 33). As states reconcile critical principles, the harmonization process is able to identify the major dissimilarities in the accounting procedures. To elaborate further, an enterprise using IFRS guidelines can only venture into the United States if it prepares secondary Generally Accepted Accounting Principles (GAAP) documents.

Through standardization, all members participating in an accounting interaction set a number of principles that each party must comply with (Fritz & Lammle, 2003, p. 33). Thus, every act is binding, homogenous, and regular. In other words, standardization does not leave room for variation, misinterpretations, or unevenness. Given that the transactions in consideration affect international players, then one accounting principle of the participant states is applied universally. The summary of the concepts and processes involved in the harmonization through socio-economic aspects is shown below (see Figure 2).

Figure 2.



MAIN FOCUS OF THE CHAPTER: ISSUES, CONTROVERSIES, PROBLEMS

2. Economic Value of the IFRS

The push for common international financial reporting standards is based on the fact that successful implementation of the policy will result in economic benefits including creation of value relevance for fair value and minimization of reporting costs. The integration of the IFRS guidelines in financial reporting has elevated the quality of fair worth with respect to financial assets and liabilities. Value relevance is an important analytical aspect used in the testing of book data, mainly within the balance sheet. The financial concept is vital because it has a direct implication on equity and market values. Assets and liabilities are the basic variables of interest, thus harmonization of the elements allows open share pricing (Okpala, 2012). In this respect, value relevance is examined using the valuation model through which market and equity worth in balance sheets are regressed (Okpala, 2012). The US banking industry is an example of a market in which value relevance is constantly applied to examine the robustness of the IFRS in contrast to the US GAAP. Through the IFRS' fair value principle macro hedging in the United States was raised, thus facilitating more funding on asset demand that in turn enhances revenue generation.

Adoption of the IFRS minimizes the reporting costs of financial documentation given that enterprises within a trade pact do not operate as the sole entities (Okpala, 2012). Compliance with the standardized regulations enables the streamlining and cohesion between foreign companies, hence enabling comparisons, benchmarking, and company status-derivation on a simplistic level that does not necessitate the hiring of external consultants or auditors, which comes with extra costs. The harmonization process also puts a company in an advantageous position over its competitors through open financial reporting. The standards also help to identify new innovative production and marketing procedures that give better results.

The adoption of the IFRS has other economic benefits. It facilitates the transcending of international boundaries, hence making mergers and acquisitions of enterprises easier. The standardized guidelines aid in identification of organized and suitable partners, thus increasing opportunities of accessing foreign capital. In other words, companies can trade, move, and secure their capital and shares in different stock exchanges (Okpala, 2012). In relation to that, a majority of stock exchanges requires statements to be prepared under the IFRS process. By late 2010, more than 127 non-European states had accepted to use the IFRS guidelines as the standard reporting principles.

The IFRS is applied to take advantage of the progressive nature of companies and in the process it has been shown that only big audit firms can provide the expertise required for international cohesion. The standards have curtailed the developments of small establishments because such entities are often inexperienced or lack familiarity with cross border rules and regulations (Okpala, 2012). Consequently, the harmonization encourages the establishment of second tier firms, particularly because of the complexities involved in reconciliation. Fortunately, the application of macro-hedging and fair value estimates on financial assets and liabilities give more structured and defined information on the status and capacities of institutions, thus removing the need for external audits. This reduces the burden for smaller enterprises.

To some extent, the IFRS facilitates fraud deterrence. Fraudulent accounting is a menace that has eaten into the profits of international organizations. Several companies, for instance, AIG, have suffered considerable losses from fraudulent practices such as offshore trading. The harmonization of financial reporting, done through the IFRS' principles, has facilitated the reduction of fraud cases. Particularly, the push for high levels of document transparency and openness has made it easy to identify malpractices (Okpala, 2012). Therefore, companies cannot falsify their financial capacities to lure investors. Similarly, an organization cannot defraud its employees and vice versa, because of the specified relationship guidelines that state that functionality is mutually exclusive and firms have direct liability over protection of labor rights.

