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The adoption of International Financial Reporting Standards in a non-colonized developing country: The case of Nepal

Ghanshyam Poudel, Andreas Hellmann *, Hector Perera

Department of Accounting and Corporate Governance, Faculty of Business and Economics, Macquarie University, Sydney, NSW 2109, Australia

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ABSTRACT

The purpose of this paper is to provide a systematic and rigorous analysis of the accounting environment in Nepal. Based on the accounting ecology framework developed by Gernon and Wallace (1995) and interviewing selected key stakeholders, it critically examines issues related to the adoption of International Financial Reporting Standards (IFRS) in Nepal. It contributes to the literature by examining issues associated with the adoption of IFRS in a non-colonized developing country. This study finds that the decision to adopt IFRS in Nepal is not driven by the needs of local organizations and is rather imposed by donor organizations such as the Asian Development Bank, International Monetary Fund and World Bank. The findings of this study provide evidence that the adoption of IFRS is likely to be problematic due to the country's contextual environment. Specifically, there is a severe lack of qualified accountants in Nepal and the accounting profession is not ready to adopt IFRS. The study also finds that social problems such as widespread corruption and fraud are likely to cause problems for the adoption of IFRS.

1. Introduction

Globalization of production, development of global consumer and capital markets, and growth of multinational companies brought together the need to establish a single set of financial reporting standards (Flower, 1997). With the aim to reduce international differences in accounting standards, among others, the International Accounting Standard Board (IASB)[1] is developing such a set of financial reporting standards for use internationally. The development of International Financial Reporting Standards (IFRS) is supported, for example, by the assumption that a single set of global accounting standards is an important means of enhancing comparability of financial statements and reducing the cost of preparing financial statements. During the last few years there has been a significant increase in the number of countries that have adopted IFRS with more than 120 countries requiring or permitting IFRS for financial reporting purposes. IFRS have been adopted both in industrialized countries such as the United Kingdom, Germany and Italy, and developing countries such as Bangladesh, Kazakhstan and Bolivia.

Achieving comparability in financial reporting depends upon whether IFRS are adopted in a similar and consistent manner across countries. However, differences in, for example, legal systems, taxation, sources of finance, inflation, political ties, colonial history, and culture cause diversity in accounting practices (for example, Doupnik & Salter, 1995; Evans, 2004; Jaggi & Low, 2000; Nobes, 1998; Richardson, 2007; Salter & Doupnik, 1992). These contextual factors are deeply embedded in the accounting environment of a country. As such, they may not be simply changed and could act as impediments to similar adoption of IFRS across countries. Additionally, achieving comparability in financial reporting depends on a consistent interpretation and application of IFRS across countries. Social, political, economic and cultural factors in countries influence accountants' professional judgments, and differences across countries may lead to an inconsistent interpretation and application of IFRS. Several studies provided evidence that professional judgments are applied inconsistently across countries, especially if countries have accounting environments that are different from those in Anglo-American countries where IFRS were developed (Doupnik & Richter, 2003; Doupnik & Richter, 2004).

Over the last few years research related to the adoption of IFRS has focused largely on the member countries of the European Union and other industrialized countries (for example Callao, Jarne, & Lainez, 2007; Doupnik & Richter, 2004; Hail, Leuz, & Wysocki, 2010; Hellmann, Perera, & Patel, 2010; Jermakowtcz, 2004). Importantly, even at a time when more and more developing countries are adopting IFRS, there are only few studies that examine the adoption of IFRS in those countries. For example, the studies in this category include

E-mail address: andreas.hellmann@mq.edu.au (A. Hellmann).
* Tel.: 61 2 9850 4055.
[1] IASB is the successor of the International Accounting Standards Committee (IASC) established in 2001. The standards formulated by IASB are called IFRS, whereas standards formulated by IASC are called International Accounting Standards (IAS). For the purpose of this study, the term IFRS and IAS are used interchangeably.

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those focusing on Indonesia (Perera & Baydoun, 2007), Zimbabwe (Chamisa, 2000), Mexico and South Africa (Prather-Kinsey, 2006), Trinidad and Tobago (Bowrin, 2007), Pakistan (Ashraf & Ghani, 2005) and Kazakhstan (Tyrrall, Woodward, & Rakhimbekova, 2007).

However, all of these countries were colonized by industrialized countries in the past. For example, Zimbabwe, South Africa, Pakistan, and Trinidad and Tobago were colonized by England; Mexico, Indonesia, and Kazakhstan were colonized by Spain, the Netherlands and Russia, respectively. This is important because these colonial powers often transferred both accounting ideas and accountants to their colonies, and highly influenced the development of accounting in those countries. For example, Ashraf and Ghani (2005) highlight that Pakistan exhibits some of the properties of its former colonial power England, namely two separate sets of reporting requirements and no direct involvement of government in standard setting. They also highlight that England's trained accountants have been a major source of influence on accounting practices in Pakistan. As such, the accounting environment of countries with a colonial past may feature characteristics such as a well-established professional body which may support IFRS adoption in those countries, whereas countries without colonial past may lack such characteristics.

