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The economic consequences of IFRS adoption in the Latin American Countries

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Abstract

The aim of this chapter is to provide comparative frameworks of the economic consequences of IFRS adoption in the Latin American Countries in accordance with good international practice. In very recent past, Latin American countries experienced the process of transition to International Financial Reporting Standards (IFRS). As industrialization and organized labor continued to progress, the IFRS implementation was a stringent necessity for countries like : Brazil, Argentina, Chile, Venezuela, Mexico, Peru, El Salvador and Colombia. Nevertheless, the emergence of democratic transitions mark the beginning of a new financial era for Latin American Countries. The reason there are so many different approaches of IFRS adoption is because of the individual character and specific culture of each of these particular countries. The effects of IFRS adoption are extremely varied and may have significant implications for each country on certain aspects such as : economic development, cultural environment, traditions, macroeconomic policies, social integration, political regime and religious cults.

Key words : IFRS adoption, Latin American countries, globalization, consolidated financial statements, foreign investments, statistics

Introduction

The global economic consequences of International Financial Reporting Standards (IFRS) adoption are extremely varied and often interrelated based on the fact that convergence and harmonisation heavily depend on jurisdiction. In this regard, certain reputable international organisations, including the G20, International Monetary Fund (IMF), International Organization of Securities Commissions (IOSCO), Basel Committee, World Bank and IFAC widely recognized IFRS global contributions in order to implement accounting standards. However, the possibility of applying an implementation guide similarly for each latin american countries is contradicted by a dynamic economic reality. An integrated approach have been widely supported considering the impact of information related to a solid international financial system.

In terms of globalization, Latin American countries (LAC) have faced various inherent challenges in the context of adopting and implementing IFRS. Basically, International Financial Reporting Standards have been designed as an international joint platform for economic purposes. Nevertheless, the complex effects of IFRS adoption are very heterogeneous and vary enormously for each country on certain aspects such as : economic development, cultural environment, traditions, macroeconomic policies, social integration, political regime and religious cults. The major challenges currently affecting Latin America countries include the implementation of effective and sustainable policies focused on economic growth and poverty reduction. Moreover, inequality, emigration, corruption and criminality are one of the most critical issues facing Latin America countries.

The most recent official raport of FTSE Country Classification issued on September 2013 suggested the manner of classification into the following subcategories : developed, advanced emerging, secondary emerging and frontier. Developed countries include (in alphabetical order) : Australia, Austria, Belgium/Luxembourg, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, South Korea, Spain, Sweden, Switzerland, UK and USA. Advanced emerging countries comprise : **Brazil**, Czech republic, Hungary, Malaysia, **Mexico**, Poland, South Africa, Taiwan, Thailand and Turkey. Secondary emerging countries include : **Chile**, China, **Colombia**, Egypt, India, Indonesia, Morocco, Pakistan, **Peru**, Philippines, Russia and UAE. Frontier countries category consists of : **Argentina**, Bahrain, Bangladesh, Botswana, Bulgaria, Côte D'ivoire, Croatia, Cyprus, Estonia, Ghana, Jordan, Kenya, Lithuania, Macedonia, Malta, Mauritius, Nigeria, Oman, Qatar, Romania, Serbia, Slovakia, Slovenia, Sri Lanka, Tunisia and Vietnam. Contrariwise, certain Latin American countries such as El Salvador and Venezuela are not even included in this classification.

An exhaustive Comparative framework

Theoretically, the adoption of IFRSs stimulates financial sustainability and generates principles of prerequisites in order to achieve a stable macroeconomic environment. On the other hand, is

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very important to implement poverty reduction strategies to trigger positive premises of a changing macroeconomic environment. The microeconomic structure of Latin America countries is highly dependent on the stability and macroeconomic policies. In Latin America, social inequality had deep roots so the adoption of IFRS can be perceive as a method to improve the overall efficiency of financial regulatory mechanisms. Undoubtedly, International Financial Reporting Standards (IFRS) represents a new fundamental direction in terms of accounting standards.

On the other hand, Blanchette, Racicot and Sedzro (2013) suggested that based on an empirical research study on Canada : “at the aggregate level, IFRS adoption does not significantly change the central values that describe the financial position and performance of the companies reported in financial statements”. In addition, in order to highlight the importance of a reliable corporate financial reporting systems, Fortin, Barros and Cutler (2010) suggested that the following directions should be implemented, ie : setting adequate requirements, developing capacity to implement applicable rules and enforcing applicable standards effectively.