3. Political Value of the IFRS

In addition, the IFRS guidelines play a major role in politics. Politics or policy-making is a socio-economic function undertaken by state leaders to ensure that the best interests of citizens are protected. The incorporation of the IFRS accounting standards is a political strategy. The Gunadarma University conducted research on the subject in 70 countries and discovered that the IFRS guidelines ensure political stability through economic progression (Alexander, Fajri & Kurniawan, 2009, p. 168). This is because the standards determine the political approach that a country's administrators will employ. Though political stability was identified as a null factor in the integration of IFRS, the standards were noted as determinants of the level political constancy (Alexander, Fajri & Kurniawan, 2009, p. 168). This suggests that the better the economic capacity of a country, the more stable its governance is. Hence, the harmonization of reporting principles enhances the economic capacity of a state.

In relation to that, since the onset of the new millennium, countries have had different perspectives on the global standards and, therefore, comply to varying extents to the guidelines, particularly because of the dissimilarities in culture, technology, governance, and endowment with natural resources (Alexander, Fajri and Kurniawan, 2009, p. 168). Jurisdictional differences in the IFRS implementation result in immediate political response. For instance, if a certain domestic market performs better in terms of revenue generation than the international market, the political rhetoric would be against using the IFRS. Such a measure would be taken to discourage foreign penetration and at the same time safeguard local resources. Conversely, if the domestic economy performs poorly in comparison to the international market, the politicians would support the integration of the IFRS standards to lure investors.

4. The Global Acceptance of the IAS/IFRS Accounting Standards

Given the political and economic benefits of accounting harmonization, there is widespread or universal acceptance of the IAS reporting standards. The guidelines equip investors with the required flexibilities

that enable expansion into foreign markets. For instance, through the IFRS, companies have enhanced their levels of capital security and have access to proficient audit consultancies. To highlight the degree of the global acceptance, the IAS guidelines have to be analyzed chronologically and in terms of the functions of the accounting standards.

The global acceptance of the IFRS guidelines can best be depicted in a chronological manner, from the introduction of the principles to present day enforcement. As earlier shown, the adoption of unified reporting standards was a gradual process that began in the late 50's and still continues to date. In 2002 all the member states of the EU voted unanimously to adopt the IFRS standards (Carmona & Trombetta, 2008). Hence, all the companies trading in the European Security Market were required to abide by IAS guidelines, while foreign or non-European investors had to adhere to the US GAAP. In 2005, the Australian Accounting Standards Board (AASB) followed suit; the agency recommended that all standards and reporting interpretation methods in the country be tailored to comply with IFRS guidelines (Carmona & Trombetta, 2008).

Some regions continue to lag behind in terms of implementation of the IFRS guidelines. Particularly, countries in South West Asia and Middle East and North Africa (MENA) regions have been slow in adopting the standards. For instance, Tunisia, Korea, Mongolia, and Morocco are still in the process of integrating the IFRS principles. The main impediment in the MENA region is Sharia Law, which compels Muslims to apply different accounting principles. Other nations are just beginning the transformation process. At the present, all banking institutions and enterprises within Russia are required to prepare financial statements using the IFRS regulations. Since 2005, New Zealand has adopted 36 novel accounting rules as well as 12 interpretation algorithms, all of which were derived from the IFRS guidelines (Carmona & Trombetta, 2008). The other accounting standards in use in the country are all past guidelines that were equivalent to the IAS principles.

Other significant markets also adopted the policies recently. The eighth largest market in terms of capitalization, Hong Kong, has been aligning its standards with the IFRS guidelines since 1990. In 2008, the Canadian Accounting Standard Board adopted the IFRS principles on a trial basis for a five-year period (Carmona & Trombetta, 2008). As a result, the United States is the only G4 country that does not comply with the harmonized practices. By the time Canada acceded to the standards, Japan and China had already begun gradually adopting the principles a decade earlier.