Using the accounting ecology framework developed by Gernon and Wallace (1995), this paper provides a systematic and rigorous analysis of the main features of the accounting environment in Nepal. In addition, the paper examines potential issues associated with the adoption of IFRS in Nepal by interviewing selected key stakeholders such as academics, professional accountants and auditors, personnel from the Accounting Board of Nepal (ASB) and the Ministry of Finance, and by surveying available documents and literature.

Nepal, represented by the Institute of Chartered Accountants in Nepal (ICAN) and the ASB, has decided to adopt IFRS from July, 2012. It offers an interesting setting to examine potential issues associated with the adoption of IFRS because it is a non-colonized developing country with a strong indigenous cultural heritage. Importantly, no prior studies have examined issues related to the adoption of IFRS in a non-colonized developing country even though there is a rich literature in international accounting suggesting that colonial history is an important factor affecting the accounting environment of a country (Hove, 1986; Doupnik & Salter, 1995; Gernon & Meek, 2001, p. 5; Yapa, 2006; Perera & Baydoun, 2007; Muniandy & Ali, 2012).

2. Research methodology

2.1. Theoretical framework

It is commonly accepted that the development of accounting systems is largely a function of environmental factors such as the legal system, taxation, providers of financing, inflation, political and economic ties, and culture. However, the number of factors that influence accounting and their individual importance vary greatly in existing frameworks explaining the development of accounting such as the frameworks of Schweikart (1985), Gray (1988), Adhikari and Tondkar (1992), Doupnik and Salter (1995) and Nobes (1998). Importantly, these frameworks view accounting as strictly dependent on selected few variables of the environment. However, Hellmann, Perera, and Patel (2013) argue that the varying number of factors included in these frameworks and their individual importance suggests that the relationship between a single factor and its impact on accounting development is unclear. They conclude that it would be too simplistic to explain accounting development in terms of one or few identified environmental factors.

The purpose of this study is to provide a holistic analysis of the context in which accounting operates in Nepal. For this purpose, the 'accounting ecology' framework developed by Gernon and Wallace (1995) is used. They define accounting ecology as:

A multidimensional system in which no one factor occupies a predominant position and in which the perceptions held by actors on some unfolding accounting phenomena, as well as the accounting phenomena themselves, are the objects of study and analysis. Such a synthesis would emphasize the interrelationships of the environmental factors which influence and are influenced by accounting and would focus upon the importance of perceptual as well as non-cultural factors such as population and land area (p. 59).

The concept of accounting ecology encompasses the following five separate but interacting dimensions:

1. The *societal dimension* refers to structural, demographic and cultural events and/or trends that may affect the demand for financial accounting services. It includes elements such as population, geographical location, level of technology, political and economic development, and cultural values.
2. The *organizational dimension* refers to events and/or trends bearing on rationalization in the choice and design of accounting systems and demands for accounting services such as organizational size, technology, complexity, and human and capital resources.
3. The *professional dimension* refers to events and/or trends bearing on the determination of roles and relationships in the accounting profession such as education, training, registration, disciplinary actions, and professional ethics and culture.
4. The *individual dimension* refers to actions of individuals in an effort to pursue their self-interest. It covers the total setting in which individuals lobby standard setters and use accounting numbers to their respective advantages.
5. The *accounting dimension* refers to accounting practices, rules and/or trends that affect or are affected by the other slices of the environment. It includes the disclosure and measurement requirements and practices, and types and frequency of accounting reports (Gernon & Wallace, 1995).

Compared to other frameworks explaining the development of accounting, the accounting ecology framework incorporates both causes and effects of accounting and allows examining accounting in Nepal in its broader institutional context. Previous studies such as Perera and Baydoun (2007) and Hellmann et al. (2010) have adopted this framework and demonstrated its appropriateness for examining the accounting environment of a particular country. For example, Perera and Baydoun (2007) examined the accounting environment of Indonesia and identified some factors that were helpful in explaining the lack of support of IFRS in Indonesia, and Hellmann et al. (2010) examined the accounting environment of Germany and identified several contextual issues related to the adoption of IFRS in Germany.

2.2. Data collection

Data were collected from multiple sources including face-to-face interviews, discussion papers from the ASB, newspaper articles, newsletters from ICAN and ASB, and reports from the government and international institutions such as the World Bank, Asian Development Bank (ADB), International Monetary Fund (IMF) and the United Nations.

