

## The effects of the legal environment on the entire application of IFRS for small and medium-sized enterprises: The case of Vietnam

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### CHRONICLE

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### ABSTRACT

The article explores the impact of factors in the legal environment on the application of the entire international financial reporting standards for small and medium-sized enterprises. Legal environmental factors include the legal system, the influence of the state role, professional associations and tax regulations. The author adopted the survey of 80 managers and 80 auditors to find out if there is any difference between the financial reporters and the financial reporting auditors on the impact of the legal environment. Through T-Test with SPSS 26 software, the author found that the tax factor is highly appreciated for both managers and auditors, especially for managers. The auditors assessed that the entire application of IFRS would bring benefits more than the costs while the managers assessed that the costs would be more than the benefits. Through the survey results, the author suggests limiting the impact of tax on accounting and further improving the role of professional associations.

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## 1. Introduction

In the world since 2009, the International Accounting Standards Board (IASB) has issued the international financial reporting standards for small and medium-sized enterprises. Then, IASB made the next adjustment in 2015. Through the assessment, IASB has applied this standard to most countries which have developed economies. According to researcher Bohusova (2011), the appropriate accounting standards can help small and medium-sized enterprises prepare financial statements with their quality to meet the requirements of providing reliable and useful information to users. Accounting career is also developed to improve the business environment. Vietnam's small and medium-sized enterprises have been increasingly participating in international activities, moreover, they also need to attract domestic and foreign capital for development, so the requirement for transparent financial information becomes imperative. Therefore, like other countries, Vietnam is also under pressure to harmonize with the international financial reporting standards for small and medium-sized enterprises. Vietnam represents an interesting case study of IFRS adoption by emerging and transition economies. When comparing Vietnam with other developing countries, it can be seen that the economic gap remains large. To developing countries like Vietnam, the legal environment has profound effects on the accounting systems of countries stemming from its close relationship with the accounting system. Thus, this article will study the factors of the legal environment that affect the application of international accounting standards for Vietnam's small and medium-sized enterprises under the management's perspective, SMEs and auditors. Article includes the introduction, literature review, research hypothesis, data and methodology, results and discussion, conclusion and policy implications.

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## 2. Literature review

### *2.1 Factors promoting the application process of the international financial reporting standards for SMEs*

In the process of global integration, the costs associated with financial reporting need to be reduced. The study of Ball (2006) shows that using international accounting standards and the international financial reporting standards can help improve the comparability of financial reporting information and thus reduce costs and risks of using information for investors. The process of bringing the world's economies together, especially the capital market, requires the standardization of accounting regulations. The international accounting integration process brings about the overall benefit of all parties globally. In particular, in the recent period, there have been many mergers and acquisitions in different countries; therefore, it is necessary to have common financial reporting standards for businesses. The application of accounting standards reduces the freedom for financial reporters to decide which standards to use. Available evidence shows that people who prepare can determine correctly: decide what information will be disclosed to whom and how it will be prepared. On the contrary, users want to maximize dissent, detailed, reliable and relevant information because it increases the likelihood of comparing businesses, reduces complexity, and makes information easier to observe. Applying common accounting standards increases transparency and users may expect these changes, but managers will have to put more effort into monitoring transactions. The researchers Franco et al. (2010), Turki et al. (2020), Alaina et al. (2020) previously gave many reasons for the higher accounting quality in financial reporting in accordance with the international accounting standards and the international financial reporting standards. In addition to debating for the higher quality of financial reporting, IFRS proponents also have an opinion that IFRS reporting enhances the comparison of companies in markets and countries (DeFond et al., 2010), thereby, facilitating cross-border investment (and capital market integration.) To the effects of IFRS on capital markets, IFRS promoters often assume that firms can access the international capital market more easily (Christensen et al., 2011), especially companies with a high degree of internationalization such as trading or fundraising in foreign markets.

