Journal of International Accounting,
Auditing & Taxation 12 (2003) 63–84

Journal of International Accounting Auditing & Taxation

Introducing International Accounting Standards to an emerging capital market: relative familiarity and language effect in Egypt

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Abstract

The purpose of this study is to assess the effect of relative familiarity and language accessibility on the International Accounting Standards (IASs) disclosures when IASs are first introduced in an emerging capital market. The study focuses on the annual reports of listed non-financial companies in Egypt when IASs were first introduced. The method used applies a disclosure index measurement to a sample of listed company annual reports and evaluates relative compliance with IASs in relation to corporate characteristics. The results show that for relatively less familiar requirements of IASs, the extent of compliance is related to the type of audit firm used and to the presence of a specific statement of compliance with IASs. A lower degree of compliance with less familiar IASs disclosure is observed consistently across a range of company characteristics. Consideration of agency theory and capital need theory would lead to prior expectation of a distinction in disclosure practices between different categories of companies. The results were, therefore, counterintuitive to expectations where the regulations were unfamiliar or not available in the native language, indicating that new variables have to be considered and additional theoretical explanations have to be found in future disclosure studies on emerging capital markets.

Keywords: International Accounting Standards; Emerging markets; Familiarity; Language effect

1. Introduction

The growing acceptance of the International Accounting Standards (IASs) by emerging capital markets has encouraged empirical investigation of compliance with the requirements

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1061-9518/03/$ – see front matter © 2003 Elsevier Science Inc. All rights reserved.
doi:10.1016/S1061-9518(03)00002-8

of IASs. Despite the increasing use of international standards in national accounting regulation, there remains evidence of significant non-compliance (Street and Gray, 2001).

Studies of acceptance of the IASs have not, however, extended to analysis of the process by which the IASs become an integral part of national accounting practice. One aspect of the process is to become familiar with new regulations not previously known nationally, while another aspect is to assimilate into the national language a set of standards written in English as the official language of the International Accounting Standards Committee (IASC), the predecessor of the International Accounting Standards Board (IASB).

This paper focuses on the application of IASs in the period immediately after they become mandatory in order to address the general question of how well a country deals with the introduction of new accounting requirements. More specifically, the paper deals with the case of listed companies in Egypt where the IASs became mandatory under circumstances in which some requirements were familiar because they were already reflected in long-established national laws, other requirements were not familiar but were translated into the local language, and some requirements were not familiar and were not available in an authoritative translation.

The research focuses on Egypt because it is a recognized leader of the Arab world (EIU, 1995, p. 4), playing a pivotal role in Middle Eastern politics (Merrill Lynch, 1996). The EU is Egypt's most active trading partner (Arab-British Trade, 1999), followed closely by the United States. According to the U.S. Embassy in Cairo, about 230 U.S. companies are investing in Egypt (ACCE, 2000).

The paper addresses three research questions:

1. How did listed companies differ in their level of compliance with the IASs disclosure requirements?
2. How may observed differences in levels of compliance be related to relative familiarity and a language barrier?
3. How may differences due to relative familiarity and a language barrier be explained in terms of corporate characteristics?

This paper is based on the view that IASs appear to be necessary in an emerging capital market. It has been argued (Briston and El-Ashker, 1984; Hove, 1989; Samuels and Oliga, 1982) that IASs may be unsuitable or even detrimental to the needs of emerging economies. However, those arguments do not focus on the needs of capital markets where there are pressures to apply and implement internationally accepted standards to command the confidence of investors.

The paper reviews prior literature for evidence of a familiarity effect and a language factor in the implementation of new regulations. It then explains the context in Egypt. Data selection for the relevant period is explained and the research questions are answered by use of disclosure indices measuring implementation of IASs requirements. The analysis separates the familiar from the less familiar aspects of the IASs and takes account of the non-availability of an official translation. Differences in disclosure scores are evaluated against corporate characteristics using statistical tests of significance. The paper concludes by identifying the role of the accounting practitioner in the process of implementing accounting change.