Ordelheide (2004) points out that accounting development is a political process which is largely influenced by affected stakeholder groups that make their influence felt whenever the legislator or standard setter formulates accounting rules. From the influential stakeholder groups in Nepal, a total of twelve individuals were interviewed including five professional accountants, six regulators and one accounting academic.

Interviewees were identified using publicly available information. Professional accountants were identified using the membership list of ICAN and a random sample of potential interviewees was identified from the first half of the membership list which is arranged in chronological order based on registration date. Those included on the first half of the membership list were likely to be familiar with the accounting environment of Nepal as they had more experience than other members on the list. The membership list also includes members of the ASB and other regulatory bodies such as the Security Exchange

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Board of Nepal (SEBON), Nepal Stock Exchange (NEPSE) and Nepal Rastra Bank (NRB) as most of the members of ICAN are involved in those bodies. All professional accountants were selected for their active involvement in policy and decision making of ICAN and the convergence process towards IFRS.

The high level executives of the ASB and Auditing Standards Board (AuSB) were identified using information provided on the ASB's web site and were personally contacted by the main author who visited the office of the ASB in Kathmandu. Three high level executives of ASB and AuSB were selected because of their active involvement in the formulation of Nepalese Accounting Standards (NAS) and the convergence process towards IFRS. Persons affiliated with other regulatory bodies such as SEBON, NEPSE, and NRB were also directly contacted and three high levels executives (two from SEBON and one from NEPSE) were selected for their active involvement in the convergence process and for being responsible for monitoring the adoption of IFRS among the listed companies. Finally, the accounting academic is a prominent member of the accounting education committee and is responsible for designing accounting courses in a major Nepalese university.

Interviews with these experts were conducted at the respective offices of the interviewees in Nepal. The purpose of the interviews was explained to all individuals before each interview session. The interviews were semi-structured and followed an interview guide, which served as a checklist for ensuring that all relevant issues were covered. The interviews covered, for example, aspects of the accounting environment in Nepal and opinions about convergence towards IFRS. The interviews were conducted in Nepali to overcome possible language barriers and lasted from 16 min to 1 h and 30 min. Interviews were recorded with permission, fully transcribed, and translated into English by a professional translator. To ensure the quality of translation, the translated interviews were checked by the main author who is fluent in English and Nepali.

2.3. Data analysis

Interview data were analyzed using the iterative process of transcription, translation, coding, and interpretation based on the accounting ecology framework. Key themes were identified and organized based on the same framework after a detailed reading of all transcripts. All transcripts were coded using the qualitative data analysis software NVivo. To code all the raw transcripts, sentences were associated with one or more themes. The coded categories were then linked together and interpreted. During data analysis, comments were arranged from the most important to the least important as related to the key issues. Verbatim quotes are provided to visualize some of the findings as suggested by Ryan and Bernard (2000). For the purpose of data analysis, the interviewees were classified into three different groups, namely professional accountants, regulators and accounting academics. To ensure the anonymity of all interviewees, they are referred to as Interviewee P1 (professional accountants), Interviewee R1 (regulators), Interviewee A (academic), and so on. The data collected from secondary sources such as publicly available documents, available literature, and newspapers articles were also analyzed using the same framework.

3. Aspects of the Nepalese accounting environment

Nepal decided to adopt IFRS from July, 2012. The systematic and rigorous analysis of the accounting environment in Nepal and the discussion related to the adoption of IFRS is based on the five dimensions of the accounting ecology framework.

3.1. Social environment

The Federal Democratic Republic of Nepal covers a small area of 147,181 km^2 between two emerging nations, namely India and China. It is approximately 885 km long and 193 km wide bordering China on the north and India on the south, west, and east. The border to China is closed and access to China is restricted (Interviewee P3). Geographically Nepal is divided into three regions, the northern mountains which is home of eight of the fourteen tallest mountains in the world, the middle hilly region and the southern plains. It ranges from 60 ft above sea level to the highest peak in the world, the Mount Everest at 29,028 ft above sea level. A great variation in altitude in the country provides a diverse range of climatic conditions from tropical to sub-arctic which may be a reason that Nepal developed a multi-cultural society with many distinct cultural groups.

Modern Nepal was founded in 1769 as the result of the unification of numerous states by the king of Gurkha, which is a state about 160 km west of Kathmandu. In 1846, *Jung Bahadur Rana*, a military commander, took over the country without overthrowing the monarchy, and his family ruled the country for 104 years. During this period the country was completely isolated from the outside world. The interviewees suggest that this isolation greatly affected the development of accounting practices in Nepal because it restricted the exchange of accounting ideas and technology. Furthermore, Nepal had no colonial past and its accounting institutions and practices were not shaped by any colonial power.