In addition, there are intangible advantages that companies adopting can benefit from implementing additional disclosure policies of information under IFRS (Florou & Pope 2012). For example, a company can have easier access to capital markets, charge higher prices for its products, and attract more experienced employees thanks to a more transparent reputation than its competitors (Fox et al. 2013). Ehoff & Fisher (2013) analyzed that each nation has different strategies in the process of harmony according to their political position. Countries with strong political positions will seek ways to influence the IASB to harmonize in a way that is favorable for their country. European countries also encounter certain difficulties in harmonizing international accounting. This stems from the economic, legal and cultural characteristics of these countries. However, due to the economic interests, these countries are required to accept in advance but still maintain the right to approve the standards before completely accepting. Experimental research shows that the benefit from applying the international financial reporting standards in general and the international financial reporting standards for small and medium-sized enterprises in particular is improving the transparency of financial statements. Palea (2014) conducted research and impact assessment when applying the international financial reporting standards in 5 European countries with the results that applying the international financial reporting standards improves the quality of financial reporting information, increases usefulness, improves transparent information to investors. Daske et al. (2013), Hasheda and Almaqtarib (2020) indicated that the international financial reporting standards are suitable for countries whose capital market is developed because the transparency and disclosure of financial statements are appropriate for investors, providing comprehensive information more clearly than national accounting standards.

### *2.2 The factors that limit the process of general application of international accounting standards*

There are still many obstacles to the application process of the international financial reporting standards such as the use of fair values of the international financial reporting standards. According to Choi (1991), Saemann (1999), Zhang and Qu (2010), the globalization process is strong, but the stock market and the legal system still depend on the characteristics of each country; meanwhile, the international financial reporting standards are not self-compliant. When wishing to expand the process of applying the international financial reporting standards, it is necessary to solve the unique characteristics of some countries such as corporate structure, special transactions ... For some countries with the main source of finance is the State, Banks: France, Germany, Japan, ... the compliance with the law is important, but some countries that the main source of finance is main through the capital market such as the US, UK require the high completeness, truthfulness and reasonableness of information. In addition, in the presence of asymmetric information, researchers have the view that the makers and users of financial statements may have conflicting interests. The diversity of users of financial statements increases the likelihood of similar diversified needs making it inappropriate to compare users and preparers. However, all users support uniformity and full disclosure. Moreover, Jermakowicz (2004), Bui et al. (2020) listed some of the challenges in implementing IFRS include: The complex nature of some IFRS standards (e.g., impairment test in IAS 36), Lack of guidance for first IFRS reporting (example IFRS 1). For small and medium-sized enterprises, Chand et al. (2015) researched on the process of applying the international financial reporting standards for small and medium-sized enterprises in Australia to evaluate and explain the problems that arise when SMEs in Australia are in the transition from accounting standards applied in this country to the application of the international financial reporting standards for small and medium-sized enterprises. The result indicates fair value regulations, deferred corporate income tax, change in foreign currency rates, reassessment of machinery, equipment and facilities, and measurement and

recognition of invisible fixed assets, related party disclosures cause difficulties for small and medium-sized enterprises in Australia when applying the international financial reporting standards for small and medium-sized enterprises. Besides, the international financial reporting standards also have more complicated regulations and lack of specific and appropriate guidelines, so the recommendations of the authors are to reassess the benefits and costs associated with applying the international financial reporting standards to small and medium-sized enterprises before giving the approval to this set of standards. The research on the accounting classification of Nobes (2006), Joseph (2017) pointed out various factors that create obstacles for the general application of the international financial reporting standards. Zeff (2007) discussed four main areas: (1) Business and financial culture, (2) Accounting culture, (3) Audit culture, and (4) Regulatory environment that may hinder the harmonization between the nations. According to the research of Phan et al. (2014), Bui et al. (2020), for developing countries like Vietnam, factors related to the legal environment have a great influence on the application of the international financial reporting standards. For the legal environment, there is a legal system, the role of State, professional associations and tax effects. With the legal system, countries often have two different ways to form their legal system based on the legal system, the role of the State and professional associations. The differences in legal systems of the countries lead to a great difference in the role of the State in accounting matters. In some countries, the State plays a negligible role in accounting matters, they have very little specific regulations on accounting. Instead, this function is assumed by professional associations such as in the UK, USA, etc. The professional associations in these countries often formed a long time ago, with a considerable force. These professional associations often promulgate professional standards on accounting and auditing that are widely accepted by society and the State. One factor in the legal environment that has a huge impact on the national accounting system is taxation. In some countries such as the United States and the UK, taxation has a negligible effect on the calculation of the profitability of the accountant. The companies which make financial statements according to these accounting principles and figures may have differences from the data on the tax return. Thus, accountants can choose an accounting method suitable to the accounting standards to be able to accurately and reasonably reflect the financial situation or performance of their units. When filing a tax return, expenses or income recorded not in accordance with the tax law will be adjusted. In contrast, in many countries, the recordings of accounting books are subject to tax requirements such as depreciation or provisions. This makes accountants less interested in honest and reasonable presentation, but mainly about compliance with tax regulations.

