

# Linkages between the Adoption of International Financial Reporting Standards and Economic Growth within CEMAC Countries

By:

**Professor Alain Aimé Ndedi**

COMERCI

Email: [ndedi.alain@gmail.com](mailto:ndedi.alain@gmail.com)

And

**Ms Chimene Djapou Fouthe**

World Bank

Email : [chimenedjapou@yahoo.fr](mailto:chimenedjapou@yahoo.fr)

And

**Ms Florence Nisabwe**

CEDIMES-Paris

Email: [flore2017new@yahoo.com](mailto:flore2017new@yahoo.com)

## **Abstract:**

In today's business climate, financial statements disclosed by firms have huge impacts on the society. Financial statements are heavily used by shareholders, creditors, labor unions and government authorities to assess a firm's financial position, performance and viability. Past experiences show that the reliable and accurate accounting information enables financial market participants to make more rational decisions. International Financial Reporting Standards (IFRS) play a vital role in the preparation of financial statements. The adoption of IFRS has a huge impact on the financial statement elements; assets, liabilities, equity, revenues and expenses. International Financial Reporting Standards contribute to create a business climate that enables investors to make more rational and accurate investment decision. Epstein (2009) asserts that IFRS adoption results in higher financial reporting quality. International authorities such as World Bank, International Monetary Fund, and International Organization of Securities Commissions (IOSCO) encourage the adoption of IFRS to advance effectiveness of financial markets, which in turn may spark the economic growth of adopting countries (Wyatt and Yospe, 1993). Ball (2008) pointed out that financial reporting is one of the most important economic activities. Further, Li and Shroff (2010) declare that high-quality accounting information enables the management of a firm to make much more effective investment decisions, translating into high growth rate of economy. A major driver for International Financial Reporting Standards (IFRS) adoption by countries is the desire to integrate into the global economy. Some of previous research studies show that the adoption of International Financial Reporting Standards has a positive impact on the economic growth. The adoption of IFRS has positive impacts on international trade and significantly enhances the comparability of financial statements prepared by firms from different countries. Samuels and Piper (1985) stated that the adoption of IFRS has a great potential to facilitate global trade activities.

The objective of this paper is to contribute the existing literature on the association between IFRS implementation and economic growth within countries. To achieve the above, a thorough literature review will be conducted with the objectives of developing effective mechanisms for IFRS implementation. In this regard, the paper argued that CEMAC government authorities and regional business organizations should make persistent efforts to enforce IFRS.