Nepal marked its first move towards democracy by overthrowing the rule of *Ranas* in 1950. Democracy was short lived as king *Mahindra* took the power in 1960 and established a single party system known as the *Panchayat*. The king kept the executive power and imposed restrictive trade and investment policies in order to maintain the political supremacy. Since then Nepal has experienced political turmoil in an effort to establish democracy. The First People's Revolution of 1990 marked the end of autocratic rule by the king and a new constitution was promulgated, which guaranteed basic human rights and established a constitutional monarchy and multi-party democracy. As a result of these changes, restrictive trade and economic policy were lifted resulting, among others, in an exchange of accounting ideas and technology with other countries. For example, ICAN was established after the First People's Revolution.

However, the democratic process was undermined by corruption and preferential treatment of those in power (Sharma, 2006). This led to a civil war that resulted in the killing of more than 12,000 people. The Second People's Revolution in 2006 overthrew the monarchy and the peace process began. As a result, a president acts as head of state and the executive power is exercised by the prime minister and his cabinet. A constitution assembly election was held in 2008 and a new constitution is in the process of being formed.

The total population of Nepal is 26.6 million as indicated by a recent survey in 2011, with a growth rate of 2.28 per annum (Central Bureau of Statistics, 2011). Kathmandu is the largest city as well as the capital of Nepal inhabited by approximately 1.7 million people (Central Bureau of Statistics, 2011). About 82% of the population are living in the rural area and are lacking access to basic infrastructure such as electricity. About half of the country's population is living in the southern region bordering India. The primary reason for this is that it provides excellent farming opportunities and easy access to Indian cities mainly for the purpose of employment.

The distinct geography of Nepal with the great variation in altitude in the country outlined before may be a reason that Nepal is a multilingual and multi-cultural society with many distinct cultural groups. The population consists of Tibeto-Burman migrants from the north and Indo-Aryan from the south. Specifically, there are more than 100 ethnicities and castes with distinct languages and cultures living in Nepal (Dahal, 2003). Hinduism is widely practiced by 80.6% of the population, followed by Buddhism (11%) (Central Bureau of Statistics, 2001). Nepali is the official language, which is spoken and understood by more than 90% of the population although there are over 100 regional and indigenous languages. About 10% of the population can only speak and understand their own regional languages.

However, no official translation of IFRS from English to Nepali exists (IFRS Foundation & IASB, 2013). This is highly problematic because the

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lack of a Nepali translation may hinder that a wide range of stakeholders in Nepal become familiar with IFRS (see for example, Larson & Street, 2004, who discuss this argument in the context of the European Union). As pointed out by the interviewees, a reason for this may be that individuals are typically more confident in applying their native language and may be able to make finer and subtler distinctions and interpretations in their own language.

This diversity in cultures and languages may be problematic for a consistent interpretation and application of IFRS within Nepal. The impact of culture on accounting practices has been identified by Gray (1988), among others, who proposed a relationship between cultural characteristics and attitudes towards financial disclosure. Indeed, Doupnik and Richter (2003, 2004) provide support for the view that cultural values may influence the interpretation of probability expressions used in IFRS. As such, as a result of the cultural diversity in Nepal, it is likely that the principle-based IFRS and the probability expressions included in them may not be consistently interpreted and applied within the country.

Nepalese society is predominantly a religious society and Hinduism and Buddhism are the guiding forces in shaping Nepalese culture. Importantly, religious beliefs and traditions are deeply rooted in Nepalese society influencing social norms and values since prehistoric times (Bista, 1991). For example, a distinct characteristic of Nepalese society is the presence of the Hindu caste system. The interviewees point out that the caste system regulates every aspect of life, including marriage and occupational roles. As such, it is primarily a collectivistic society with a high power distance where social values are highly regarded and people and families are closely tied together by religious belief and social structure (Gautam, Van Dick, Wagner, Upadhyay, & Davis, 2005).

3.2. Organizational environment

Nepal is one of the poorest countries in the world with an annual per capita income of $480 (World Bank, 2010). The United Nations human development report in 2004 ranked Nepal 140 out of 177 countries in terms of living standards and 151 in terms of per capita income. Approximately 37% of the population lives below absolute poverty earning $2 per day (World World Bank, 2010). Some main factors contributing to this situation are lack of national resources, high level of unemployment, fragile business environment due to political instability, and ineffective use of foreign aid (Adhikari, 2005).

Indeed, Nepal relies heavily on foreign aid which comprises a large proportion of its budget. For example, foreign aid accounted for approximately 6% of the GDP and financed over 50% of Nepal's development budget until 2002 (Bhattarai, 2007). This dependence on foreign aid is important to note because it may be an important factor which greatly influenced Nepal's decision to adopt IFRS. Importantly, Gordon, Loeb, and Zhu (2012) support this argument and provide evidence that adoption of IFRS leads to increased foreign direct investment inflows into developing countries.

