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The adoption of International Financial Reporting Standards in a non-colonized developing country: The case of Nepal

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ABSTRACT

The purpose of this paper is to provide a systematic and rigorous analysis of the accounting environment in Nepal. Based on the accounting ecology framework developed by Gernon and Wallace (1995) and interviewing selected key stakeholders, it critically examines issues related to the adoption of International Financial Reporting Standards (IFRS) in Nepal. It contributes to the literature by examining issues associated with the adoption of IFRS in a non-colonized developing country. This study finds that the decision to adopt IFRS in Nepal is not driven by the needs of local organizations and is rather imposed by donor organizations such as the Asian Development Bank, International Monetary Fund and World Bank. The findings of this study provide evidence that the adoption of IFRS is likely to be problematic due to the country's contextual environment. Specifically, there is a severe lack of qualified accountants in Nepal and the accounting profession is not ready to adopt IFRS. The study also finds that social problems such as widespread corruption and fraud are likely to cause problems for the adoption of IFRS.

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1. Introduction

Globalization of production, development of global consumer and capital markets, and growth of multinational companies brought together the need to establish a single set of financial reporting standards (Flower, 1997). With the aim to reduce international differences in accounting standards, among others, the International Accounting Standard Board (IASB)¹ is developing such a set of financial reporting standards for use internationally. The development of International Financial Reporting Standards (IFRS) is supported, for example, by the assumption that a single set of global accounting standards is an important means of enhancing comparability of financial statements and reducing the cost of preparing financial statements. During the last few years there has been a significant increase in the number of countries that have adopted IFRS with more than 120 countries requiring or permitting IFRS for financial reporting purposes. IFRS have been adopted both in industrialized countries such as the United Kingdom, Germany and Italy, and developing countries such as Bangladesh, Kazakhstan and Bolivia.

Achieving comparability in financial reporting depends upon whether IFRS are adopted in a similar and consistent manner across countries. However, differences in, for example, legal systems, taxation, sources of finance, inflation, political ties, colonial history, and culture cause diversity in accounting practices (for example, Doupnik & Salter, 1995; Evans, 2004; Jaggi & Low, 2000; Nobes, 1998; Richardson, 2007; Salter & Doupnik, 1992). These contextual factors are deeply embedded in the accounting environment of a country. As such, they may not be simply changed and could act as impediments to similar adoption of IFRS across countries. Additionally, achieving comparability in financial reporting depends on a consistent interpretation and application of IFRS across countries. Social, political, economic and cultural factors in countries influence accountants' professional judgments, and differences across countries may lead to an inconsistent interpretation and application of IFRS. Several studies provided evidence that professional judgments are applied inconsistently across countries, especially if countries have accounting environments that are different from those in Anglo-American countries where IFRS were developed (Doupnik & Richter, 2003; Doupnik & Richter, 2004).

Over the last few years research related to the adoption of IFRS has focused largely on the member countries of the European Union and other industrialized countries (for example Callao, Jarne, & Lainez, 2007; Doupnik & Richter, 2004; Hail, Leuz, & Wysocki, 2010; Hellmann, Perera, & Patel, 2010; Jermakowtcz, 2004). Importantly, even at a time when more and more developing countries are adopting IFRS, there are only few studies that examine the adoption of IFRS in those countries. For example, the studies in this category include

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¹ IASB is the successor of the International Accounting Standards Committee (IASC) established in 2001. The standards formulated by IASB are called IFRS, whereas standards formulated by IASC are called International Accounting Standards (IAS). For the purpose of this study, the term IFRS and IAS are used interchangeably.

those focusing on Indonesia (Perera & Baydoun, 2007), Zimbabwe (Chamisa, 2000), Mexico and South Africa (Prather-Kinsey, 2006), Trinidad and Tobago (Bowrin, 2007), Pakistan (Ashraf & Ghani, 2005) and Kazakhstan (Tyrrall, Woodward, & Rakhimbekova, 2007).

However, all of these countries were colonized by industrialized countries in the past. For example, Zimbabwe, South Africa, Pakistan, and Trinidad and Tobago were colonized by England; Mexico, Indonesia, and Kazakhstan were colonized by Spain, the Netherlands and Russia, respectively. This is important because these colonial powers often transferred both accounting ideas and accountants to their colonies, and highly influenced the development of accounting in those countries. For example, Ashraf and Ghani (2005) highlight that Pakistan exhibits some of the properties of its former colonial power England, namely two separate sets of reporting requirements and no direct involvement of government in standard setting. They also highlight that England's trained accountants have been a major source of influence on accounting practices in Pakistan. As such, the accounting environment of countries with a colonial past may feature characteristics such as a well-established professional body which may support IFRS adoption in those countries, whereas countries without colonial past may lack such characteristics.

