Zeszyty Teoretyczne Rachunkowości
Nr 106 (162), 2020, s. 177–190
http://dx.doi.org/10.5604/01.3001.0013.9004
Stowarzyszenie Księgowych w Polsce

# IFRS adoption in emerging markets: the case of Iraq

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**Abstract**

The objective of this paper is to review a synthesis of theories and empirical studies dealing with the mandatory adoption of International Financial Reporting Standards (IFRS) in emerging countries on the example of Iraq. The methodology of this paper is a literature review which mainly focuses on three main streams, including related factors that pressure or prevent such adoption over time, the role of comparability with the implementation of IFRS standards, and the economic consequences of IFRS adoption. Based on the theoretical data analysis and a prior review literature, an adoption paradox model was developed. The study found that mandatory IFRS adoption in Iraq is unlikely to improve financial information comparability. We also found that weak political system issues and complaints about the rules are more likely to reduce the faithful implementation process of IFRS. Further, financial information users, home country institutions and IFRS adoption experience affect the effectiveness of IFRS adoption. We contribute to the literature by showing important factors that can be either supportive or obstructive to IFRS adoption.

**Keywords:** accounting; IFRS adoption, emerging countries, Iraq.

**Streszczenie**
**Przyjęcie MSSF na rynkach wschodzących: przypadek Iraku**

Celem artykułu jest przeprowadzenie syntezy teorii i badań empirycznych dotyczących obligatoryjnego przyjęcia Międzynarodowych Standardów Sprawozdawczości Finansowej (MSSF) w krajach rozwijających się na przykładzie Iraku. Zastosowana w artykule metodyka obejmuje przegląd literatury, obejmujący trzy główne nurty, w tym czynniki determinujące presję na przyjęcie MSSF lub unikanie przyjęcia MSSF w określonym przedziale czasu, rolę porównywalności informacji dzięki wdrożeniu MSSF oraz konsekwencje ekonomiczne przyjęcia MSSF. Na podstawie analizy teorii i dotychczasowej literatury opracowano model paradoksu adopcyjnego. Przeprowadzona analiza wykazała, że obligatoryjne przyjęcie MSSF w Iraku raczej nie poprawi porównywalności informacji finansowych. Stwierdzono również, że słabo rozwinięty system polityczny i narzekanie na zasady najprawdopodobniej ograniczają wierny proces wdrożenia MSSF. Co więcej, użytkownicy informacji finansowej, instytucje w kraju pochodzenia użytkowników oraz doświadczenia związane z przyjęciem MSSF wpływają na skuteczność wdrożenia MSSF. Artykuł przyczynia się do rozwoju wiedzy przez wskazanie istotnych czynników, które mogą wspierać albo przeszkadzać zastosowaniu MSSF.

**Słowa kluczowe**: rachunkowość; przyjęcie MSSF, kraje rozwijające się, Irak.

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ISSN 1641-4381 *print* / ISSN 2391-677X *online*

## Introduction

The harmonization of International Financial Reporting Standards (IFRS) has become a major issue globally. In the last twenty years, the adoption of IFRS for listed companies has become one of the most significant regulatory changes around the world. Recently, over 140 countries have moved to adopt IFRS reporting or decided to require the use of these standards soon. Regulators believe that the mandatory IFRS adoption enhances the comparability of financial statements, improves corporate transparency, and increases the quality of financial reporting (e.g. Regulation No. 1606/2002). Emerging markets have sustained the attention of investment opportunities economically and politically. Prior research examined environmental, macroeconomic and microeconomic factors, including political, economic and legal systems, education, and religion, which are the main factor affecting the adoption of IFRS in emerging countries (e.g. Albu, 2012; Ali et al., 2009; Samaha, Khlif, 2016; Hassan et al., 2014). The extensive mandatory and voluntary adoption of International Financial Reporting Standards (IFRS) in emerging economies was the result of various political, economic, financial and technological changes (Alberti et al., 2011). This paper aims to review the IFRS adoption process in the emerging market of Iraq as a case study. This study extends the previous studies by considering the comprehensive picture of IFRS adoption in emerging countries, in particular, Iraq.  We propose an extension to the proposed model, which is based on the Gray model (1988), to understand the complex, interrelated factors at the micro and macro levels that shape IFRS adoption in Iraq (Al-Htaybat, 2018). The motivation is that Iraq is increasingly introducing IFRS against the background of existing regulation in the country – the Iraqi Unified Accounting Standard (IUAS). IFRS are considered to be of higher quality standards.