Until the First People's Revolution of 1990, Nepal was a centrally controlled economy and extensive disclosure was not required (Interviewee R6). Today, main trading partners of Nepal are India, China and Bangladesh. India accounts for 65.5% of its export and 57% of the imports (Department of Foreign Affairs & Trade, 2011). The major exports are carpets, handy-crafts, pashmina, cloths and tea whereas major imports are oil, machinery and automobiles. Approximately 82% of Nepalese live in rural areas and rely heavily on agriculture for income and employment. Indeed, the agricultural sector contributed to 33.55% of the GDP in 2009 and employs 65% of the population (Central Bureau of Statistics, 2011; World World Bank, 2010).

Following the First People's Revolution of 1990, the government lifted export and import quotas, privatized government owned entities and re-structured the previously nationalized banking sector to attract foreign investment. It also increased the number of import and export licenses, modernized the tariff structure, and simplified the tax system. The financial sector experienced great reforms as the NRB permitted the establishment of commercial banks. With growing political instability and insufficient career opportunities, many Nepalese are seeking employment overseas. Their remittance from overseas is a major source of income for the country, which equals 22% of the GDP (World World Bank, 2010).

IFRS adoption is likely to lead to an unnecessarily high financial burden for companies because they are largely developed with a focus on the information needs of investors and require extensive disclosure. However, additional to the superiority of the agricultural sector, 98% (approximately 83,980) of the 85,277 companies registered with the Register of Companies are privately owned. Furthermore, only 235 companies are listed on the NEPSE (NEPSE, 2011). This shows that the capital market in Nepal is underdeveloped and that the principle source of capital for companies in Nepal is credit from the banking system (Interviewee R3). Given the prominence of bank credit as main source of finance, the financing system in Nepal fits Nobes' (1998) definition of a 'credit-insider' system in which no pressure exists to publish detailed financial information.

Transparency is also influenced by the governance structure. Most of the large businesses are controlled by powerful families and the governance structure is highly influenced by networks which reduce the pressure to publish detailed financial information (Interviewee P2). The majority of Nepalese companies are small companies in rural Nepal whose main area of business is agriculture and handicrafts (Ministry of Industry Nepal, 2011). These companies are funded by the government and receive bank loans at subsidized rates. Interviewee R6 points out that most of these companies lack a proper accounting information system. They are using a manual system for bookkeeping and outdated technology and Interviewee R6 argues that this often leads to a situation in which accounting information and records older than one year cannot be found. This shows that the majority of companies may not have an appropriate accounting information system suitable for increasing disclosure requirements.

3.3. Professional environment

The origins of accounting in Nepal can be traced back to the 14th century when *Mallas*[2] introduced a systematic form of single entry bookkeeping to record land and other commodities (Adhikari, 2005). Nepal became an important transit route for trade between India and Tibet during the *Mallas* period, and the accounting system was modified to facilitate the collection of revenue by the government and to control the state expenditures. The professionalization of accounting occurred during this era by the establishment of a particular sub-caste called *Joshis*. Only members of this caste were allowed to work as accountants (Adhikari, 2005). These accounting professionals were accountable to the king only and did not have to disclose any information to others.

With the unification of Nepal in 1769, king *Pritivi Narayan Shah* modernized the accounting system in Nepal by establishing a royal audit office, which kept a record of government revenues and expenditures. Accounting responsibilities were transferred to the sub-caste *Pradhans* because members of this caste were highly regarded for their business skills (Adhikari, 2005). In the absence of formal procedures and regulations for accounting, accountants had to use their experience and knowledge in order to develop accounting and reporting formats suitable for their needs (Adhikari, 2005). During the *Ranas* period, the main purpose of the accounting system was to ensure compliance with taxation rules, and restrictive sanctions were imposed. For example, accountants were liable for accounting manipulation up to seven generations (Chatterjee, 1967).

[2] The Mallas dynasty ruled medieval Nepal from approximately 1200 till unification of Nepal in 1769.

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A Companies Act was introduced in 1932. This act has been amended several times, most recently in 2006, and is the basis of present day accounting practices. As a result of the political changes in 1950, the accounting profession was modernized (Adhikari, 2005). The auditing profession was established in 1956 with the creation of the Office of Auditor General (OAG). The Auditor Act, which was promulgated in 1974, entrusted the OAG to issue auditor licenses based on qualification. Chartered Accountants with more than five years of work experience were given a class 'A' license with unlimited authority to audit any organization. All others were awarded a 'B', 'C', or 'D' license based on qualification. The OAG was responsible for regulating the auditing profession until 1997, when ICAN was established for accounting standard setting and regulation.

With the establishment of ICAN, formal accounting standards were put in place. ICAN has two classes of members, namely, Chartered Accountants and Registered Auditors. Chartered Accountants are those members with extensive professional qualification who mostly received their qualification from overseas bodies such as the Institute of Chartered Accountants in India (ICAI), Institute of Chartered Accountant in England and Wales, American Institute of Certified Public Accountants and Association of Chartered Certified Accountants. There are about 500 Chartered Accountants in Nepal who are allowed to audit large and listed companies. As a result of this small number, most Chartered Accountants are involved in auditing and only a few are involved in preparing financial reports.

