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Accounting standards internationalization revisit: Managing responsible diffusion

Lasmin*

Ritsumeikan Asia Pacific University, Beppu, Oita 874-0925, Japan

Abstract

We first examine the predictive factors of adopting IFRS and then create a framework based on our empirical finding. Following DiMaggio and Powell (1983)’s Institutional Isomorphism theory and applying regression analysis, we empirically show a contradictory fact that IFRS adoption is not related with its corresponding economic benefits because countries’ need to be socially accepted by global community is very paramount that the decision to adopt IFRS might not be triggered by the need to compete economically. We further reveal that countries are social entities that seek legitimacy and have been influenced by international organizations (coercive isomorphism), uncertain situations (mimetic isomorphism), and their own cognitive base (normative isomorphism) to accept IFRS for non-economic reasons. Finally, we offer a framework of IFRS diffusion by contrasting our proposed institutional perspectives with main stream neoclassical views of the west.

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1. Introduction

The year 2010 witnessed an unprecedented degree of consensus among more than 120 countries to require or permit the use of International Financial Reporting Standards (IFRS)

* Corresponding author. Tel.: +81-977-78-1122; fax: +81-977-78-1123.
E-mail address: lasmin007@gmail.com.
in their jurisdictions, making the standards as one of the most successful global business innovations that we have ever known. Initiated in London in 1973, IFRS was required in the European Union in 2005 and allowed to be used in the United States in 2008. This makes the International Accounting Standards Board (IASB), a body that promulgates IFRS, as prominent private-sector standards-setter (Mattli & Woods, 2009). The question then how a nongovernmental organization without revenue-based funding (Koppell, 2010) could have such high degree of legitimacy that standards enacted by it have been accepted by most countries in the world? Do countries accept IFRS due to (perceived) economic benefits attached to the standards or due to other factors?

So far, consistent with neoclassical standpoint, IFRS that is believed could improve transparency and comparability of financial reporting is consistently linked with higher chance to obtain economic benefits such as a higher inflow of Foreign Direct Investment (FDI) and higher Gross Domestic Product (GDP) growth rate (Zeghal & Mhedhbi, 2006). IFRS, that is regarded as “single set of high-quality, understandable and enforceable accounting standards that requires high quality, transparent and comparable information in financial statements” (IASB, 2007, p. 4) has been set to meet the needs of all countries’ financial reporting requirements and fit into their national economic and business characteristics.

The notion of “one set of standards fits all countries” stands on one premise that all countries share common institutional contexts where the relation of the IFRS adoption and its associated economic benefits established in a country or a group of countries is also applicable in other regions. However, IFRS that is crafted by developed countries, might not able to induce the same relationship in developing countries because of different socio-economy and political-economy environments. Thus, while some countries might enjoy the benefits of IFRS internalization, countries like Botswana, Malawi, Panama, Papua New Guinea, Tajikistan, and Tanzania are among countries that have substantially adopted IFRS but have not experienced significant grow in their FDI inflows and GDP growth. This hints that the process of internationalization of IFRS might not be exclusively related to its corresponding economic benefits.

2. IFRS Diffusion and Countries Institutional Context

Previous section makes it clear that IFRS internationalization might not be related only to its economic benefits. In some cases, even if these benefits are significant toward countries’ decision to adopt IFRS, there is no strong evidence support this argument (Chua & Taylor, 2008). If the economic benefits related to IFRS adoption have never been certain, the bigger question is then why International organizations, such as IASB, the World Trade Organization (WTO), the Organization for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), the World Bank (WB) and virtually all multinational companies (Rodrigues & Craig, 2007), and “the IASB, the European Union,
the International Organization of Securities Commissions (IOSCO), and the United Nations (UN)” (Wyatt, 1997, p. 10.15), unanimously support and promote the internationalization of IFRS?

Contemporary studies on the antecedents of IFRS adoption have been centered on the issue of how the adoption is associated with its economic benefits. Specifically, their examined the phenomenon of the globalization of IFRS, which is endorsed by these international organizations, under one premise: “a global business needs a set of global standards”. In other words, IFRS is believed to be able to achieve a degree of comparability that will help investors make their decisions while reducing costs of Multi-National Enterprises (MNE) in preparing multiple sets of accounts and reports (Radebaugh, Gray, & Black, 2006). Other studies revealed that the local governments or financial reporting regulators might benefit from the adoption due to lower monitoring costs and higher inward global capital flows (Roberts et al., 2008), (Rodrigues & Craig, 2007). However, the primary beneficiaries of IFRS internalization is capital market participants because IASB contends that global capital markets can help to distribute global wealth more efficiently and effectively, and it is necessary to develop IFRS in such a way that it assures the higher quality of financial reporting for capital market participants as they are the primary users of financial reporting (Salvary, 2006), (Jorissen, Lybaert, & van de Poel, 2006).