**Keywords:** International Financial Reporting Standards (IFRS), CEMAC countries, Economic growth.

## **INTRODUCTION**

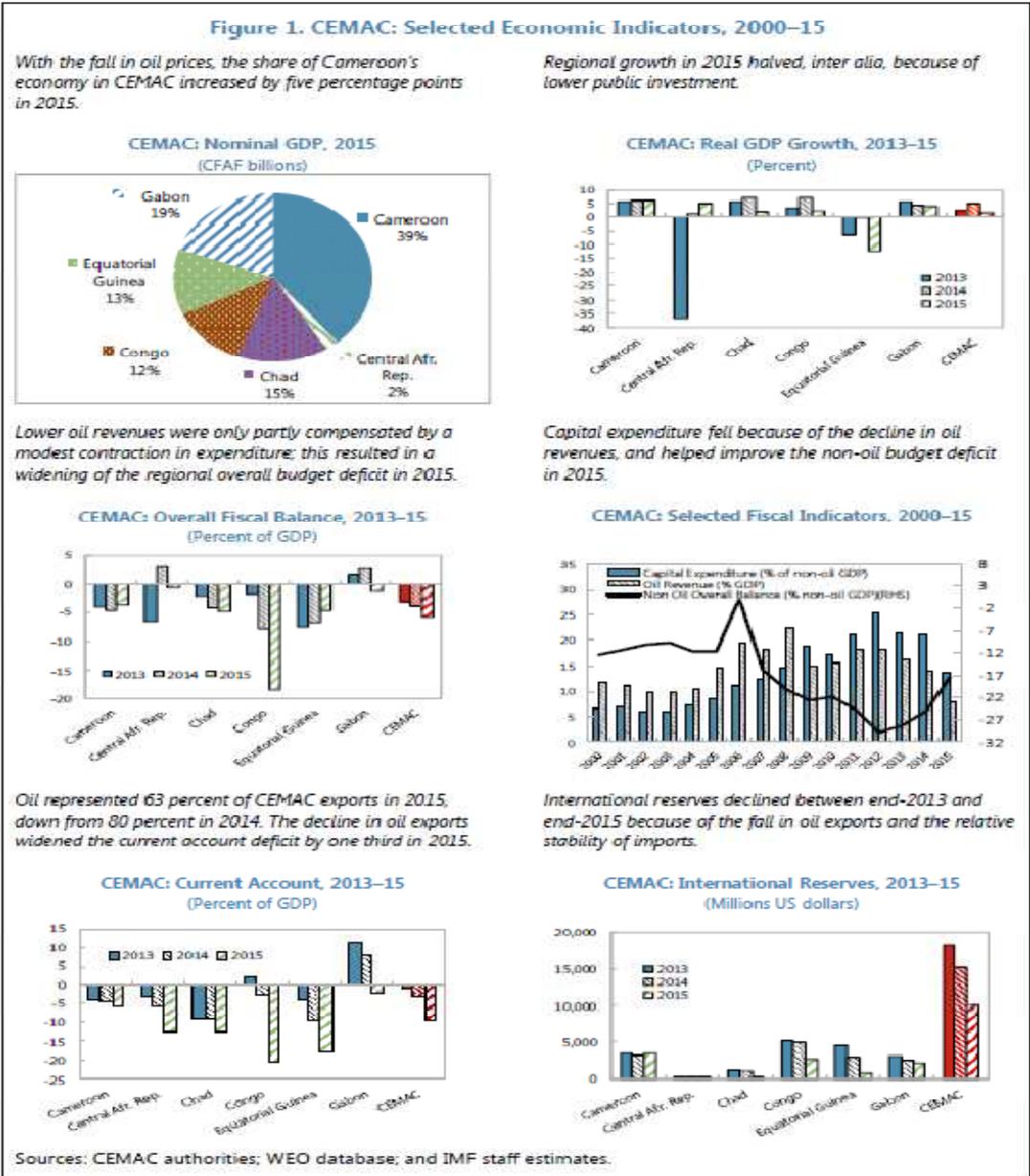
Today, International Financial Reporting Standards have been adopted by more than one-hundred countries. International Financial Reporting Standards have massive impacts on the dynamics of the business environment. Although, the IFRS has drawbacks, IFRS adoption is a necessity of rapidly changing business environment. (Zaidi and Huerta 2014) Undoubtedly, the reliability and quality of financial statements prepared by firms have been increased with the advent of International Financial Reporting Standards. International agencies such as the World Bank and the International Organization of Securities Commissions (IOSCO) promote the adoption of International Financial Reporting Standards (IFRS) to create a solid international financial infrastructure, which in turn should stimulate economic development of the adopting countries (Collins, 1989; Wyatt and Yospe, 1993). The objective of this research was to link the effect of IFRS adoption on the economic growth of CEMAC countries as shown in figure 2. However, adopting IFRS may not be enough to promote economic growth; enforcement mechanisms need to be in place to ensure IFRS compliance. In fact, since the beginning of the movement towards globalized accounting standards in the 1990s, research has attempted to gather empirical evidence on the impact of harmonized accounting standards on the economic growth of adopting countries. Studies conducted when the predecessors of the IFRS-the International Accounting Standards (IAS)-were in place, do not provide conclusive evidence. These early studies investigated the impact of IAS adoption on countries from a particular region (Africa (Larson, 1993) and Asia (Woolley, 1998)), or from a particular level of economic development (developing countries (Larson and Kenny, 1995)). Some studies found that the adoption of IAS did not promote the economic growth (Larson and Kenny 1995; Woolley, 1998), whereas one study found that IAS adaption promoted economic growth (Larson, 1993). The next sub section gives an outlook of the economic situation of CEMAC countries. After this section, some examples of cases studies linking IFRS adoption and economic growth will be explained.