According to the official website of the IFRS Foundation and the IASB, the most representative objectives are the following :

- to develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRSs) through its standard-setting body, the International Accounting Standards Board (IASB);

- to promote the use and rigorous application of those standards;

- to take account of the financial reporting needs of emerging economies and small and medium-sized entities (SMEs);

- to promote and facilitate adoption of IFRSs, being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

According to Fortin, Barros and Cutler (2010) the main problem in adopting and implementing IFRS consists of the activity of ensuring the effective and sustained implementation of the standards. Moreover, the final and most important aim of the application of IFRS should be limited to companies in which there is a public interest based on extensive transition time and adequate mechanism for suitable adjustment between so-called “local IFRS” and the new standards issued by International Accounting Standards Board (IASB). Moreover, the authors, ie Fortin, Barros and Cutler (2010) suggested that in the Latin America and Caribbean (LAC) region, as in the rest of the world, reliable financial information is the

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cornerstone of a robust market economy and efficient public sector. On the other hand, Brüggemann, Hitz and Sellhorn, T., (2012) suggested that “there is plentiful and almost unanimous evidence that the mandatory introduction of IFRS coincides with capital-market and macroeconomic benefits”.

According to general framework of the Organisation for Economic Co-operation and Development (OECD), Latin American Corporate Governance Roundtable was established in April 2000 and its importance is significant in terms of globalization. Roundtable participants, ie policymakers, regulators, stock exchanges, corporate governance, institutes and private sector stakeholders from countries such as Argentina, Bolivia, Brazil, Canada, Chile, Colombia, Dominican Republic, Ecuador, Italy, Mexico, Panama, Peru, Spain, Turkey, the United Kingdom and the United States. Practically, it can be concluded that many countries in Latin America are an integral part of this important structure.

In the particular case of Latin American countries the legal system does not provide distinctive requirements regarding consolidated financial statements. An adapted insight regarding internationally comparable data on tax levels and tax structures is provided by OECD Revenue Statistics database in order to establish the main taxation trends in Latin America countries. In addition, considering that Latin American and Caribbean countries represents a quite attractive investment area, this statistical overview is very useful for international investors. The following table includes data for the period 1990 to 2012.

Table 1. Total tax revenue as percentage (%) of GDP between 1990 and 2012

	1990	**2000**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Argentina	16,1	21,5	29,1	30,8	31,5	33,5	34,7	37,3
Bolivia	7,2	14,7	22,6	20,5	22,7	20,7	24,2	26,0
Brazil	28,2	30,1	33,8	34,0	32,6	33,2	34,9	36,3

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Chile	17,0	18,8	22,8	21,4	17,2	19,5	21,2	20,8
Colombia	9,0	14,6	19,1	18,8	18,6	18,0	18,8	19,6
Costa Rica	16,1	18,2	21,7	22,4	20,8	20,5	21,0	21,0
Dominican Republic	8,3	12,4	16,0	15,0	13,1	12,8	12,9	13,5
Ecuador	7,1	10,1	12,8	14,0	14,9	16,8	17,9	20,2
El Salvador	10,5	12,2	15,2	15,1	14,4	14,8	14,8	15,7
Guatemala	9,0	12,4	13,9	12,9	12,2	12,3	12,6	12,3
Honduras	16,2	15,3	19,0	18,9	17,1	17,3	16,9	17,5
Mexico	15,8	16,9	17,7	20,9	17,4	18,9	19,7	19,6
Nicaragua	n.a.	16,9	17,4	17,3	17,4	18,3	19,1	19,5
Panama	14,7	16,7	16,7	16,9	17,4	18,1	18,1	18,5
Paraguay	5,4	14,5	13,9	14,6	16,1	16,5	17,0	17,6
Peru	11,8	13,9	17,8	18,2	16,3	17,4	17,8	18,1
Uruguay	19,6	21,6	25,0	26,1	27,1	27,0	27,3	26,3
Venezuela	18,7	13,6	16,8	14,1	14,3	11,4	12,9	13,7

Source : *Revenue Statistics in Latin America - Organisation for Economic Co-operation and Development (OECD) Centre for Tax Policy and Administration, the OECD Development Centre, the Economic Commission for Latin America and the Caribbean (ECLAC) and the Inter-American Centre of Tax Administrations (CIAT).*

The most significant issues regarding full implementation of IFRS is based on a global financial and economic conglomerate consisting of stable democratic principles. In recent past, promising developmental level and poverty reduction strategies provided a relatively encouraging perspective for international financial mechanisms. Contrariwise, geographical

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boundaries and insufficient level of industrialization are still a significant mark for Latin America countries.