To this end, this paper proposes a general understanding of Iraq's current economic and regulatory environment, and specifically its accounting and financial reporting environment, and it sheds light on IFRS adoption in other emerging economies. The recommendations of this study can assist the Iraqi government in the evaluation of the consequences of adopting IFRS.

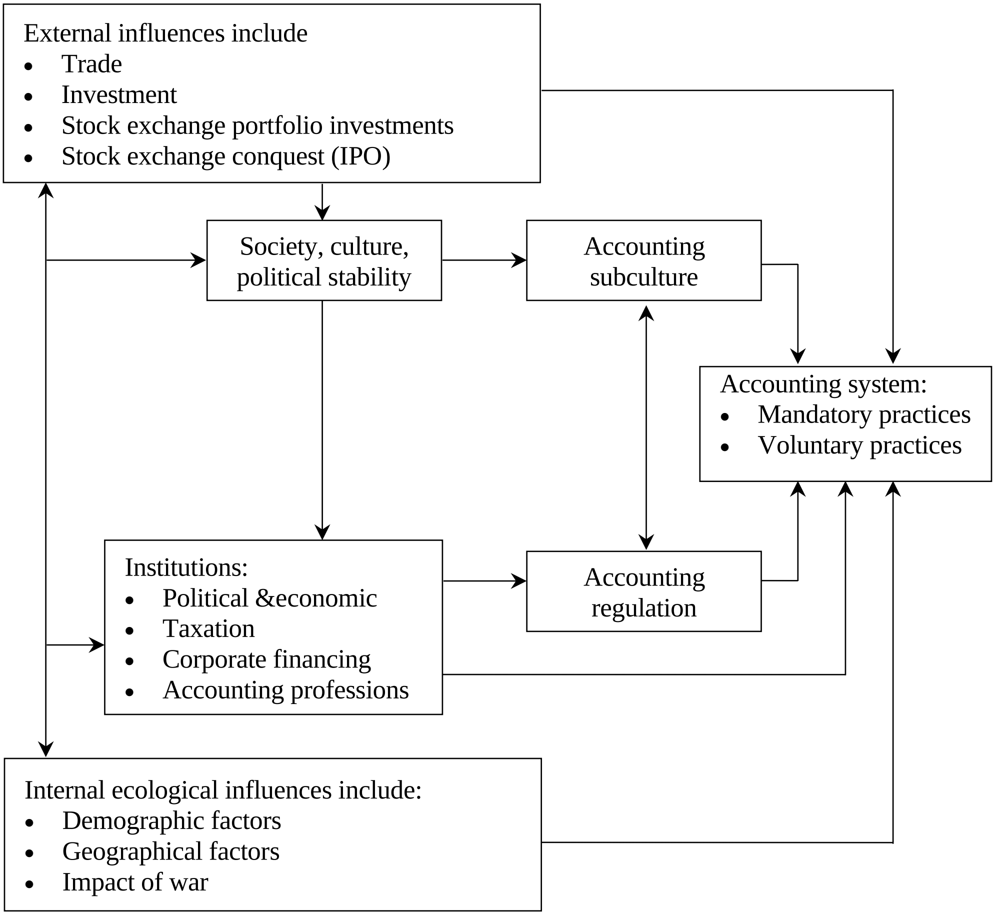
## 1. Motives for IFRS adoption in Iraq – a literature review