Thus, the primary reasons of adopting IFRS however were built on one perspective that all countries need to prioritize investors over others firms’ stakeholders, and all countries have a considerable numbers of MNE; the perspective which is widely shared by capitalists and neoclassical economists. Consequently, countries that have less developed capital markets and higher concentration of Small and Medium Enterprises (SME) may not able to reap the optimum benefits of adopting IFRS.

What might be overlooked by the proponents of internationalization of IFRS is that, first, in a broader views, a set of accounting standards as part of accounting systems is continuously influenced by several differing institutional factors where that set of standards operates. These factors include culture, enterprise ownership and activities, finance and capital markets, economic growth and development, accounting regulation, legal system, social system, political system, accounting profession, accounting education and research, inflation, and international factors (Radebaugh, et al., 2006); (Roberts, Weetman, & Gordon, 2008); (Alexander, 2007); and (Saudagaran, 2009). Hofstede (2001) put it in a simpler sentence: free market capitalism cannot be universal.

Second, countries might be pressured by international organizations to meet the necessity of having legitimate, modern, and high quality accounting standards. They have to accept IFRS partly because of their limited ability to produce a legitimate set of standards, and partly because of their dependence on these international organizations (Lasmin, 2011).

Drawing on Institutional Isomorphism perspective that will be further elaborated in the next section, we then propose that in the context of IFRS diffusion, countries look for more on social acceptance and legitimacy from external forces such as other organizations, beliefs
and processes perceived as legitimate rather than for associated economic benefits related to IFRS adoption.

3. Responsible diffusion: Economic benefits or Legitimacy?

The rate of IFRS diffusion has significantly declined over the last five years, from 2006 to 2010 those of countries adopting IFRS has been stabilized and remained constant around 50% of total countries surveyed (IASPlus, 2010). In the same periods, the percentage of non-adopters and partially adopters stay relatively stable around 25% each, making the percentage of non-full adopters fairly equal to full adopters (See figure 1). It is then fair to say that any countries adopting IFRS after 2010 will be considered as laggards.

![Figure 1. IFRS Adoption Status](image)

Dimaggio & Powell (1983) suggest that early adopters of organizational innovations accept the innovation due to the needs to strengthen their competitiveness. However, the laggards accept the innovation usually not because they can enjoy the increased competitiveness, but because they would be punished for not accepting the innovation. This is because as “innovation spreads, a threshold is reached beyond which adoption provides legitimacy rather than improves performance” (Meyer & Rowan, 1977). While to some extent, the decision to get involve into the process of internationalization of IFRS is triggered by the needs of having strong economic competitiveness, organizations or countries compete for resources and customers, as well as legitimacy and social acceptance (DiMaggio & Powell, 1983); (Judge, Li, & Pinsker, 2010). In this regard, the use of the concept of legitimacy and institutional perspective is approriate to examine how economic pressure...
are not the only drivers and how accounting standard-setting bodies and accounting practitioners have searched for legitimacy and have been influenced by external forces to adopt IFRS (Lasmin, 2011).

4. Institutional Isomorphism

Institutional Isomorphism has been used to “globally examining transfer pricing, international alliances, distributive justice norms, strategic renewal of incumbent firms, penetration of e-commerce, foreign entry mode…” [Eden, Dacin & Wan (2001), Giacobbe-miller, Miller, Zhang & Victorov (2003), Flier, Van den Bosch & Volberda (2003), Gibbs & Kraemer (2004), Meyer & Nguyen (2001) in (Judge, Li, & Pinsker, 2010)]. Furthermore, Institutional Isomorphism were used to explain the process of IFRS adoption (Rodrigues & Craig, 2007), and used to empirically study the determinants of IFRS adoption(Judge, Li, & Pinsker, 2010);(Lasmin, 2011). They all found that countries’ decision to adopt IFRS is closely related to Isomorphic pressures experienced by those countries.

Much of their works based on DiMaggio & Powell’s (1983) institutional isomorphism, which was derived from their observation that adoption provides legitimacy rather than improves performance (DiMaggio & Powell, 1983, p. 148) and “the concept of institutional isomorphism is a useful tool for understanding the politics and ceremony that pervade much modern organizational life” (DiMaggio & Powell, 1983, p. 150). DiMaggio & Powell (1983, p. 150) provide three forms of isomorphic changes from which our hypotheses will be derived: “(1) coercive isomorphism that stems from political influence and the problem of legitimacy; (2) mimetic isomorphism resulting from standard responses to uncertainty; and (3) normative isomorphism, associated with professionalization”.