Furthermore, the most recent general framework regarding the domestic equity market capitalization is highlighted in the following table :

Table 2 Domestic equity market capitalization performances

Time zone	USD billion End of 2013	USD billion End of 2012	% change in USD
Americas	28.297	23.193	22%
Asia – Pacific	18.415	17.131	7%
Europe - Africa - Middle East	17.483	14.373	22%
Total WFE	64.195	54.697	17%

Source: *World Federation of Exchanges*

Various empirical studies have demonstrated that most previous financial crisis were generated by the severe lack of liquidity. Moreover, a rather low level of liquidity represents a major factor of risk which may result in extreme events such as the recent global financial crisis. Liquidity risk is supposedly higher in the case of emerging markets which are characterized by certain functional disturbances. In other words, it is important to focus attention on the bid-offer spread (bid-ask spread or buy-sell spread). The bid-offer spread represents the amount of money by which the ask financial asset price exceeds the bid. Consequently, the stability of capital markets significantly depends on the level of liquidity so the investment implications are considerable.

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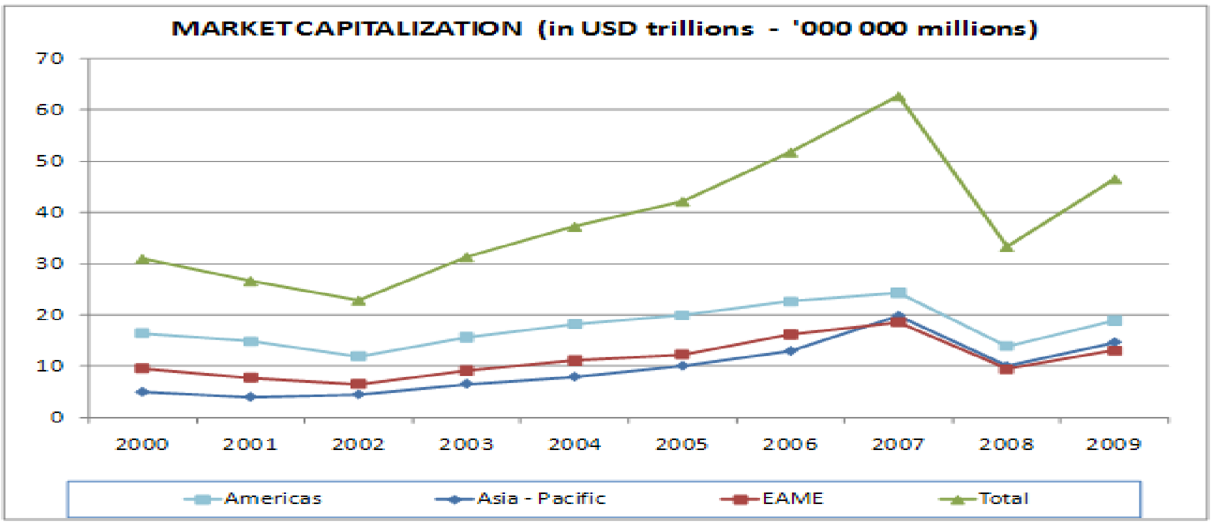

Fig. 1 Market Capitalization

Source: *World Federation of Exchanges*

According to the official informations provided by G20 Financial Inclusion Indicators regarding Small and Medium Enterprise (SME) Accounts in Latin American and Carribean countries, statistics suggest a favorable evolution in time. However, certain negative aspects such as : social inequity, economic disorder, changing institutional structures, civil rights violations and ethnic nationalism generated the image of a turbulent investment environment. Moreover, the role of monetary and financial policies is essential in order to provide a macroprudential approach. Moreover, this particular market segment provides an overview on certain relevant statistical indicators as can be seen in the tables below :

Table 3 Recent statistics on SMEs in Latin America and Caribbean countries

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Indicator	2011
SME borrowers from commercial banks (% of non-financial corporation borrowers from commercial banks)	-
Percent of SMEs where the top manager is female with an outstanding loan or line of credit (5-99 employees)	41,9 %
Percent of SMEs where the top manager is male with an account at a formal financial institution (5-99 employees)	92,5%
Percent of SMEs where the top manager is male with an outstanding loan or line of credit (5-99 employees)	46,7%
Percent of SMEs where the top manager is female with an account at a formal financial institution (5-99 employees)	92,7%