Iraq is an Arabic country with a legal system based on civil law that is modelled after the Egyptian Civil Code. However, the Iraqi Civil Code also incorporates certain elements of Sharia law. Iraq encompasses a total area of 438,317 $km^2$ (CIA world factbook). Accounting in Iraq dates back to the Mesopotamians (4500 B.C.) (Keister, 1963). The Iraqi Unified Accounting Standard (IUAS) is a professional accountancy organisation uniting accountants and auditors in Iraq, which was implemented by the Ministry of Trade in 1969, and it applies to both trade and industry sectors. The IUAS system requires double-entry recording to standardise the format for preparing financial statements (Al Najjar, 2009, p. 132). The IUAS is parallel to the US GAAP in that it is a ‘rules-based’ rather than a ‘principles-based system’ of IFRS. This system led to the government actively controlling the structure of the accounting system in the country. Additionally, “the primary role of the unified accounting system is to serve the economy of the State or the central marketplace” and all domestic companies are required to prepare their statement according to the UAS (Ibrahim, Rodrigs, 2014).

The Iraqi Board of Accounting and Auditing Standards (IBAAS) is a professional body established by the office of the President in 1988 to provide the government with advice on financial services and to set the National Accounting Standards (NASs) and auditing standards. The IBAAS was the first semi-private accounting standard-setting body in Iraq. The standards were initially modelled on International Accounting Standards (IASs), although there are still significant differences between standards issued by the International Accounting Standards Committee (IASC) and those issued by the IBAAS. Iraq’s commitment to a single set of global accounting standards is evident from Iraqi Company Law (Number 21, 1997, phase 133), which has required listed companies to apply IFRS Standards since 2005 (Iraq IFRS Jurisdiction, 2016). The Iraq Union of Accountants and Auditors (IUAA) promotes the adoption and implementation of IFRS Standards by supporting the education and training of accountants in those standards so they can learn how to implement these standards. It is compulsory for full IFRS to be used by companies whose securities are listed on the stock exchange and publicly traded, as well as private banks, private shared companies and consultancy companies.

Hassan et. al. (2014) stated that Iraq’s IFRS adoption results from institutional isomorphism (coercive, normative and mimetic pressure). Coercive pressure comes from, e.g., the World Bank, the International Monetary Fund (IMF), and the World Trade Organization (WTO), while normative pressures include, e.g., the accounting profession, through membership of International Federation of Accounting (IFAC), and the Asian-Oceanian Standard-Setters (APSSG). Mimetic pressures derive from the desire to attract multinational corporations to the country, attract foreign direct investment through equity markets, and the desire to attract international partners for local private entities. The Gross Domestic Product (GDP) in Iraq was worth US$225.91 billion in 2018, which represents 0.36 percent of the world economy. The inflation rate in Iraq was recorded at -0.80 percent in May 2019, although it averaged 9.99 percent from 2005 until 2019, reaching an all-time high of 76.55 percent in August 2006 and a record low of -6.37 percent in October 2009 (World Bank, 2018). The decision to adopt IFRS can be voluntary or mandatory. Proponents of IFRS argue that IFRS adoption should be treated as a result of many internal and external factors. This subjects the accounting system to changes both in the country environment and environmental developments. The accounting environment combines societal, organisational, professional, individual and accounting dimensions. IFRS adoption was not motivated by the needs of locals; rather, it was imposed by big organisations, such as the Asian Development Bank and the World Bank (Poudel et al., 2014; Gornon, Wallace, 1995). The motivations of local users in adopting IFRSs are more likely to increase the overall standard and quality of financial reporting, which helps to attract investors in the Iraqi stock markets. The benefits of adopting IFRS for local users inevitably outweighed the difficulties and costs. Additionally, the adoption of IFRS was likely to be problematic due to the country's contextual environment, as there is a severe lack of qualified accountants, and the accounting profession is not ready for such adoption (see Poudel et al., 2014; Roberts et al., 1998; Nobes, 1998).

**Figure 1**. The extensions of the adoption IFRS adoption




Source: author's own elaboration, based on the Gray model (1988).