There are about 7000 Registered Auditors who are allowed to audit small companies and organizations such as village development committees and government schools. Registered Auditors are not professionally qualified and most of them are employed as accountants in government bodies and business organizations, and are involved in the preparation of financial reports. In 2008, ICAN stopped to issue practicing licenses to Registered Auditors and required that individuals had to qualify as a Chartered Accountant in order to be eligible for the auditing license. Importantly, there is no requirement for financial statement preparers to be a member of ICAN. As a result, most of the financial statement preparers are university graduates without professional qualification. ICAN established its education program in 2000 to address the shortage of qualified accountants in Nepal. There are about 8000 students currently enrolled in the Chartered Accountants program.

There are no dedicated accounting degree programs offered at universities, but accounting units can be studied as part of commerce degrees (Interviewee A). Moreover, the same interviewee points out that accounting units focus mainly on management accounting. As a result, Interviewee A and Interviewee R6 argue that many companies are reluctant to hire graduates from Nepalese universities and prefer to hire accountants who received their qualification in India. Indeed, about 7000–8000 Nepalese students go to India for accounting education every year, which is facilitated by close links between the governments of both countries and an open border policy (Interviewee R5). However, accountants obtaining their professional qualification in India may not always be familiar with specific Nepalese laws and regulations (Interviewee R4). Another example for the close relationship between India and Nepal in regard to accounting education is that ICAN frequently organizes joint seminars and workshops for accounting professionals together with ICAI (Interviewee P4). ICAI also helped in the curriculum development of ICAN's Chartered Accountant program (Interviewee R5).

Concerns have been expressed by the interviewees over the general level of competence of Nepalese accountants in regard to applying IFRS. In comparison to India, for example, accounting education is considered insufficient, and many university graduates are lacking skills to apply IFRS (Interviewee A). Furthermore, there is no co-ordination between universities and the profession in regard to the extent of teaching IFRS and taking up this issue (Interviewee A). The number of qualified accountants is relatively small with about 500 professionals; however, most of them are unfamiliar with IFRS (Interviewee R4). Recruitment of skilled employees can be problematic for companies as there is a shortage of skilled IFRS specialists. This is likely to lead to a high financial burden for companies. The reason is that the training burden is principally on the individual firm until the shortage of accountants skilled in applying IFRS is addressed by universities.

3.4. Individual environment

Recall that Nepal is a collectivistic society with a high power distance. Family members and close relatives of people with power are given high priorities in policy and decision making roles in many organizations. For example, one interviewee said that

…with every political change there is distribution of power between the political parties. Important positions are filled by close relatives of ministers and relatives of those people in power. This is not based on merit but rather on self-interest; this frequent political change has hampered the development of accounting in Nepal (Interviewee P2).

This may be a reason for widespread corruption and fraud which can be widely noticed in Nepal. Indeed, Nepal is ranked 146 out of 178 countries on the corruption perception index in 2010 (Transparency International, 2010). A recent example is the scandal related to Value Added Tax (VAT) in 2010, which involved many well-known and large business entities in Nepal such as Chaudary Groups, Golcha, and Jyoti, and in which accountants accepted bribes in return for the preparation and verification of favorable financial statements (Interviewee R5). Specifically, fictitious entities were established which provided non-existent sales and which were used for VAT refunds. This scandal involved almost all major businesses in Nepal and evasion of as much as 10 billion rupee in tax (Gyawali, 2011; National Information Comission Nepal, 2011). As a result of this widespread corruption, the adoption of IFRS in Nepal is not likely to result in increased accountability and transparency (Interviewee P2).

Accounting standards in Nepal are formulated by the ASB, an independent standard-setting body established in March, 2003. Exposure drafts are made available to the public and various stakeholders can express views and opinions during the political process of standard setting (Interviewee P3). The accounting standard setting process and regulatory bodies are greatly influenced by accounting professionals. Interviewee R2 considers ICAN as the most powerful lobbying body influencing the ASB. Indeed, twelve of the ASB's thirteen members are affiliated with ICAN. Importantly, the lobbying activities of ICAN are aimed at convergence towards IFRS. A reason for this might be that the promotion of IFRS is important for maintaining their status with the International Federation of Accountants and to attract financial aid from international institutions (Interviewee R6). Indeed, Points and Cunningham (1998) observed that international donor agencies are very active in promoting IFRS. For example, they show that international donor agencies pushed developing countries belonging to the former Soviet Union to adopt IFRS. More recently, Mir and Rahaman (2005) also argue that international donor institutions exercise pressure on developing countries and show that Bangladesh's decision to adopt IFRS was largely driven by the desire to receive foreign aid.