5. Hypotheses and Research Model

In the context of IFRS diffusion, Coercive isomorphism suggests that there are external pressures from international financial organizations that can induce a country to comply with IFRS (see Touron (2005); Ashraf & Ghani (2005)). Mimetic isomorphism implies that the more open the economy of a country, characterized by the size of its capital markets, the more likely that that country to comply with IFRS (see Touron (2005); Lasmin (2011)). Normative isomorphism reveals that levels of education affect country’s decision of adopting IFRS (see DiMaggio & Powell (1983). Thus, our hypotheses comprise:

“IFRS diffusion is more related to social pressures of isomorphic changes (coercive, mimetic, and normative isomorphism) than it is to economic pressures”

We apply an ordinary least square (OLS) which is defined as:

$$Y_i = \beta_0 + \beta_1 \text{AID}_i + \beta_2 \text{MCAP}_i + \beta_3 \text{ENROL}_i + \beta_4 \text{FDI}_i + \beta_5 \text{GDP}_i + \beta_6 \text{RICH}_i + \epsilon_i$$
Where: $Y$ is the level of adoption of IFRS, $\beta_0$ is the intercept, $\beta_1-\beta_5$ are the slopes/regression weighs that represent the relationships between dependent variable and independent variables, and AID is countries’ foreign aid, MCAP is countries’ stock market capitalization, ENROL is countries’ level of education, FDI is countries’ foreign direct investment inflows, GDP is the countries’ gross domestic product growth rate, and RICH is countries’ income group classification. In order to obtain more holistic results we also apply binomial logistic (logit) and multinomial logistic (mlogit) regression on the same variables.

Dependent variable constitutes the status of IFRS adoption of selected as of 2010 (IASPlus, 2010). A country or jurisdiction is codified “3” if it fully adopts IFRS; “2” if it permits the use of IFRS or requires the use of IFRS for some listed domestic and international firms, otherwise it is codified “1”.

Our independent variables are proxies to coercive, mimetic, and normative isomorphism; and economic attributes related to the decision to adopt IFRS. We use the average of total foreign aid as a percentage of GDP, the average of market capitalization as a percentage of GDP, and average enrolment of secondary schools as a percentage of total population from to represent coercive, mimetic, and normative isomorphism respectively. To represent economic pressures related to IFRS adoption, we use the average of FDI inflows as a percentage of GDP and the average growth of GDP. All variables are average of 2005-2009 observations, recalculated and retrieved from the World Bank’s World Development Indicators (World Bank, 2010).

We also apply a control variable that serves as the indicator for the degree of national governance due to the fact that the degree of governance affects countries’ decision to or not to adopt IFRS and affects countries’ decision when to adopt IFRS (Ramanna & Stellen, 2009). As a proxy for this variable, we select 2009 World Bank’s countries classifications based on income group (World Bank, 2010), where a country is codified “1” is if it is classified as low or middle income and is codified “2” is it is classified as high income country.

6. Sample Description and Regression Results

We use countries listed in the “use of IFRS around the world” (IASPlus, 2010) as our sample (see Table 1). The sample consists of 161 countries and covers a wide range of geographical and institutional aspects, making it a fair representation of countries in the world. We first take a descriptive statistics of dependent and independent variables (see Table 2). To reduce the skewness, we take a natural logarithm transformation on all independent variables except RICH. RICH is a dummy variable for income status of a country.

For the OLS and binomial logit regression, we classify the partial adopters as non adopters to accommodate the nature of binary features of binomial logit regression and selected OLS regression model. To make our analysis more robust, we also apply multinomial regression analysis which uses all adoption status listed in Table 1.

To assure the quality of our model, we perform the heteroskedasticity check (White test, Breusch-Pagan LM statistics, and Breusch-Pagan / Cook-Weisberg test); omitted variable
check (Ramsey RESET); and Variable inflation check (VIF test) for OLS. We also perform the Hosmer-Lemeshow goodness of fit test, link test, and collinearity diagnostics for logistics regressions. Overall, the checks imply that the models are free of significant errors.