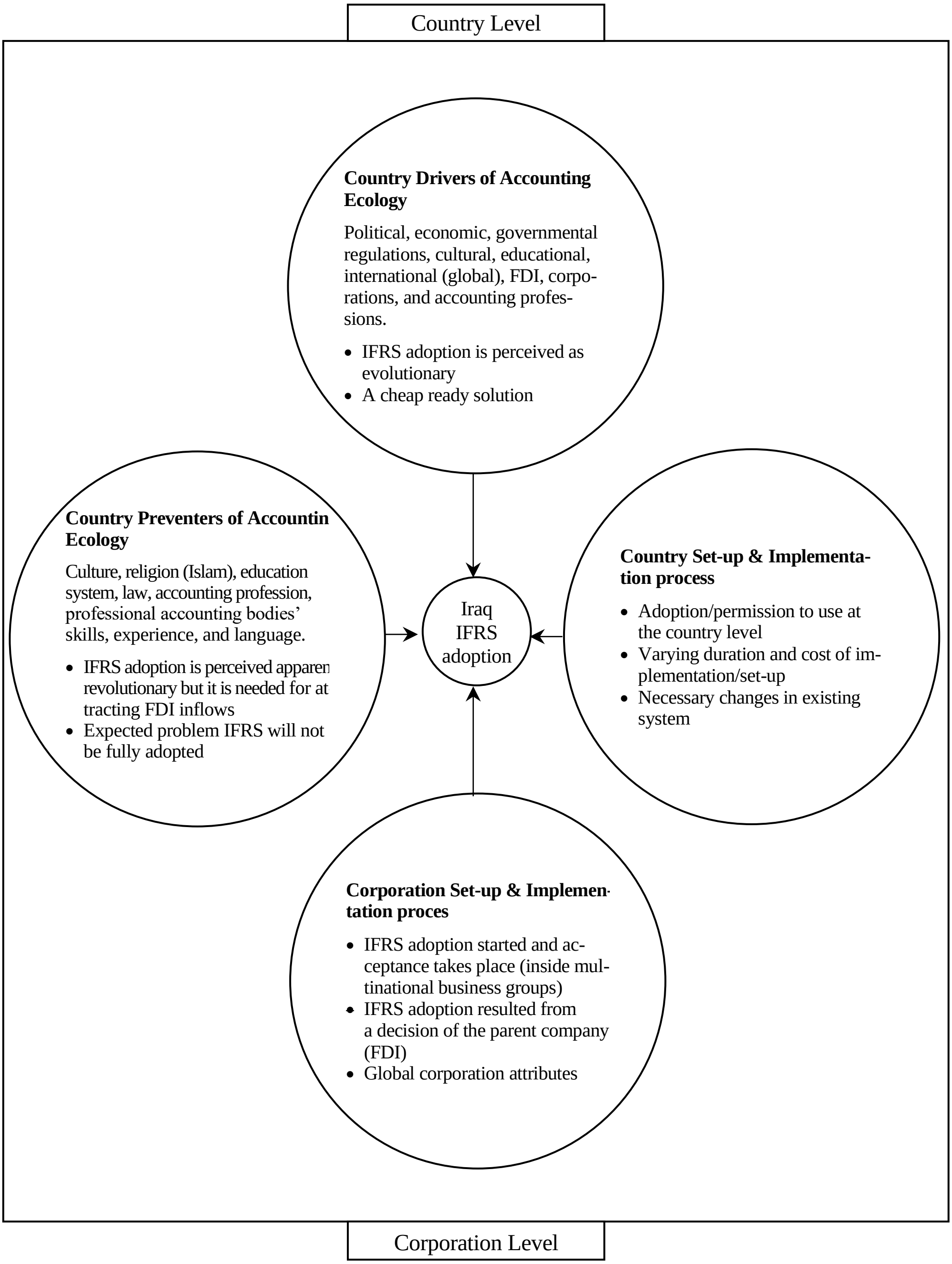
In this study, we develop a model for adopting the IFRS framework to explore the contextual factors that may impact accounting regulation changes in emerging countries, in particular, Iraq. We expect that when adopting IFRS, political and economic factors, as well as privatisation, contribute more to the development of accounting practices than other environmental factors. It is important to note that different accounting regulation systems react differently to these environmental factors. For instance, in the context of emerging economies, the framework of accounting practices and regulation systems lack basic requirements and guidance for what things should be like (Hutaibat et al., 2011). Thus, the underlying aim of the accounting regulation changes in Iraq was to create an attractive investment climate to encourage foreign direct investment; since then, foreign investment in Iraq has slowly grown. Change occurred due to the introduction of a new regulatory system, and we suggest that such changes also took place as a result of external pressures (Burns, Scapens, 2000; Dillard et al., 2004). A change is subject to different rules and routines, and that change can be perceived as a natural, evolutionary development or as a radical, revolutionary change; however, that change should be interpreted according to the rules and norms in place (Burns, Scapens, 2000).