Indeed, Interviewee R6 observes that ICAN is pushing forward the formulation of accounting standards based on IFRS even if the government and private sector are not ready for its adoption. Importantly, this push towards IFRS adoption and the resulting use of fair value measurements is in contrast to the conservative nature of Nepalese society which is slow to embrace changes and may resist fair value measurements (Interviewee P3).

Lobbying activities from the general public and corporations are not common because of two main reasons. First, decisions made by ASB are commonly accepted as being correct due to the large power distance in Nepalese society (Interviewee P3). Second, the level of education among the Nepalese population is relatively low. For example, approximately 28% of the adult population (those aged 15 and over) are illiterate and lack basic skills to read and write (World Bank, 2010).

3.5. Accounting environment

Before the establishment of ICAN in 1997, no systematic set of accounting rules existed in Nepal. Auditing was largely based on guidelines issued by the OAG, which were general in nature and aimed at the audit of government offices. As a result, professional accountants were required to rely heavily on their professional judgments. Interviewee R6 points out that the large number of Nepalese accountants who receive their professional qualification in foreign countries could be problematic because professional judgments are influenced by education and training. For example, accountants who were educated and trained in the United States would be influenced by models incorporated in U.S.-GAAP (Interviewee R6).

From 1997 to 2003, ICAN issued Nepalese Accounting Standards based on IFRS. With the amendment of the Chartered Accountant Act in 2003, the ASB took over the role to formulate and issue accounting standards. Interviewee R5 points out that the ASB basically adopts IFRS without any amendments that would reflect the needs of the Nepalese accounting environment. The Companies Act 2006 provides detailed requirements regarding financial reporting. It requires all publicly listed companies to apply the double-entry bookkeeping system and to prepare financial statements based on Nepalese Accounting Standards (Section 108(2), Companies Act, Government of Nepal, 2006). Furthermore section 110 requires financial statements to be audited by a qualified auditor.

However, it has long been argued in the literature that environments of developing countries significantly differ from Anglo-American countries where IFRS were developed and that adoption of IFRS without modifications to meet local environmental factors may not always be useful or appropriate (see for example, Larson & Kenny, 1996; Al-Rai & Dahmash, 1998; Hassan, 1998; Mirghani, 1998; Points & Cunningham, 1998; Mir & Rahaman, 2005). More specifically, Zeghal and Mhedhbi (2006) provide evidence that the adoption of IFRS would be easier for developing countries with an Anglo-American background. An important reason may be that institutional characteristics in those countries may be similar to that environment in which IFRS were developed. Nepal, however, was not colonized by any Anglo-American country and is lacking key characteristics of Anglo-American countries such as a strong capital market.

Additionally, Gordon et al. (2012) point out that developing countries may have the greatest potential for increasing transparency through IFRS adoption. However, the regulatory environment in Nepal is relatively weak. The SEBON is the regulator of the securities market under the Security Exchange Act of 2006. It is, for example, responsible for specifying listing requirements. There are 235 companies listed at NEPSE, which is the only stock exchange in Nepal. Additional institutions are responsible for regulating specific sectors. For example, the NRB is responsible for regulating the banking and financial sector and the *Beema Samiti* (Insurance Board of Nepal) is responsible for regulating the insurance sector. Sector specific regulatory bodies have the power to fine and suspend trading if companies fail to comply with their directives. For example, NEPSE has the power to delist companies. However, Interviewee R5 points out that this would not happen and argues that companies threatened to be delisted would bribe politicians to put pressure on NEPSE. Indeed, Pandey (2004) reports that although only few companies comply with all NAS, NEPSE did not take any actions against them. A reason for this is that there is a culture of promoting family members and close associates irrespective of merit and experience (Interviewee P2). This has effectively helped that powerful individuals maintain influence on the regulatory bodies for their advantages, which is likely to lead to an inconsistent application of IFRS within Nepal.

The accounting environment in Nepal is further characterized by a weak enforcement mechanism and non-compliance of many companies with accounting rules and regulations. A recent report by SEBON clearly shows that the enforcement mechanism is weak. Only 10 companies of 204[3] listed companies have submitted financial reports to SEBON for the financial year 2010/11 (SEBON, 2011). Interviewee R2 points out that relatively low fines up to 200,000 Rupee (approximately $1500) are a reason for this. Furthermore, resource constraints may also contribute to weak enforcement. Some regulatory bodies are unable to carry out proper surveillance and ensure the compliance with relevant regulations. For example, Interviewee R3 points out that there are currently only two individuals monitoring the compliance of listed companies.