Using the accounting ecology framework developed by Gernon and Wallace (1995), this paper provides a systematic and rigorous analysis of the main features of the accounting environment in Nepal. In addition, the paper examines potential issues associated with the adoption of IFRS in Nepal by interviewing selected key stakeholders such as academics, professional accountants and auditors, personnel from the Accounting Board of Nepal (ASB) and the Ministry of Finance, and by surveying available documents and literature.

Nepal, represented by the Institute of Chartered Accountants in Nepal (ICAN) and the ASB, has decided to adopt IFRS from July, 2012. It offers an interesting setting to examine potential issues associated with the adoption of IFRS because it is a non-colonized developing country with a strong indigenous cultural heritage. Importantly, no prior studies have examined issues related to the adoption of IFRS in a non-colonized developing country even though there is a rich literature in international accounting suggesting that colonial history is an important factor affecting the accounting environment of a country (Hove, 1986; Doupnik & Salter, 1995; Gernon & Meek, 2001, p. 5; Yapa, 2006; Perera & Baydoun, 2007; Muniandy & Ali, 2012).

2. Research methodology

2.1. Theoretical framework

It is commonly accepted that the development of accounting systems is largely a function of environmental factors such as the legal system, taxation, providers of financing, inflation, political and economic ties, and culture. However, the number of factors that influence accounting and their individual importance vary greatly in existing frameworks explaining the development of accounting such as the frameworks of Schweikart (1985), Gray (1988), Adhikari and Tondkar (1992), Doupnik and Salter (1995) and Nobes (1998). Importantly, these frameworks view accounting as strictly dependent on selected few variables of the environment. However, Hellmann, Perera, and Patel (2013) argue that the varying number of factors included in these frameworks and their individual importance suggests that the relationship between a single factor and its impact on accounting development is unclear. They conclude that it would be too simplistic to explain accounting development in terms of one or few identified environmental factors.

The purpose of this study is to provide a holistic analysis of the context in which accounting operates in Nepal. For this purpose, the 'accounting ecology' framework developed by Gernon and Wallace (1995) is used. They define accounting ecology as:

A multidimensional system in which no one factor occupies a predominant position and in which the perceptions held by actors on some unfolding accounting phenomena, as well as the accounting phenomena themselves, are the objects of study and analysis. Such a synthesis would emphasize the interrelationships of the environmental factors which influence and are influenced by accounting and would focus upon the importance of perceptual as well as non-cultural factors such as population and land area (p. 59).

The concept of accounting ecology encompasses the following five separate but interacting dimensions:

- The societal dimension refers to structural, demographic and cultural events and/or trends that may affect the demand for financial accounting services. It includes elements such as population, geographical location, level of technology, political and economic development, and cultural values.
- 2. The *organizational dimension* refers to events and/or trends bearing on rationalization in the choice and design of accounting systems and demands for accounting services such as organizational size, technology, complexity, and human and capital resources.
- The professional dimension refers to events and/or trends bearing on the determination of roles and relationships in the accounting profession such as education, training, registration, disciplinary actions, and professional ethics and culture.
- 4. The *individual dimension* refers to actions of individuals in an effort to pursue their self-interest. It covers the total setting in which individuals lobby standard setters and use accounting numbers to their respective advantages.
- The accounting dimension refers to accounting practices, rules and/or trends that affect or are affected by the other slices of the environment. It includes the disclosure and measurement requirements and practices, and types and frequency of accounting reports (Gernon & Wallace, 1995).

Compared to other frameworks explaining the development of accounting, the accounting ecology framework incorporates both causes and effects of accounting and allows examining accounting in Nepal in its broader institutional context. Previous studies such as Perera and Baydoun (2007) and Hellmann et al. (2010) have adopted this framework and demonstrated its appropriateness for examining the accounting environment of a particular country. For example, Perera and Baydoun (2007) examined the accounting environment of Indonesia and identified some factors that were helpful in explaining the lack of support of IFRS in Indonesia, and Hellmann et al. (2010) examined the accounting environment of Germany and identified several contextual issues related to the adoption of IFRS in Germany.

2.2. Data collection

Data were collected from multiple sources including face-to-face interviews, discussion papers from the ASB, newspaper articles, newsletters from ICAN and ASB, and reports from the government and international institutions such as the World Bank, Asian Development Bank (ADB), International Monetary Fund (IMF) and the United Nations.

Ordelheide (2004) points out that accounting development is a political process which is largely influenced by affected stakeholder groups that make their influence felt whenever the legislator or standard setter formulates accounting rules. From the influential stakeholder groups in Nepal, a total of twelve individuals were interviewed including five professional accountants, six regulators and one accounting academic.

Interviewees were identified using publicly available information. Professional accountants were identified using the membership list of ICAN and a random sample of potential interviewees was identified from the first half of the membership list which is arranged in chronological order based on registration date. Those included on the first half of the membership list were likely to be familiar with the accounting environment of Nepal as they had more experience than other members on the list. The membership list also includes members of the ASB and other regulatory bodies such as the Security Exchange

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