Through the research overview, we see that the research is mainly focused on the application of the international financial reporting standards in countries with developed economies. Developing countries have a lot of differences related to institutions, laws, and economic characteristics. The object of research in this article is the small and medium-sized enterprises that account for a high proportion in the Vietnamese business system. However, small and medium-sized enterprises have a simple, unclear and inconsistent accounting system, the application of accounting standards has not been unified, ... In particular, the legal factor affects many small and medium-sized enterprises in Vietnam. The article is studied from the perspective of two different objects: managers and auditors. Representative theory shows that different subjects have different interests that lead to taking action in different ways and there is always a conflict of goal between the parties because the information is always inconsistent. This is the gap for the author to carry out research activities.

### **3. Research Hypothesis, Data and Methodology.**

#### *3.1. Research Hypothesis*

To compare the effects of legal factors on the entire application of the international financial reporting standards for SMEs in the opinion of managers and auditors, we use T-test to test the differences between the two sides. We have the first hypothesis to test:

H<sub>1</sub>: There is no difference in assessing the impact of accounting guidelines on the entire application of the international financial reporting standards to SMEs of auditors and managers.

The second and third hypotheses tested are related to the views on the role of the State and professional associations in the application of international accounting standards for SMEs of auditors and managers.

H<sub>2</sub>: There is no difference in assessing the impact of the State on the entire application of the international financial reporting standards to SMEs of auditors and managers.

H<sub>3</sub>: There is no difference in assessing the impact of the professional associations on the entire application of the international financial reporting standards to SMEs of auditors and managers.

The next hypothesis.

H<sub>4</sub>: There is no difference in assessing the impact of tax on the entire application of the international financial reporting standards to SMEs of auditors and managers.

H<sub>5</sub>: There is no difference in assessing the costs and benefits of the SMEs' accounting reconciliation process between auditors and managers.

### 3.2 Research Data

The author conducted the research to identify the legal factors affecting the ability of the entire applications of the international financial reporting standards for small and medium-sized enterprises through a survey. The author sent 300 questionnaires to the auditors and audit assistants at several auditing companies in Vietnam. The auditors and audit assistants are all at least 3 years of experience. The author collected 80 answered questionnaires. Besides, the author sent to 350 managers in small and medium-sized enterprises. The author obtained 80 answered questionnaires from managers.

70% of auditors are men, 30% of auditors are women, and 65% of managers are men. For auditors, the highest percentage is from 26-35 years old accounting for 58%, the age from 35 and over is 31% and the age under 26 is 11%. For managers, the age from 35 and over is 68% and the age from 26-35 is 32%.

### 3.3 Research Methodology

The questions in the comment sheet are evaluated on a 5-point likert scale from 1 to 5, of which 1 strongly disagrees and 5 is totally agree. Through T-Tests carried out through SPSS 26 software, the author wants to find out whether opinions about the impact of legal factors on auditors and managers and assess benefits and expenditures of applying the international financial reporting standards for small and medium-sized enterprises. Questions related to factors of the legal environment have been studied in the past.