## 2. A conceptual framework of IFRS adoption

Katz and Shapiro (1985) and DiMaggio and Powell (1991) explained that the macroeconomic decision to adopt IFRS in developing counties can be justified by two main network theories, i.e., isomorphism and economic network theory. First, economic network theory notes that emerging countries are more likely to follow IFRS adoption if their trade partners in the same geographical region adopt IFRS (Ramanna, Sletten, 2009). A country's trade partners can reduce financial statement barriers by implementing IFRS where their partners adopt IFRS similarly. According to Ramanna and Sletten (2009, p. 7), "the inherent value of implementing IFRS is commonly called the 'autarky value of IFRS,' while the value of the product network is [called] the 'synchronisation value of IFRS.'" The autarky value of IFRS is the direct value to the adopting country from using the IASB developed accounting standards, and includes economic and political benefits.

Figure 2 shows the adoption of IFRS as a paradox model in emerging markets; it includes the country-level and corporate level. Each level consists of factors that can be a driver or a preventer of accounting ecology. Ecological accounting focuses on the theoretical aspect, including the background of concepts and models specific research on a conceptual framework. Based on the country level, the main drivers of IFRS adoption are political and economic factors, FDI, governmental regulations, culture, law, education, international (global) corporations, and professional accounting career. Introducing IFRS in Iraq should improve the FDI inflow. Hence, the motivation of FDI and foreign investors is profit generation and obtaining a new market. In this point, FDI inflow supports the Iraq government by increasing employment, while advancing technology and economic growth are the most apparent advantages of FDI. The political factor is an essential factor in supporting the adoption decision. General political interest to engage in societal advancement were identified as important factors supporting the adoption decision. Culture, laws, the education system and accounting professions are further factors that impact uniform accounting standards. Emerging countries with the highest educated people are more likely to adopt IFRS (Zeghal, Mhedhbi, 2006). Culture can also be very supportive of adoption, and if the economic and political situation necessitates, it can influence the cultural context sufficiently to facilitate IFRS adoption.

**Figure 2**. International Financial Reporting Standard (IFRS) adoption model applied by Iraq




Source: author's own elaboration, based on Al-Htaybat (2018).

At the corporation level, culture, religion (Islam), the education system, law, the accounting profession, professional accounting bodies' skills, experience and language are the factors that delay and prevent IFRS adoption. For instance, Islam and culture are related; Islam is a cultural obstacle to the approval of IFRS in some countries and some institutions. Hamid et al. (1993, p. 134) claim that "the incompatibility of accounting practices with Islamic principles requires explanation." This comment indicates that some adopters of IFRS are incompatible with Islamic "Sharia" law. Islam takes account not only of religious practices, such as prayer, but it determines even the commercial transactions that Muslims must deal with in their lives (Oukil, 2013). Therefore, skill, education and expertise are obstacles to the adoption of IFRS in emerging countries. Additionally, accounting education, skills and experience are other obstacles as a lack of these things can prevent IFRS adoption. The accounting profession is a preventing factor, as accountants are required to demonstrate if their understanding of IFRS is good enough. For instance, Iraqi accountants have a lack of training opportunities and an inability to work internationally, which limits their knowledge and ability to follow IFRS. Politics prevents IFRS adoption as it consists of "self-interested" considerations or pleadings by preparers and others that may be detrimental to the interests of investors and other users. Figure 2 indicates the country set-up process and corporation implementation stage after a decision has been made to adopt IFRS. At the country level, the IFRS implementation process requires that professional and regulatory bodies set up a new system, but with few changes or significant adjustments of the standards. Therefore, the implementation process has several cost components, including personnel training costs, consultants' fees and costs to adjust existing information systems (Ionas¸cu et al., 2007), contrary to expectations of beneficiaries of financial information that shape the process of preparing these standards (Albu et al., 2011).