| Table 1 |
| --- |
| **COUNTRIES AND THEIR ADOPTION STATUS** |
| Non Adopters | Partial Adopters | Full Adopters |
| Albania | American Samoa | Antigua and Barbuda | Kenya |
| Algeria | Aruba | Australia | Kuwait |
| Argentina | Azerbaijan | Austria | Latvia |
| Bangladesh | Belarus | Bahamas, The | Lebanon |
| Benin | Belize | Bahrain | Liechtenstein |
| Bhutan | Bermuda | Barbados | Lithuania |
| Brazil | Bolivia | Belgium | Luxembourg |
| Burkina Faso | Brunei Darussalam | Bosnia and | Macedonia, FYR |
| Colombia | Cambodia | Herzegovina | Malawi |
| Côte d'Ivoire | Cayman Islands | Botswana | Malta |
| Cuba | Dominicana | Bulgaria | Mauritius |
| Guam | El Salvador | Canada | Mongolia |
| India | Eritrea | Chile | Montenegro |
| Indonesia | Gambia, The | Croatia | Namibia |
| Iran, Islamic Rep. | Gibraltar | Cyprus | Nepal |
| Libya | Greenland | Czech Republic | Netherlands |
| Malaysia | Haiti | Denmark | New Zealand |
| Mali | Japan | Dominican Republic | Nicaragua |
| Mauritania | Kenya | Ecuador | Norway |
| Mexico | Lao PDR | Egypt, Arab Rep. | Oman |
| Moldova | Lesotho | Estonia | Panama |
| Niger | Macao SAR, China | Fiji | Papua New Guinea |
| Nigeria | Madagascar | Finland | Peru |
| Pakistan | Maldives | France | Poland |
| Philippines | Morocco | Georgia | Portugal |
| Senegal | Mozambique | Germany | Qatar |
| Singapore | Myanmar | Ghana | Romania |
| Syrian Arab Republic | Netherlands Antilles | Greece | Serbia |
| Thailand | Paraguay | Grenada | Sierra Leone |
| Togo | Russian Federation | Guatemala | Slovak Republic |
| Tunisia | Samoa | Guyana | Slovenia |
| United States | Saudi Arabia | Honduras | South Africa |
| Uruguay | Sri Lanka | Hong Kong SAR, China | Spain |
| Uzbekistan | Suriname | Hungary | St. Kitts and Nevis |
| Venezuela, RB | Switzerland | Iceland | Sweden |
| Vietnam | Swaziland | Iraq | Tajikistan |
| Virgin Islands (U.S.) | Switzerland | Ireland | Tanzania |
| | Turkey | Italy | Trinidad and Tobago |
| | Uganda | Jamaica | Ukraine |
| | Vanuatu | Jordan | United Arab Emirates |
| | Yemen, Rep. | Kazakhstan | United Kingdom |
| | Zambia | | West Bank and Gaza |

| Table 2 |
DESCRIPTIVE STATISTICS

| Variable | N  | Mean  | Std. Dev. | Min   | Max   | Corr. to Adoption |
|----------|----|-------|-----------|-------|-------|-------------------|
| Adoption | 161| 1.509 | .50147    | 1     | 2     | 1                 |
| AID      | 100| -3.581| 1.9392    | -8.1705| -5.7097| .3311             |
| MCAP     | 147| 4.294 | .45773    | 2.3741| 5.00302| .1854             |
| ENROL    | 107| 3.673 | 1.1371    | -4.8523| 6.43897| .2894             |
| FDI      | 143| 1.377 | 1.0598    | -2.73252| 5.72208| .3003             |
| GDP      | 149| 1.262 | .72592    | -1.15172| 3.05446| -.1248            |
| RICH     | 161| 1.354 | .47971    | 1     | 2     | .2291             |

Table 3

REGRESSION RESULTS

| Variable | Model 1: OLS | Model 2: Logit |
|----------|--------------|----------------|
|          | Coefficient  | t-value        | Coefficient | z-value |
| AID      | .1308791     | -3.87*         | .832317     | 3.02**  |
| ENROL    | .3288861     | 1.82**         | 1.837183    | 1.56    |
| MCAP     | .0936829     | 1.82**         | .664483     | 1.73*** |
| FDI      | .0501603     | 0.81           | .300371     | 0.77    |
| GDP      | -.0408096    | -0.39          | -.242077    | -0.35   |
| RICH     | .5445584     | 2.07**         | (omitted)   |         |
| Intercept| -1.190274    | -0.22          | -6.332902   | -1.33   |

Note: *p<0.01, **p<0.05, ***p<0.1; OLS: R²=0.384, Adjusted R²=0.302, F-value=4.67, N=52; Logit: Pseudo R²=0.314, LR Chi²=21.35, N=49