The distinctive element of the IFRS/IAS guidelines is its principle-based approach; domestic standards employ a rule-based approach. A principle-based approach overrides secondary rules that increase data complexities (Carmona & Trombetta, 2008). In addition, its associated restrictions, precedents, and exceptions are clear and precise unlike the criteria thresholds of rule-based systems. Hence, the principle-based approach offers generic practices that address controversial issues, while simultaneously ascertaining ambiguity (Carmona & Trombetta, 2008). The approach also allows the diverse and broad nature of harmonization to be viewed from a narrow and simplistic perspective, thus enhancing report comprehension. For example, according to principle 19 of the IAS that addresses employee benefits, integration of the corridor approach eases documentation of losses and gains that in turn reflects on the net income for any portion that surpasses the corridor.

5. Effects of Mandatory IFRS Adoption in the EU Commerce

The European Union officially adopted the IFRS standards in 2005 and, as a result, all European companies listed on the unified stock exchange were forced to abandon their domestic national accounting

standards in favor of the new reporting principles. The adoption of the new accounting practices had implications on loans and advances, particularly due to changes on fair value estimation. The fair worth of loans and advances became vital and relevant derivatives for the determination of a bank's performance (Dimos, 2011, p. 100). In addition, the fair values gave a clear picture of a firm's economic position by highlighting its financial capacities. In other words, the values on loans, advances, and debts showed that fair value was a functional indicator of an institution's financial health as well as its revenue generation variability. Hence, the nations with strong financial institutions found it easy to adopt the IFRS, while the reverse is true.

Besides that, (Dimos, 2011, p. 102) conducted an analysis of several European banks over a five-year period and discovered that the adoption of the IFRS resulted in lower equity-capital costs. Even the European states that fared poorly in IFRS enforcement recorded the reduction in equity-capital costs; possibly the benefits resulted from the complete implementation of the IFRS principles by neighboring nations. The capital costs may have also reduced because of the changes in measurement and presentation methods along with the asset holding to maturity function prior to the commencement of a financial transaction (Dimos, 2011, p. 102). The measurement and presentation of all assets and liabilities incorporated a mixture of fair value and remunerated expenses that in turn increased the accuracy of status depiction. Hence, the investors and entrepreneurs could effectively and efficiently carry out share pricing. This in turn elevated trading within the region. The act of holding stock to maturity ensures that trading is done in instances when the shares fetch the optimal market values, thus maximizing revenue generation (Dimos, 2011, p. 102). In addition, the practice encourages provision of bank advances and loans, hence also increasing revenue generation in the long term.

Adoption of the IFRS by the EU also improved the hedge accounting process. The purpose of hedge accounting is to pair up gains and losses to reduce risk. According to the IAS, hedging accounting can be classified into cash flow, fair value, and net venture on alien operation hedging (Dimos, 2011, p. 104). Fair value hedges mitigate an institution's exposure to fair value risks, cash flow hedges protect a firm from poor cash flows, and the net investment hedges on foreign soil ensures that a company's interest or total assets are free from exposure in the novel territory. The effectiveness of the risk management functions of the IFRS facilitated by the modified hedge accounting process improved the financial performance of European institutions. The banking sector benefited by receiving expansion guarantees, thus encouraging ventures into South West Asia and the MENA regions that lagged behind financially because of adopting religion-based accounting principles. In this respect, macro hedging has extensively been promoted by the EU's banks.

A report from ICAEW (2015) examines the findings of about 200 research papers on the effects of mandatory IFRS adoption in the EU. The report aims to add to the debate on the future of IFRS in the EU. The report shows that there is evidence of benefits following IFRS adoption in relation to financial reporting transparency and comparability, the cost of capital, market liquidity, corporate investment efficiency and cross-border capital flows. The report points out that the benefits found are uneven, varying with the institutions and incentives that apply for different companies in different countries.