The first questions relate to the auditors and managers' assessment of the legal environment factors that affect the entire application of the international financial reporting standards to the small and medium-sized enterprises.

**Question number one:** In your opinion, do the legal documents of accounting guidelines affect the entire application process of the international financial reporting standards for small and medium-sized enterprises?

**Question number two:** In your opinion, does the State affect the entire application process of the international financial reporting standards for small and medium-sized enterprises?

**Question number three:** In your opinion, do the professional associations affect the entire application process of the international financial reporting standards for small and medium-sized enterprises?

**Question number four:** In your opinion, does the tax affect the entire application process of the international financial reporting standards for small and medium-sized enterprises?

Then, the author studied the costs and benefits for the accounting integration process in small and medium-sized enterprises as well as the application of the accounting integration process in all small and medium-sized enterprises according to the opinions of auditors and managers.

**Question number five:** Do you think that the benefits gained from the application of the international financial reporting standards for SMEs are greater than the costs involved in this process?

## 4. Results and Discussion

The author compares the opinions of auditors and managers by testing the equality of the mean of two populations from information of the two Independent Samples T-test between 80 auditors and 80 managers. Likert scale is rated from 1 to 5 in which 1 is the lowest in the evaluation, the closer to level 5 is the higher rating.

**Table 1**

Evaluation of the impact of legal document guidelines on the application of the international financial reporting standards for SMEs from the perspective of auditors and managers

		Group Statistics			
	Classification	N	Mean	Std. Deviation	Std. Error Mean
Mark	Auditors	80	3.69	.565	.063
	Managers	80	3.94	.460	.051

  

		Independent Samples Test		
		Mark		
		Equal variances assumed	Equal variances not assumed	
Levene's Test for Equality of Variances	F	21.935		
	Sig.	.000		
t-test for Equality of Means	t	-3.071	-3.071	
	df	158	151.748	
	Sig. (2-tailed)	.003	.003	
	Mean Difference	-.250	-.250	
	Std. Error Difference	.081	.081	
	95% Confidence Interval of the Difference	Lower	-.411	-.411
		Upper	-.089	-.089

The test results are shown in Table 1 with the mean of opinion of the auditors assessing the impact of legal documents is 3.69 and the mean of the managers is 3.94. In this case, the observed significance of the Levene test on the equality of two population variances (Levene's test) is  $0.00 < 0.05$ , so we will use the results of the two equal variances not assumed. For these tests, the result is meaningful or not based on the observational significance (sig) in the t-test for Equality of Means test. The test results have a significant level of observation (sig) =  $0.003 < 0.05$ . Thus, auditors and managers have different assessments on the impact of legal documents on the application process of the international financial reporting standards for SMEs. Hypothesis H1 is rejected.

**Table 2**

Evaluation of the impact of the State on the application of the international financial reporting standards for SMEs from the perspective of auditors and managers

		Group Statistics			
	Classification	N	Mean	Std. Deviation	Std. Error Mean
Mark	Auditors	80	4.29	.578	.065
	Managers	80	4.36	.579	.065

  

		Independent Samples Test				
				Mark		
				Equal variances assumed	Equal variances not assumed	
Levene's Test for Equality of Variances	F			.431		
	Sig.			.513		
t-test for Equality of Means	t			-.820	-.820	
	df			158	157.999	
	Sig. (2-tailed)			.413	.413	
	Mean Difference			-.075	-.075	
	Std. Error Difference			.091	.091	
	95% Confidence Interval of the Difference			Lower	-.256	-.256
				Upper	.106	.106

The results in Table 2 assess the impact of the State on the entire application of the international financial reporting standards according to the opinion of auditors and managers. Through the survey results, we can see that the opinions of auditors and managers who assess the State role factor are not much different. The mean score of auditors is 4.29 and the mean score of managers is 4.36. The significance level is  $0.413 > 0.05$  so there is no difference in the rating level of auditors and managers when comparing this issue. Hypothesis H<sub>2</sub> is not rejected.