Source : World Bank, Enterprise Surveys, *G20 Financial Inclusion Indicators*

Table 4 Aggregate indicators assessing the access to certain financial services

Latin America and Caribbean countries	
Aggregate Indicators (%)	
Customs and trade regulations	4.7
Labor regulations	4.5
Access to finance	15.0
Business licensing and permits	2.6
Tax administration	2.2
Tax rates	10.0

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Aggregate Financial indicators (%)	
Percent of firms with a checking or savings account	92.9
Percent of firms with a bank loan/line of credit	47.6
Proportion of loans requiring collateral (%)	72.4
Percent of firms not needing a loan	42.1
Percent of firms using banks to finance investments	33.6
Proportion of investments financed internally (%)	63.2
Proportion of investments financed by banks (%)	20.3
Proportion of investments financed by equity or stock sales (%)	4.3
Proportion of investments financed by supplier credit (%)	7.5
Percent of firms using banks to finance working capital	43.0
Proportion of working capital financed by banks (%)	16.0
Proportion of working capital financed by supplier credit (%)	18.1
Percent of firms identifying access to finance as a major constraint	30.8

Source : *World Bank, Enterprise Surveys*

** most recent available official statistics*

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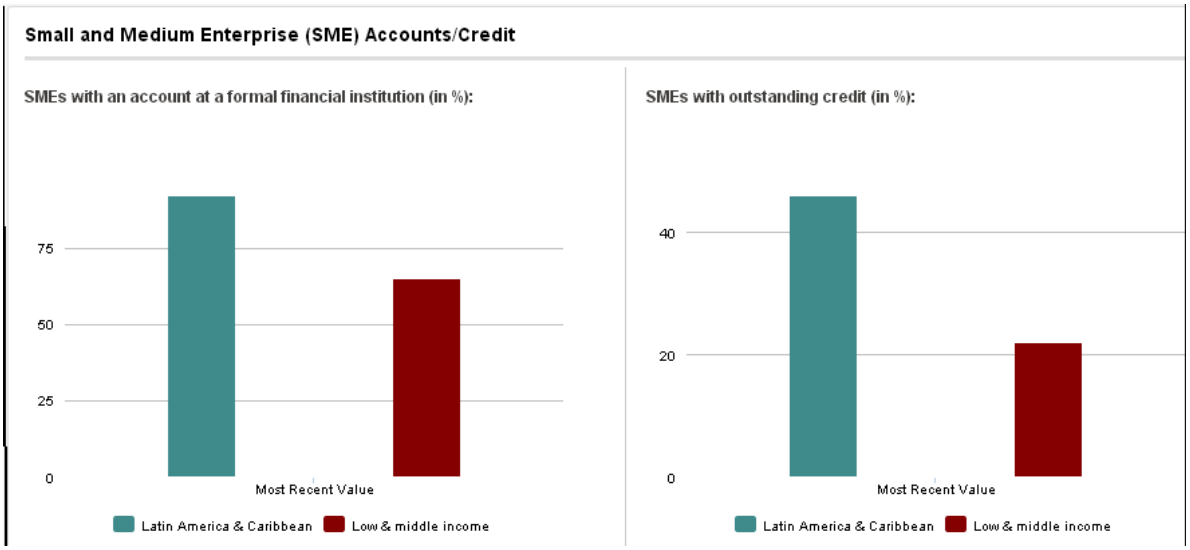

Fig. 2 Small and Medium Enterprise (SME) Accounts/Credit (2011)

Source : *World Bank, G20 Financial Inclusion Indicators*

Conclusions

The main aim of this research study is to empirically examine the economic consequences of International Financial Reporting Standards (IFRS) adoption on the value relevance of financial reporting in Latin American countries. As a result, financial decisions based on accounting information (according to international accounting standards) are essential so that an unitary international system is a priority especially in the context of globalization. This consolidated approach is very useful both for investors and creditors due to a high degree of transparency regarding financial reporting. More specifically, consolidated financial statements according to International Financial Reporting Standards (IFRS) have various implications in terms of earnings management and quality of corporate financial disclosure.

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Technically, the highly complex and heterogeneous economic effects of IFRS adoption in Latin American countries are rather difficult to commensurate based on conventional methods. Additionally, considering improved accounting quality, IFRS adoption includes the establishment of a stable financial order based on a higher liquidity of capital markets and positive measures of supporting foreign investments. Furthermore, opportunities to obtain significant benefits are more attractive, but also potential risks are higher in the case of a rapidly changing investment environment.

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