6. Multinational Companies and Accounting Convergence

The movement towards a global economy has increased the need for global accounting standards. The growth of multinational companies has enhanced the need of such standards. The Securities and Exchange Commission (SEC) has influenced the topic of converging US GAAP and international accounting stan-

dards. The commission has allowed foreign companies to use IFRS in financial reporting without having to reconcile US GAAP and international standards. In addition, it has sought to unite world regulators on the convergence of global accounting standards. The convergence and harmonization of IFRS and American GAAP into a single set of accounting standards would benefit multinationals significantly.

According to the United Nations Conference on Trade and Development (2008), the decision to adopt IFRS is determined by a cost-benefit trade-off between some factors. Firstly, it recognizes the benefits of the investors. Secondly, it recognizes the recurring cost savings on the multinationals. The third trade-off involves the one time transition cost that multinationals and the national economy have to incur. The cost involves the adjustments to the institutions of a specified country. Multinational companies have enhanced the spread of IFRS. They provide a significant channel for foreign direct investment into most economies. They were involved in the formulation of the standards. In addition, their support has been essential to the success of the standards. Due to the important role that they play in the national economy, it is impossible to imagine if the standards would have been so successful had they opposed them.

Furthermore, governments should let multinational companies to decide whether and when to adapt the IFRS. The companies incur the heaviest burden of the process. In addition, they hold the key to determining the success of implementing the standards.

Countries should embrace the model that Russia has adopted. Their financial reporting standards should be implemented in a dual manner. Firstly, the national GAAP should be upheld as alternatives to the IFRS. Secondly, countries should adopt the IFRS. Having the two options will enable the country to comply with the needs of the international financial community without undermining its local practices. In addition, it would save domestic organizations from incurring the expense of adopting international standards that would have no real impact on their operations.

The accounting scandals that have occurred in major multinationals such as Enron and World Com have highlighted the need for high quality international accounting standards. The need for the standards has been increased by the expansion of the internalization of the securities market.

The Securities and Exchange Commission (SEC) has joined forces with the European Commission and the Japan Commission to increase the globalization of international accounting standards. However, the threat of increased global power for the SEC is a contentious issue. The formation of the International Accounting Standards Committee Foundation (IASCF) is expected to solve the problem of a super powerful SEC.

The process of globalization has combined with the increased awareness of capital markets to increase the need for the convergence of accounting standards (Fortin, Barros, & Cutler, 2010). In addition, the size of investors has increased significantly. For example, foreign institutional investors are investing in significant global volumes. Furthermore, the television and online media have enabled the public to track the movements of share prices in the global market. The convergence of accounting standards would enable investors to make quick investment decisions.

Multinational organizations have adopted institutional entrepreneurship. The institutional entrepreneurs are organizations that use their resources to advocate for change. They have been change agents on the subject because they perceive the value in the implementation of international accounting standards.

7. IFRS Adoption, FDI and Institutions

An evaluation of the data on international trade and financial reporting standards demonstrates that the development of institutions in a country has a greater impact than the mere adoption of the standards.

Although adopting the standards has a positive immediate impact, it does not have a long-term influence. According to the United Nations Conference on Trade and Development (2008), investors consider multiple factors when making an investment decision. As a result, the presence of one positive factor is not enough. The observation can be used to explain why the implementation of the standards in developing countries has a limited impact. Governments should instead match the adoption of the standards with a number of key factors. Firstly, they should work on strengthening the institutions in the country. Most developing countries have weak institutions controlled by the government. They should ensure that there is a strict separation of powers between the arms of government. They should also promote the rule of law. Countries with low corruption rates will benefit from increased FDI. There should be a strong focus on the implementation of property law and the enforcement of contracts.

The World Bank has made more countries to adopt the standards. Most countries are forced to adopt the standards in order to receive funding from the institution. As a result, the standards have been driven by international forces as opposed to a deliberate desire among the countries to increase the integrity of their standards.

