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The global institutionalization of financial reporting: The case of the United Arab Emirates

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Abstract

Almost 100 countries have agreed to adopt or work towards convergence with the International Accounting Standards Board's international financial reporting standards (IFRS). Applying an institutional theory framework at a nation state level, and using publicly available data about the emerging economy of the United Arab Emirates (UAE) as a case, this paper identifies some of the global coercive, normative and mimetic pressures which have contributed to this widespread adoption. The challenge for emerging economies such as that of the UAE is whether the reality of IFRS implementation can match the image of IFRS adoption.

Keywords: International financial reporting standards; Globalization; Emerging economy; Institutional theory

> . . . as capital roams the world, nation states are obliged to provide regulatory and other frameworks to bring it under political control not merely to protect the interests of citizens, but also to facilitate and foster the conditions in which private accumulation can take root and flourish (Arnold & Sikka, 2001, p. 492).

1. Introduction

The "sudden rush" of the international community to converge national generally accepted accounting principles (GAAP) with IFRS (Fontes, Rodrigues, & Craig, 2005, p. 416) represents the outworking of economic and political factors, demonstrates the power and ubiquitous nature of globalization (Neu & Ocampo, 2007, p. 364), and has resulted in the institutionalization of a new regulatory regime. This paper uses the United Arab Emirates (UAE), a Middle Eastern Federation of seven states, and a member of the Gulf Cooperation Council (GCC)[1] as an example of IFRS adoption by an emerging economy,[2] offering an institutional interpretation within a global context.

The need for high quality "global GAAP" (Ampofo & Sellani, 2005, p. 228) was officially recognized in 1966, when professional accounting bodies first began working towards a set of international accounting stan-

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[1] The other states making up the GCC are Bahrain, Kuwait, Oman, Qatar and Saudi Arabia.

[2] This paper defines emerging economies as those which, although they are not classified as "developing" in terms of wealth, are characterized by their recent emergence into global financial markets, the development of regulatory processes, the opening of stock exchanges, and the breaking down of trade barriers as they become more sophisticated economically. Standard and Poor's emerging market database indices focus on the GCC markets, classifying them as "not yet fully open for foreign investment" (Standard & Poor's, 2006). Emerging and developing economies, while vastly different in terms of wealth, both face similar challenges in their adoption of the economic policies and regulatory systems of western nations.

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dards (IASC/IASB Chronology, 2006). Since then world capital markets have become increasingly tied to one another (Turner, 2001, p. 1), and so "integrated and interdependent" that "the stability of one market affects others" (UNCTAD, 2005, p. 5). As the barriers between nations have become more "porous" (Harris, 2002, pp. 417–418), domestic economies have become increasingly vulnerable to the "external shocks" caused by an "expanding world economy", necessitating the adoption of globalized practices if they are to function effectively (Lehman, 2005, p. 979).

This level of integration meant that the financial crises of the late 1990s affected all nations, resulting in a heightened recognition of the benefits of having "one set of high-quality globally recognized financial reporting standards" (UNCTAD, 2005, p. 5) and a call for the development of such standards (IASC/IASB Chronology, 2006). Furthermore, as labour and capital flows have been freed up over the last decade, there have been "huge increases in foreign direct investment (FDI) flows across countries" (Floyd, 2001, p. 109), arguably driven by the dominant nation-states as they have pursued "intentional politics and policies" designed to enhance their wealth and economic standing (Arnold & Sikka, 2001, p. 478). Whereas, some countries have attempted to avoid the "cultural imperialism" of globalization (Steger, 2003, p. 70), emerging and developing nations, if they wish to participate in the wealth enjoyed by the developed nations, have had no choice but to embrace its logic and realities. The development of IFRS is one manifestation of that institutional logic, with the globalization of IFRS described as "part of a general wave of standardization that has taken place in broader, non-accounting contexts over the last 150 years" (Rodrigues & Craig, 2007, p. 740). For the purposes of this paper, globalization is defined as "a worldwide pressure for change" (Granell, 2000, p. 89), as the "closer integration of the countries and peoples of the world" (Stiglitz, 2001, p. 9), and is interpreted as a universal process of institutionalization that both relies on and results in greater interdependence between economies, political systems, culture and societies. This is illustrated in the case of the UAE.

Each of the seven Emirates of the UAE retains control of its own natural resources and directs its own commercial activity. Formed in 1971 as a coalition of sheikhdoms, and relying primarily on revenue from oil and gas (DIFC, 2006j), the UAE in the last few years has expanded its economy significantly through trade and finance, has been active in seeking commercial partnerships, and is currently experiencing a high level of business optimism and strong revenue growth. Sheikh Khalifa bin Zayed Al Nahyan, the President of the UAE since his father died in 2004 (The World Factbook, 2006), has maintained his father's pro-western thinking, with an "aggressive approach to marketing the country as an attractive destination for business as well as residence" (Global Investment House, 2005). While it is an Islamic country, Islamic banking has not dominated the UAE. A "niche" market in the 1990s (Wilson, 1995), Islamic banking is now expanding to countries other than Islamic states (Kowsmann & Lane, 2007; Wright & Yuniar, 2007), but still claims a small segment of the UAE's banking industry. Al-Tamimi and Al-Mazrooei (2007) quantified Islamic banks' share of total UAE commercial bank assets at just 11.1% in 2004. Changes in the structure of banking systems in GCC countries to greater economic integration and deregulation (Ariss, Rezvanian, & Mehdian, 2007), and UAE plans for a "mega merger" of two of its commercial banks to create "a national and regional champion" (Timewell, 2007), are further indications of the UAE's pro-western emphasis.

The UAE's expansion has increased its need for the adoption of IFRS, which in turn has increased the legitimacy of the UAE as a worthy recipient of FDI.[3] The UAE currently requires the application of IFRS for its banks and for domestic companies listed for trading at the recently formed Dubai International Financial Centre (DIFC) (DIFC, 2006a, 2006e, 2006f; IAS Plus, 2006a). Prior to and following its adoption of IFRS, the government of the UAE has faced the task of attempting to reform its regulatory, legal and economic structures in order to provide the necessary infrastructure for the adoption of western-style financial reporting standards.

From an institutional perspective, the focus of this paper is both global and societal. The UAE, like many other emerging or developing countries, has responded to powerful global pressures to develop economic and political systems that conform to those of western developed nations, and to adopt IFRS in order to be seen as legitimate participants in international capital markets. Rather than focusing at the organizational field level within the UAE, and investigating the way in which institutional practices are embedded in individual organizations, this study steps up a level, paying attention to the global pressures for IFRS adoption to which the UAE has responded. The UAE is

[3] UAE adopted International Accounting Standards as early as 1999, initially for banks (Jose, 2004).