At the corporation level, it is necessary for firms to adjust a process of preparing the financial statements according to IFRS, and improve internal regulations, procedures, processes and quality of financial statements. These changes indicate the success of the set-up IFRS at the corporation level. Therefore, to achieve full compliance, corporations need to ramp up their efforts and pull their practices towards full disclosure levels, while at the same time addressing corporate deterrents to adoption. A misapplication of accounting standards and procedures intended to comply with IFRS in Iraq happen, and such problems need to be solved. relate This relates to the difficulties and obstacles usually associated with IFRS implementation in any emergent country, listed by Albu et al. (2011), including the lack of expertise and the underdeveloped accounting profession, the questionable practices of professionals, the lack of resources for regulation and enforcement for companies, the need to educate the business environment about IFRS implications (including tax authorities, investors, analysts), the lack of IFRS knowledge, the need to change the mindset of finance personnel. Therefore, implementing IFRS at the corporate level depends on elements of the cost-benefit trade-off and regulator support. Subsequently, based on contingency theory, as mentioned early, in developing countries, compliance with standards depends on the country and economic context (Leseure et al., 2004).

## 3. Economic consequences of IFRS adoption in emerging countries

The recent move towards IFRS in over 140 countries is one of the most significant regulatory changes in accounting. In 2001, the IAS were replaced by IFRS and a new standard-setting board called the International Accounting Standards Board (IASB). In 2005, the European Union led the first wave of jurisdictions adopting IFRS. The period of 2005-2008, which was closely followed by the second wave of adoption IFRS, including the large Latin American jurisdictions such as Mexico and Brazil. In Latin America, jurisdictions representing more than 99% of regional GDP have now adopted IFRS. In addition, three of the world's largest countries – China, India and Indonesia – have achieved substantial convergence between their national accounting standard and IFRS requirements, with only a few differences remaining. China is close to fully adopting IFRS since some of its big companies show identical results under IFRS and Chinese GAAP. In 2012, Japan adopted IFRS for listed companies on the stock exchange (TSE or Tosho). Currently, major Japanese companies are adopting IFRS. The CFO of Toyota, Japan's largest company, stated his intention to adopt IFRS Standards in the near future. Today, almost 200 Japanese companies representing more than 30% of the total market capitalisation use IFRS. The United States is the only large jurisdiction where adoption has been delayed. IFRS plays a crucial role in Middle East (IFRS 2019). Most Middle Eastern countries have adopted IFRS, excluding Iran, Algeria and Libya. Mandatory IFRS adoption has had a significant positive effect on economic growth around the Middle East. Contrary to this, in the case of Iraq, the economy has sustained little growth. The weak infrastructure, local conflicts, war and security issues are just a some of the obstacles the accounting profession in the country is facing. These explain why economic effect of IFRS adoption in Iraq still is not a remarkable achievement, especially measured in a short period of time. Globally, the poor business environment has led to decline in FDI inflow, from US$4.1 billion (2.4 percent of GDP) in 2014 to US$1.8 billion (1 percent of GDP) in 2017. Private consumption and investment slightly picked-up in 2017 following the end of the conflict that affected supply of goods and household spending (World Bank, 2018). There is a growing body of evidence that a convergent accounting standard, including its financial reporting regime, are important determinants of aggregate economic outcomes (Shleifer, Vishny, 1997; La Porta et al., 2000). A country's institutional framework is likely important for the performance of a country's financial and economic system. As a result, a switch to IFRS by Iraq could lead to welcome consequences for the Iraqi economy in a stable political situation, without war conflicts.