Another key thing to note is that the developing countries as opposed to their developed counterparts drive the overall increase in FDI. The observation is because foreign direct investment is skewed in favor of emerging markets. In addition, most developed countries already have similar financial reporting standards.

The success of the international financial reporting standards is dependent on government institutions. Governments adopt the standards and commit themselves to enforce them in their jurisdictions. However, the implementation of the standards requires the participation of all the stakeholders. In most instances, the government would have to give the organizations within its jurisdiction sufficient time to implement the new standards. The relevant government institutions will have to police the organizations.

Financial standards setters, regulators and policy-makers have a significant interest on the impact of financial reporting standards on the economy (Tsamenyi & Uddin, 2008). The interest can be attributed to the economic consequences associated with the financial information. The financial information influences the behavior of investors by determining their portfolio selection. Firms have a significant interest in the information because it determines the pricing of securities that in turn affect their ability to get additional funding. The regulation of financial reporting mechanisms is a significant mechanism that determines the operation of securities markets. The markets are a significant channel of foreign direct investment.

Adoption of IFRS has been influenced by the desire to among transitional economies to adopt corporate governance practices that would give them global intimacy (Tsamenyi & Uddin, 2008). The move acknowledges the modernization of developing economies. The practice is bound to result in greater financial transparency. Achieving a high level of transparency will encourage international trade and FDI. The adoption of the practices has been both mandatory and voluntary. However, a country's adoption of the standards was not affected.

The increased push for more countries to adopt International Financial Reporting Standards requires a determination of their impact on international trade. The practice results in increased foreign direct investment and international trade because it fosters transparency and comparability. International investors are keen on investing in countries whose financial practices are understandable. Furthermore, they desire to work in countries that have high levels of transparency. The countries with transparent institutions have the ability to attract investors from diverse countries (Fortin, Barros, and Cutler, 2010). For example, the United States has a code of standards that investors and companies working abroad should

follow. If they engage in questionable financial practices, then there is the possibility that they could be sued for their actions. As a result, they are keen on entering into countries with clear financial practices.

In addition, the practice enhances the ease of doing business. The standards will enhance the process of doing business because agents will understand each other more. Furthermore, the adoption of such standards will reduce information cost. International trade and foreign direct investments are often hampered by the high cost of acquiring the right information. In cases where there are different accounting standards involved, the investors are forced to invest in consultants. The price of hiring consultants increases the investment cost significantly.

In 2010, 120 countries decided to adopt the International Financial Reporting Standards and made a commitment to enforce them in their jurisdictions (Lasmin, 2011). In the same year, foreign direct investment in foreign countries increased significantly. As a result, an increase in people who support the adoption of uniform accounting standards has been noted. However, there is no sufficient data to prove that developing countries benefit from adopting the standards. According to the United Nations Conference on Trade and Development (2008), developing countries are not likely to receive more FDI inflows and increased international trade by adopting the standards. This is because international trade is determined by many different factors. In contrast, the European countries benefited the most from the adoption of those standards.

The process is characterized by several challenges. For example, the United Nations Conference on Trade and Development (2008) notes the high cost involved in adopting the standards for the organizations involved due to the overhauling of systems and training costs involved. Furthermore, the organizations would be forced to implement many changes in their financial practices. However, the benefits of benchmarking with their peers from any part of the world are enough to offset the high cost. In addition, adopting the standards would allow a multinational company to have consistent reporting standards with its subsidiaries. The move would improve international communications. Moreover, it would result in a better quality of reporting. The decision-making process within the organization will also be improved in a significant manner.

However, it is clear that there should be further research on accounting standards harmonization process in Europe and other countries. Furthermore, a deliberate effort to address the unwanted effects of adopting IFRS standards is crucial. The process will lead to a better understanding of IFRS standards on national and international economies.