## **CEMAC ECONOMIC OUTLOOK**

According to IMF (2016), the CEMAC growth was subdued in 2015. It slowed to 1.6 percent, from 4.9 percent in 2014, because of reduced public investment and lower oil production. Growth is projected to be 1.9 percent in 2016, as oil production and investment remain sluggish. From 2017 onward, growth is expected to reach 3½ percent a year, as oil prices gradually recover, some one percentage point below the average growth level of the past decade of high oil prices. Growth of money and credit to the economy turned negative in 2015 for the first time in a decade, contributing to keeping inflation low. The regional fiscal and current account deficits grew to 6 and 9 percent of GDP in 2015, respectively, as oil export proceeds fell by 32 percent. Continued low oil prices and high public

expenditure will contribute to maintaining both deficits at about 6 and 8 percent of GDP in 2016, respectively. The gradual recovery in oil prices and the expected moderate fiscal consolidation should narrow the regional fiscal and current account deficits to 3 percent by 2021. Reserves have declined. Banks appear to have weathered the economic downturn thus far. CEMAC medium-term prospects are challenging. A weaker-than-expected oil price recovery or a relapse in security conditions in the Lake Chad region could undermine macroeconomic stability and private investment. Lower growth in China could dampen commodity prices—especially oil, lower demand, and reduce financing. In these challenging times, stronger regional institutions are necessary for promoting regional integration and supporting regional economic growth. (IMF, 2016) Some details concerning the CEMAC economic outlook are developed in figure 1.

CEMAC

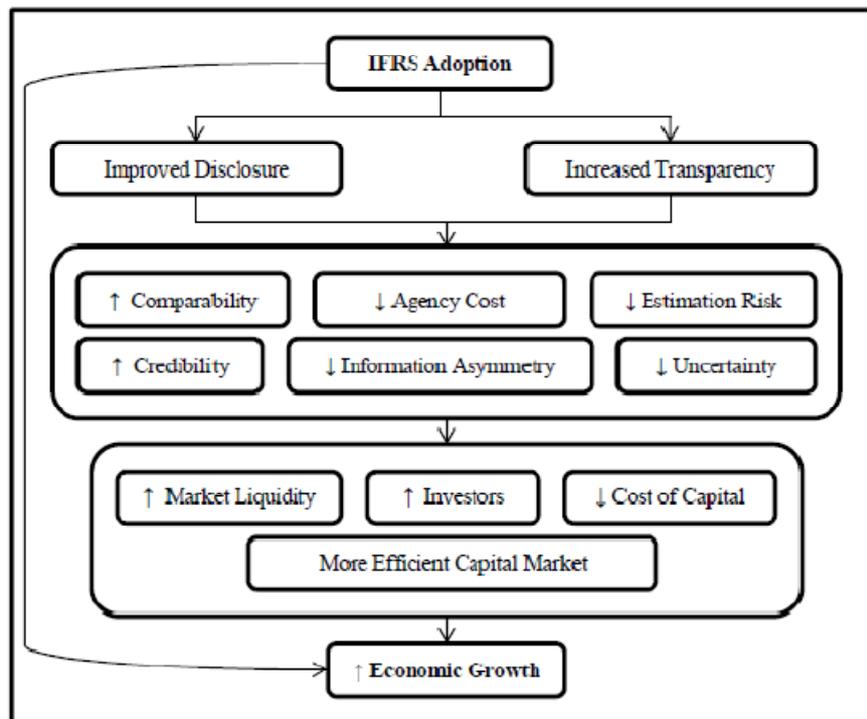


## **IFRS ADOPTION AND ECONOMIC GROWTH**

To substantiate the linkages between IFRS adoption and economic growth within CEMAC countries, it is important to explore some cases studies not only in Africa, but also in the African continent. Some examples are given with an empirical research that was done by Larson (1993) as a cross-sectional study including data from many African countries to determine whether the economic growth of countries that adopted or adapted IAS differed from those of non-adopter countries. The author found that countries that adapted IAS to meet local environmental factors experience larger economic growth than countries that either adopted IAS wholesale or did not adopt IAS. (Zaidi and Huerta 2014) Similar to Larson's (1993) research, Woolley (1998) conducted a study to examine the differences in economic growth rates between IAS adopter and non-adopter countries in Asia (Cited in Zeghal & Mhedhbi, 2006). The author found no significant differences in the economic growth rates of IAS adopter and non-adopter countries. Larson and Kenny (1995) conducted a study in many developing countries that have equity markets to determine the effects of IAS adoption on equity market development and economic growth. They found a small negative relationship between IAS adoption and economic growth rates in the developing countries studied. In summary, these studies report conflicting findings. In terms of the impact of IAS adoption on the economic growth, one study reported a positive impact (Larson, 1993), another reported a small negative impact (Larson & Kenny, 1995), and the other study reported no impact (Woolley, 1998).