Accounting institutions in Nepal lack human and capital resources and are largely funded by international organizations such as the ADB, World Bank, and IMF (Alliance for Aid Monitor Nepal, 2011). For example, the ASB was created with a grant from the ADB. Interviewee R1 points out that the ADB not only funded the ASB but also provided technical help during the initial phase of ASB's operations. The World Bank is also a major financial contributor (Interviewee P4). However, these organizations also impose conditions on Nepalese institutions which may influence the accounting environment. For example, Nepal joined the World Trade Organization on 23rd of April 2004 and accepted some obligations as condition of its membership. Obligations included the liberalization of the service sector including the accounting profession. This created some visible changes in the Nepalese accounting environment as it allowed the transfer of foreign accounting technology and professionals (Interviewee P3). With the condition of citizenship for professional practice removed, multinational companies can employ foreigners for accounting work.

4. Summary and concluding remarks

Using the accounting ecology framework developed by Gernon and Wallace (1995), this paper has examined the main features of the Nepalese accounting ecology. Nepalese society is characterized by conservatism, collectivism and a high power distance. Religious beliefs and the caste system are important aspects of the Nepalese society. Traditional Nepalese accounting practices reflect cultural differences and trade practices between caste groups. Historically, the main purpose of accounting was to inform the king about governmental revenues and expenditures. This task was carried out by certain castes, namely the *Joshis* and later the *Pradhans*. As a result of political changes, accounting standard setting was entrusted to the ASB in 2003. The traditional accounting castes lost influence with the establishment of ICAN in 1997 which is highly involved in accounting standard setting and education.

However, widespread corruption and fraud can be widely noticed. The capital market in Nepal is underdeveloped and the number of listed companies is low compared to Anglo-American countries. Most Nepalese companies are small companies in rural areas whose main businesses are agriculture and handicrafts. The Companies Act introduced in 1932 and modernized in 2006 is the basis of accounting for Nepalese companies. Unlike the practice in Anglo-American countries, financial statements in Nepal can be prepared by accountants who may not be affiliated with the professional body. This is likely to cause issues of consistency in the application of IFRS.

Findings of the interviews also suggest that certain characteristics of the Nepalese accounting ecology may cause problems concerning the consistent application of IFRS and may hinder the comparability of financial statements across countries. The main problems that have been identified include lack of qualified accountants and inconsistent training and education, cost of IFRS implementation and lack of accounting technology, and widespread corruption and enforcement.

An adequate supply of qualified and trained accountants and auditors is necessary in order to apply IFRS. In Nepal however, there is a relatively small profession whose members often receive their

[3] This figure does not match with the total number of listed companies because some companies are in a liquidation process and are exempt from submitting annual reports.

qualification in India. Concerns have been expressed by the interviewees over the general level of competence of Nepalese accountants in regard to IFRS. There are no IFRS related accounting degree programs offered at Nepalese universities and the extent of teaching IFRS varies greatly between institutions. As a result, recruitment of skilled employees can be problematic for companies as there is a shortage of skilled IFRS specialists. To address this issue, it would be important that technical aspects as well as reasoning and accounting models behind IFRS are fully included in the curriculum at Nepalese universities.

Further, the adoption of IFRS is a financial burden especially for small and medium-sized companies which would be mainly responsible for training educating employees in-house. It is suggested that the decision to adopt IFRS was mainly driven by lobbying activities of few powerful individuals and international institutions providing foreign aid. The interviewees are also concerned that the decision to adopt IFRS in Nepal was not driven by the needs of local organizations and the suitability of IFRS for local companies, but was rather imposed on them by international organizations such as the ADB, IMF and the World Bank. It appears that lobbying activities of less powerful stakeholders such as small companies do not take place and the decisions of few powerful individuals are widely accepted. The vast majority of companies is privately owned, and operates in rural Nepal in the agricultural sector. The interviewees suggest that many of these companies are using a simple manual system of accounting which is not adequate for applying IFRS.

Importantly, the adoption of IFRS is not likely to result in increasing transparency and accountability in Nepal because of a weak enforcement mechanism and the presence of widespread corruption and fraud. The broad aim of comparable financial statements may be undermined if weak enforcement and corruption leads to different compliance levels across companies.

In summary, it is clear that Nepal recognized the benefits of IFRS adoption such as attracting external funds from international institutions. However, the paper shows that Nepalese institutions face several contextual issues as a result of the decision to adopt IFRS. This may raise concerns whether accounting standards developed with significant influence from advanced industrialized countries are suitable for developing countries such as Nepal if they are not modified to reflect local concerns. Importantly, Nepal may have to find ways to overcome some of the potential issues highlighted in this paper if it wants to take advantage of being part of the global capital market. As suggested by Albu, Albu, Bunea, Calu, and Girbina (2011) and Assenso-Okofo et al. (2011), merely adopting IFRS without changing or improving the various dimensions of the accounting ecology may not yield desired improvements in financial reporting quality.

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