8. When do the Adoption and Use of IFRS increase Foreign Investment?

A significant challenge that firms face when attracting foreign investment is the asymmetry of information between foreign and direct investors. IFRS gives firms the opportunity to reduce the asymmetry. The move will increase their attractiveness among foreign firms. However, significant differences are noted in the manner that firms implement the IFRS standards. The observation is because firms have different reporting practices. Firms with strong reporting standards tend to attract many foreign investors. In contrast, those with weak reporting standards only attract little foreign investment (Bowe, Miletkov & Wintoki, 2013, p. 3). The countries that have weak investor protection systems would not benefit significantly from the adoption of the standards if the practice were not matched with a deliberate process to reform the institutions of the organization.

Foreign investors consider many factors before investing in a country. For example, the country must demonstrate its respect for the rule of law. Strong property laws and a commitment to enforce contract

characterize countries that respect the rule of law. Since corruption increases the cost of doing business significantly, most investors are keen on investing in countries with low levels of corruption. Consequently, an enabling environment is necessary for the IFRS to increase foreign investment. As a result, countries looking to benefit from the adoption of the standards should ensure that a deliberate process to create an enabling environment that protects investors accompanies them.

In addition, IFRS are effective in countries with high quality auditing standards. Auditors play a noteworthy role in ensuring that organizations comply with the financial practices of their countries. Foreign investors rely on auditor reports to enable them to make appropriate investment decisions. In the event that a country with high quality auditors adopts IFRS, then it can attract many foreign investors.

A critical evaluation of IFRS standards shows that they were designed for developing and mature capital markets. Although it is clear that financial statements assist investors to make critical investment decisions, countries with no stock markets should not adopt IFRS. Financial statements help users to estimate the value of securities when they are buying or selling. Financial reporting should not exist in developing markets. The accounting systems in a particular country are determined by its socio-economic and political history. The fact that some economies differ significantly from others shows that the adoption of the standards is only effective in some countries.

In order for IFRS to be effective, it is important to modify some aspects in order to make it suitable to the accounting needs of the country. The European Union and other countries have adopted modifications that ensure that the standards address their needs. If the standards are suited to a given country, then they are likely to succeed in attracting foreign investment.

Many countries have adopted the European Union-based IFRS standards. Understanding the reasons that motivate their actions provides a strong indication of the future of the standards. An evaluation of the countries that have adopted the standards shows that more powerful countries are less likely to adopt them. The countries have a strong economy that has good corporate governance systems. As a result, they fail to perceive any value in adopting additional standards. The approach explains why the developing countries represent a significant portion of the states that have adopted the standards.

The indifference that powerful countries have towards the standards is due to their unwillingness to surrender standard setting authority to an outside entity. In most instances, countries try to avoid surrendering any authority to independent entities. For instance, the United States has been reluctant with the adoption of the IFRS (MAFK International, 2013). However, with hundreds of countries adopting the standard, the United States is likely to replace its US GAAP standards with the new accounting practices (MAFK International, 2013).

The network effect that is associated with the adoption of the standards provides a powerful motivation for other countries to join them. A country is more likely to adopt the IFRS standards if other countries within their geographic region did the same. In addition, if trade partners adopt the standards, then a country would be under intense pressure to act similarly. Consequently, the practice has been driven by strategic considerations as opposed to a willful desire to demonstrate financial prudence.

Furthermore, the increasing number of countries adopting the standards has led to higher network effects. The argument postulates that some countries are forced to adopt the standards so that they can benefit from the effects of a global economy that focuses on the creation of a unified financial code.

However, there is no evidence to show that changes in the trade and foreign direct investment have any direct impact on the decision of a country on the subject. In contrast, the adoption is due to the economic theory of networks. The theory postulates that the value of something such as a product or service increases when it is adopted by a wide group of people. The adoption of the standards has oc-

curred in a gradual manner. Countries did not adopt the standards at once. Instead, the adoption process has been gradual. As more countries embrace the standards, their counterparts have to adopt them in order to avoid missing a new global reality.

The strength of the governance and corporate structures in a country determine whether they are likely to adopt the IFRS standards. Countries, whose governments have the ability to make timely-decision making, are more likely to adopt the standards. In addition, they are more likely to embrace the standards if the cost of switching to the new standards is expensive.