Table 4

REGRESSION RESULTS (MULTINOMIAL)

| Variable | Adoption=“1” | Adoption=“2” |
|----------|--------------|--------------|
|          | Coefficient  | z-value      | Coefficient | z-value |
| AID      | -1.191746    | -3.15**      | -3.147216   | -0.87   |
| ENROL    | -1.970416    | -1.36        | -1.595455   | -1.20   |
| MCAP     | -.5634638    | -1.32        | -.8414717   | -1.75***|
| FDI      | -.5650193    | -1.16        | -.1946153   | -0.40   |
| GDP      | 1.410267     | 1.22         | -.613826    | -0.79   |
| RICH     | -16.79174    | -0.01        | -15.09637   | -0.01   |
| Intercept| 19.61518     | 0.01         | 23.11519    | 0.01    |

Note: Adoption=“3” as base outcome; **p<0.05, ***p<0.1; Pseudo R²=0.3577, LR Chi²=36.60, N=52

Table 3 presents the results of the OLS and binomial logistic regression and Table 4 shows the result of multinomial logistic regression analysis. The OLS regression analysis uncover that all proxies for isomorphic changes are found significant toward countries’ decision to adopt IFRS. The logistic and multinomial logistic models reveal that foreign aid as a proxy for coercive isomorphism and market capitalization as a proxy for mimetic isomorphism are significant toward countries’ decision to adopt IFRS. Because all economic pressures are found to be insignificant in all models, the results strongly supports our
hypothesis that IFRS diffusion is more related to social pressures of isomorphic changes (coercive, mimetic, and normative isomorphism) than it is to economic pressures.

In all models, Foreign aid as a proxy for coercive isomorphism is the most important determinant to adopt IFRS. This is not surprising because countries that are dependent upon a single or several similar source of support for vital resources are likely to experience higher level of coercive isomorphism (DiMaggio & Powell, 1983). Foreign aid is a good predictor of adopting IFRS is also supported by Ashraf & Ghani’s (2005) in their observation on the development of accounting standards in Pakistan. Market capitalization as a proxy for mimetic isomorphism is found to be the second most significant predictive factor to adopt IFRS, followed by enrolment in education as a proxy for normative isomorphism. While at this point, we do not have enough explanations about the order of significance of the three forms of isomorphism, we are confident that they compared to economic pressures can better explain countries’ decision to adopt or not to adopt IFRS.

7. Implications for IFRS diffusion framework

A comparison of the effects of social pressures with economic pressures in the study of predictive factors of countries’ decision to adopt or not to adopt IFRS results in surprising results. Economic pressures, such as the desire to have higher inflows of FDI and higher GDP growth, have been reiterated by international organizations (e.g. IASB, WB, IMF, UN, OECD, IOSCO) as the most important factors to adopt IFRS. In the contrary, we empirically find that countries adopting IFRS are pressured more by social legitimacy in the forms of coercive, mimetic, and normative isomorphism. Figure 2 illustrates an IFRS diffusion framework based on neoclassical economic views. As noted earlier, this framework heavily emphasizes on investors and MNE interests, which according to Radebaugh et al., (2006) reflects Anglo-American accounting. Prompted by Chua & Taylor (2008) who stated that IFRS diffusion constitutes the desire of Anglo-American accounting and audit industry on international accounting standards-setting process, we present Figure 2 as a logical framework of western mainstream behinds the process of IFRS diffusion that is supported by neoclassical theorists and capitalists.
Based on our empirical findings, we then propose an alternative framework in which institutional perspective serves as a base for the logic. Contrary to mainstream belief presented in Figure 2, proposed framework in Figure 3 contends that countries’ decision to adopt IFRS is significantly influenced not by economic rationale, but by social pressures from (1) international organizations that control countries vital resources, (2) the uncertainty of the future of international accounting standardization, (3) the isomorphic changes instilled through professionalization and education.

8. Conclusion

In our quest to reveal the reasons of growing acceptance of IFRS in the world, by drawing on institutional isomorphism theory and by performing ordinary least squares, binomial logistic, and multinomial logistic regression on data of selected 161 countries, we find that social pressures of isomorphic change compared to economic pressures are better predictive factors in examining the decision of countries to adopt or not to adopt IFRS. Particularly, we find that countries decided to adopt IFRS due to the fact that they are forced by international organizations to comply with IFRS; they mimic other organizations and countries that are perceived as more successful and legitimate; and they are influenced by their level of educations.

The results of our study however neither to justify that countries do not consider economic reasons when they decided to adopt IFRS nor to theorize that social pressures is the only significant determinant for IFRS diffusion. Rather, we call for the initiation of studies in capturing the real motives behind countries’ decision to adopt or not to adopt IFRS. Finally, the results should be carefully interpreted considering that we heavily rely on archival data and we perform cross-countries study in only one particular period.
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