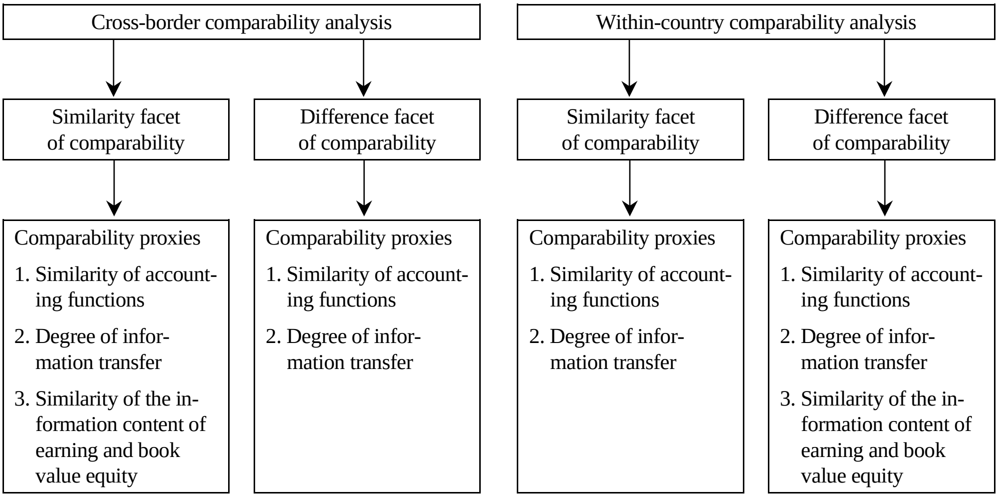
## 4. The comparability and uniformity of information in financial statements

Comparability, one of the "enhancing qualitative characteristics" of accounting information, is a crucial motivation behind the initiative to converge global accounting standards through mandatory IFRS adoption (e.g. Capkun et al., 2008; Daske et al., 2008; Armstrong et al., 2010; Horton, Serafeim, 2010; Clarkson et al., 2011). As mentioned earlier, mandatory IFRS adoption results in improved financial statement comparability, which leads to an increase in foreign direct investment. Uniformity means requiring firms to apply the same set of standards, while comparability is a characteristic of the relation between two or more items of information. Comparability should improve financial reporting quality by allowing financial statement users to identify similarities in, and differences between, two or more sets of economic phenomena (FASB, 2008; IASB, 2008). According to FASB's Concepts Statement 2: *"Comparability is achieved when information being compared is a faithful representation of a relevant phenomenon."* The Statement goes on to point out that regardless of how comparable the information may be, it is useless unless it faithfully represents the information it purports to represent. The above discussion suggests that the adoption of a set of uniform standards is unlikely to improve financial information comparability in countries where IFRS adoption has a weak implementation and lack credibility. Iraq has increasingly introduced IFRS since 2005, but a weak political system and country-level institutions brought poor implementation. Prior literature suggests a country with a weak level of institutions cannot implement high-quality accounting standards (e.g. Ball et al., 2000, 2003; Hung, 2001; Daske et al., 2008). According to the INDEX 2019 ECONOMIC FREEDOM database, Iraqi government integrity is 20.3 percent[1] which results from reduced public trust, corruptions and low credibility of government regulators. . IFRS in Iraq has less comparability and no uniform set of accounting standards among firms for two reasons. First, increased uniformity is only expected to improve comparability when the uniform standards are credibly implemented. Second, comparability is only likely to improve when IFRS adoption results in a large increase in uniformity. The financial statements prepared by Iraqi companies lack credibility; thus, the adoption of a set of uniform standards is unlikely to improve financial comparability in Iraq. Figure 3 indicates two types of information comparability: "similar facet" and "different facet". Similar facet confirms whether companies present their financial statements similarly, and different facet shows whether companies present their reports differently. It is appealing that adopting IFRS improves the quality of financial information and leads to companies presenting their statements in the similar manner. Some empirical evidence from prior studies is consistent with the above (e.g. Ashbaugh,

[1] Countries are scored 0–100, with 0 being the lowest integrity and 100 the highest. Higher values are associated with high quality IFRS adoption.

Pincus, 2001; Chi, 2009; Barth et al., 2012; DeFond et al., 2011). IFRS adoption improves the similarity facet of cross-country information comparability without discernibly impairing the difference facet of comparability (Franco et al., 2011). The similarity aspect of comparability increases for the accounting function measure, but not for the information transfer measure.