The implementation of the standards does not result in a significant reduction in information costs for advanced economies. The observation demonstrates that the developing economies would benefit the most from adopting the standards. As a result, it is evident that adopting the standards is driven by strategic considerations.

Countries understand that widespread adoption of the standards is integral towards creating a global accounting standard that benefits everyone. The standards will result in a significant reduction in the investment decision. In addition, it would lead to a reduction in the cost of accessing the information (MAFK International, 2013). Many countries realize the importance of being part of the global economy. They hope that by adopting the standards they are likely to create an environment that matches the emerging trends in the international arena.

9. IFRS, Foreign Direct Investment, and Corporate Social Responsibility

Although there is not a standard definition of corporate social responsibility, the term is widely known as contributing to a better society through company actions in the benefit of the workforce and local community. This means the adoption of voluntary codes of conduct and rules of behavior by companies which go beyond public legislations. There is a strong relationship between corporate social responsibility and foreign direct investment as the increase of foreign direct investment has fostered the growth of corporate social responsibility. Corporate social responsibility is an important determinant for multinational companies to start operations. FDI increases the working conditions due to established CSR initiatives (see Frost & Ho, 2005; Goyal, 2006; Kolk & van Tulder, 2010).

Some authors claim that FDI and CSR have played an important role for poverty reduction, as well as having an impact on salaries and working conditions in developing countries (see Brown *et al*, 2004). On the other hand, other authors explain that corporate social responsibility is the reaction to the social dissatisfaction from globalization (see Jenkins, 2005; Gonzalez-Perez & McDonough, 2007). CSR policies have increased as a result of globalization creating a sense of responsibility creating a sense of responsibility engaging companies in an improvement of the societies where they operate. There is also a relationship between CSR and economic performance of companies (see McWilliams & Siegel, 2000, 2001; Carter, 2005). Although it is not clear if companies are successful as a result of the CSR implementation or if companies implemented CSR policies due to their economic success.

It is often suggested that there is a mutual relationship between society and economic actors. In this sense, Edwards (2004) explains society needs to access the surplus of market economies in order to have sustainable social objectives, he points out that society needs markets and these markets need a strong civil society to develop. Goyal (2006) points out that corporate social responsibility can create a sense of responsibility for companies entering new countries to cooperate in poverty reduction and social welfare. Thus, an increase in FDI will promote growth of CSR practices, and a higher degree of responsible business initiatives will attract new FDI.

Emerging economies are still perceived as risky places to invest, although multinationals countries are actively investing in many developing countries. Countries which are rich in resources are a strong motivation for investment. Most developing countries depend on FDI inflow to transform their fast growing economy. These countries hope that a higher inflow of FDI will improve their economy and increase the standard of living of their population with more employment opportunities. The implementation of the appropriate macroeconomic policies together with the liberalization of the economy, and privatization are the key factor to attract FDI to emerging economies (See Ajayi (2008)). Unemployment and poverty are the major challenges faced by developing economies, being the high unemployment the main determinant of low standard of living in these countries. Thus, developing countries have a strong incentive to attract foreign companies to invest and to use trade in favor of their country's interest.

Most developing countries have implemented policy reforms with the intention to create great business atmosphere for foreign investors. The leaders of developing countries work to attract more FDI to alleviate poverty. Creating job opportunities in a country would contribute to alleviate poverty. The higher economic growth would increase employment, improving the standard of living and reducing poverty. Furthermore, FDI can contribute to the improvement of infrastructure by host countries. Another factor which contributes to poverty alleviation is the taxation of foreign subsidiaries. Taxes from foreign companies would increase the revenues of the host country. This tax revenue can be used to finance poverty reduction initiatives or creating a safety net for the poor. In this sense, Prahalad (2002, p. 42) stated that "By stimulating commerce and development at the bottom of the economic pyramid, MNCs could radically improve the lives of billions of people and help bring into being a more stable, less dangerous world".