Larson and Kenny (1995) suggest that mere adoption of IFRS does not lead to greater equity market development and economic growth. Enforcement plays an important role in this regard. Enforcement is the act of enforcing rules and laws; it is the imposition of compliance or adherence to the designated guidelines. From the perspective of IFRS adoption, enforcement implies that the financial statements that companies report adhere to the regulations established in the IFRS. Enforcement plays a crucial role in the implementation of standards. If a country adopts IFRS but does not enforce them, the reliability of the financial statements reported can be doubtful. When enforcement mechanisms are active, the financial statements reported adhere to IFRS, and the overall accounting quality improves.

**Figure 2. Linkages between IFRS adoption and economic growth**



Source: Adopted from (Zaidi and Huerta 2014)

The Figure 3 shows that the impact of IFRS adoption on the economic growth of CEMAC countries can be moderated by CEMAC countries level of enforcement. The figure shows other factors (control variables) that can also affect the economic growth of the CEMAC countries. The Level of enforcement measures the perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence (Kaufmann et al., 2008: 7). The level of enforcement is included also as a moderator variable to test whether an interaction exists between level of enforcement and IFRS adoption. This study focuses on the impact of IFRS adoption and level of enforcement on the economic growth of adopting countries. However, other factors can also play a role in the economic growth of a country. In the presence of these factors, the expected influence of IFRS would be marginal.

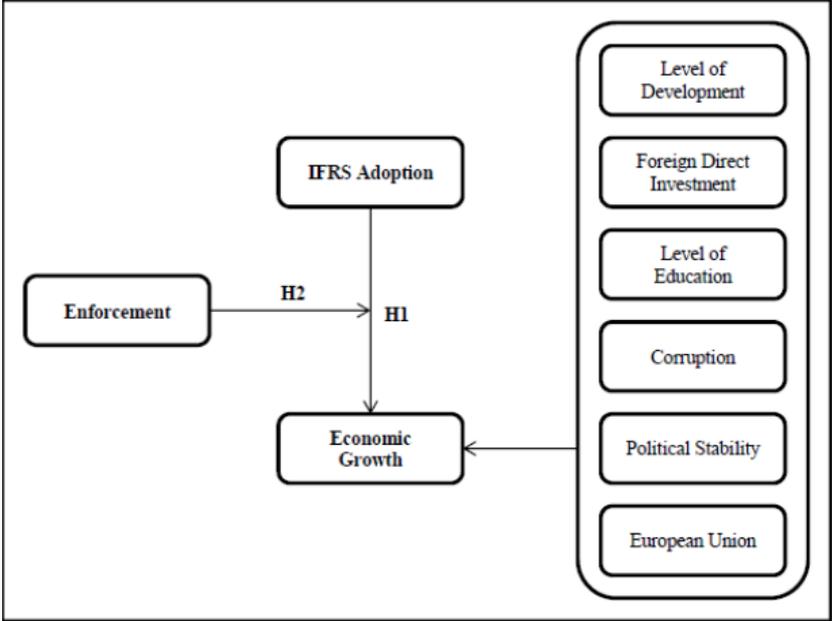
Taking in consideration volumes of research conducted, it is important to come out with some factors that have an impact on the level of enforcement in a region or a country. These factors are:

- (1) The level of corruption in the CEMC sub region,
- (2) The level of education,
- (3) The level of foreign direct investment,
- (4) The level of development, and
- (5) The level of political stability.

These variables have been selected for various reasons. Some have been selected because they were included in past research due to their importance; such as level of education (Larson, 1993; Larson &

Kenny, 1995), level of development (Larson, 1993), and political stability (Larson and Kenny, 1995). Corruption is selected because it can impede the economic growth of a country (Bardhan, 1997). Foreign direct investment is included because it can influence the economic growth (De Mello, 1999).

**Figure 3: The Impact of IFRS Adoption on Economic Growth.**



Source: Adopted from Zaidi and Huerta (2014)

**CONCLUSION**

The objective of this paper has been to contribute the existing literature on the association between IFRS implementation and economic growth within countries with the focus on CEMAC countries. To achieve the above, a thorough literature review was conducted with the objectives of developing effective mechanisms for IFRS implementation within the sub region. In this regard, the paper argued that CEMAC government authorities and regional business organizations should make persistent efforts to enforce IFRS to reach the objectives of economic growth.

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