**Figure 3**. Summary of empirical analysis and comparability measures




Source: Yip, Young (2012).

However, the increase in the similarity facet of within-country comparability does not statistically differ from that of cross-country comparability using both measures. Several significant differences between the Iraqi Unified Accounting System and IFRS remain when it comes to particular transactions. The debate begins regarding how specific items are recognised, measured and presented on the financial statements and what disclosure is needed.

## 6. The consequences of IFRS adoption for attracting FDI inflow

Iraq has difficulty in attracting foreign capital because of its significant security problems, weak institutions and lack of governance integrity. Nevertheless, hydrocarbons continue to draw in international companies, and the majority of FDI operate in the oil industry. Since 2013, FDI inflow has been negative, reaching US$-5 billion in 2017. Therefore, the total FDI stock fell to US$10.1 billion, accounting for nearly 5.3% of GDP (UNCTAD 2018 World Investment Report). A weak business environment and corruption keep Iraq at the bottom of global rankings for doing business. An unfavourable business environment continues to be a significant deterrent to foreign investment.

Overall, Iraq ranked 168th out of 190 economies in the 2018 Doing Business; 15 places behind other countries in the region (Al Dabbagh, Al Tamimi, 2019).

Additionally, during 2016 and 2017, Iraq implemented substantive changes in the local regulatory framework in two main sections: starting a business and obtaining credit. Starting a business in Iraq has become more accessible by combining multiple registration procedures and decreasing the time to register a company. Companies spend a shorter time registering thanks to an improved online registration system. As a result, Iraq's rank in the ease of doing business improved by 11 points from 165 to 154, although it still below that for the MENA region (113), (Al Dabbagh, Al Tamimi, 2019). It has also improved access to credit information by launching a new credit registry, managed by the Central Bank of Iraq (UNCTAD, 2018). Finally, the decline in foreign direct investment inflow in Iraq is greater due to weak institutions rather than the adoption of IFRS. Financial information users' home country institutions and IFRS adoption experience affect the effectiveness of IFRS usage in Iraq. The Iraqi government wants to attract additional foreign direct investment, but it faces several obstacles, for example, the weak political system, corruption, obsolete infrastructure, lack of skilled labour and outdated commercial laws limit investment growth in non-oil sectors.

## Conclusion

The literature has emphasised a synthesis of theories and empirical studies dealing with the uniform set of accounting standards (i.e., mandatory IFRS adoption), comparability and the uniformity of financial statement information. The current paper focuses on related factors that pressure and prevent the adoption of IFRS in Iraq. It contributes to the body of studies examining IFRS adoption in emerging economies, focusing on factors supporting and hindering IFRS adoption (detterents) at the country and corporation level. We develop the IFRS adoption framework which explains various factors influencing mandatory IFRS adoption in Iraq. The findings of this study are similar to other studies (e.g., Hassan et al., 2014; Yip, Young, 2012; Judge et al., 2010; Irvine; 2008; Shraf, Ghani, 2005) regarding the influences of the political system in adopting IFRS, and how external regulations, aid agencies and foreign direct investment (FDI) motivate IFRS adoption in Iraq. However unstable political situation, investment risk and war conflicts decrease FDI inflow to Iraq. This effects in lower outcomes of substantial improvement of credibility of financial reporting compliant to IFRS than expected. This effects in lower economic growth than could be expected thanks to substantial improvement of credibility of financial reporting compliant to IFRS impact on FDI inflow.

A primary contribution of this study is that it develops prior theoretical arguments regarding IFRS adoption in emerging economies. Overall, our findings suggest that the effects of improved comparability associated with mandatory IFRS adoption depend on the institutional environment and high-quality IFRS implementation. Issues regarding the weak political system, complaints about the rules, security and social stability, the inadequate level of institutions, a lack of professional accounting skills and corruptions are the main obstacles in promoting the implementation of IFRS faithfully. This paper suggests that future studies consider the influence of war conflicts on the quality of lower-level institutions and the degree of usage of IFRS by Iraqi enterprises.

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