INVESTMENTS THROUGH EMPLOYMENT OPPORTUNITIES: SOLUTIONS AND RECOMMENDATIONS

10. The Effect of IFRS on Cross-Border Acquisitions

One of the biggest arguments advanced by proponents of the IFRS is its ability to create an efficient capital allocation process through greater cross-border investment. An evaluation of investment data shows a significant increase in the level of investment due to the adoption of the IFRS standards. The observation is consistent with the fact that investors benefit from a significant reduction in information symmetry due to the increase in the comparability of financial reports.

In addition, a strong implementation of the IFRS standards may result in a significant increase in mutual funds investment. The countries that have strong implementation credentials tend to attract many investments from both individual and institutional investors. In contrast, countries with weak implementation capacities realize no significant impact from the adoption of the standards. Achieving financial comparability is bound to have a net positive result of cross-border trade. Comparability refers to achieving uniformity in accounting practices between two different countries (DeFond, Hu, Hung & Li, 2010, p. 1). High comparability levels will reduce the cost of accessing information. As a result, increased investment in firms will be noted.

However, two factors should qualify any claim about the impact of achieving financial comparability. In jurisdictions where the enforcement of the standards is mandatory, the success of the new accounting standards is dependent on the management credibility of the new organizations (DeFond, Hu, Hung &

Li, 2010, p. 1). Management credibility involves the ability of the management to implement the new accounting standards. Financial reporting practices vary significantly amidst countries. In addition, managers have a lot of flexibility in determining the implementation of accounting standards.

The second qualifying factor involves the magnitude of the increase in uniformity. A large increase in uniformity will result in increased financial comparability. The magnitude varies from one country to another (DeFond, Hu, Hung & Li, 2010, p. 2). As a result, the adoption of IFRS standards is bound to result in varying implications in different countries.

(Henock & Oktay, 2015) examine the effect of IFRS on foreign direct investments (FDIs) by analyzing whether the 2005 mandatory adoption of IFRS leads to an increase in cross-border acquisitions in the adopting countries. They find that the adoption of IFRS led to a significant increase in FDIs, which is consistent with the primary objective of IFRS.

FUTURE RESEARCH DIRECTIONS

The European Union provides an effective case study for analyzing the impact of the implementation of the IFRS standards on a large scale. In the European Union, the implementation of the IFRS standards was mandatory. As a result, they were implemented in many firms at the same time. An analysis of the information is based on mutual fund investments. In most instances, mutual fund investors are sophisticated investors who make their investment decisions based on a comprehensive analysis of financial information.

CONCLUSION

The impact of adopting the IFRS standards is limited to domestic investors. The investors have access to alternative channels of communication. For example, they can obtain information from industry analysts or managers. Similarly, the increase in cross-border transactions is due to the activities of foreign-owned organizations. The organizations tend to have a presence in multiple foreign markets. Consequently, they have a significant interest in benchmarking with a large number of firms.

The effects of adopting IFRS on cross-border trade are dependent on the economic institutions in the countries involved. Furthermore, the management incentives in the country determine the process. The enforcement of the IFRS standards is bound to play a significant role in determining if the implementation of the organization is bound to have a significant effect. Some countries have strong financial regulatory bodies that ensure all the organizations in the country implement the standards. Others have weak institutions that lack the resources or ability to ensure that all firms in a country implement the new standards. In the former countries, a significant increase in cross-border trade is noted while in the latter countries, the impact will be limited.

Multinational companies contribute to economic development through investments, taxation, jobs, and the transfer of technology and skills. As the level of corporate social responsibility is strongly related to FDI inflow for developing countries, there should be a higher degree of cooperation between local governments and multinational companies to improve FDI inflow and reduce poverty. Local governments

should implement programs to engage foreign companies to hire and train their local employees with the view of increasing long-term employability. Initiatives followed by developing countries should include liberalization of trade, increase export-led growth, and privatization of public companies.

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