**Table 3**

Evaluation of the impact of the professional associations on the application of the international financial reporting standards for SMEs from the perspective of auditors and managers.

		Group Statistics			
	Classification	N	Mean	Std. Deviation	Std. Error Mean
Mark	Auditors	80	3.03	.616	.069
	Managers	80	2.33	.497	.056

  

		Independent Samples Test				
				Mark		
				Equal variances assumed	Equal variances not assumed	
Levene's Test for Equality of Variances	F			1.802		
	Sig.			.181		
t-test for Equality of Means	t			7.910	7.910	
	df			158	151.320	
	Sig. (2-tailed)			.000	.000	
	Mean Difference			.700	.700	
	Std. Error Difference			.089	.089	
	95% Confidence Interval of the Difference			Lower	.525	.525
				Upper	.875	.875

The survey results in Table 3 assess the impact of the professional associations on the entire application of the international financial reporting standards according to the opinion of auditors and managers. Through the survey results, we can see that the opinions of auditors and managers who assess the professional associations' role factor are much different. The mean score of auditors is 3.03 and the mean score of managers are 2.33. The significance level is  $0.00 < 0.05$  so there is a difference in the rating level of auditors and managers when comparing this issue. Hypothesis H<sub>3</sub> is rejected. However, the mean score of auditors and managers on the role of professional associations are low, especially the mean score of managers.

**Table 4**

Evaluation of the impact of the tax policy on the application of the international financial reporting standards for SMEs from the perspective of auditors and managers.

		Group Statistics				
	Classification	N	Mean	Std. Deviation	Std. Error Mean	
Mark	Auditors	80	3.88	.603	.067	
	Managers	80	4.29	.556	.062	
		Independent Samples Test				
		Mark				
		Equal variances assumed		Equal variances not assumed		
Levene's Test for Equality of Variances	F			.617		
	Sig.			.433		
t-test for Equality of Means	t			-4.499		
	df			158		
	Sig. (2-tailed)			.000		
	Mean Difference			-.412		
	Std. Error Difference			.092		
	95% Confidence Interval of the Difference	Lower			-.594	
		Upper			-.231	

The survey results in Table 4 assess the impact of the tax policy on the entire application of the international financial reporting standards according to the opinion of auditors and managers. Through the survey results, we can see that the opinions of auditors and managers who assess the tax role factor are different. The mean score of auditors is 3.88 and the mean score of managers is 4.29. The significance level is  $0.00 < 0.05$  so there is a difference in the rating level of auditors and managers when comparing this issue. Hypothesis H4 is rejected. The managers assess that the tax factor has a great influence on the application process of the international financial reporting standards for small and medium-sized enterprises more than auditors. Some studies shows that managers, especially small and medium-sized enterprises are more concerned with taxation than the presentation in financial statements according to accounting.

**Table 5**

Evaluation of the impact of the benefits and costs on the application of the international financial reporting standards for SMEs from the perspectives of auditors and managers

		Group Statistics				
	Classification	N	Mean	Std. Deviation	Std. Error Mean	
Mark	Auditors	80	3.74	.689	.077	
	Managers	80	2.73	.729	.081	
		Independent Samples Test				
		Mark				
		Equal variances assumed		Equal variances not assumed		
Levene's Test for Equality of Variances	F			.642		
	Sig.			.424		
t-test for Equality of Means	t			9.031		
	df			158		
	Sig. (2-tailed)			.000		
	Mean Difference			1.012		
	Std. Error Difference			.112		
	95% Confidence Interval of the Difference	Lower			.791	
		Upper			1.234	

Next, compare the benefits and costs that an enterprise has to spend if implementing the international accounting harmonizing process shown in Table 5. We have the mean score of auditors is 3.74 and the mean score of managers is 2.73. The test results have a significant level of observation ( $\text{sig} = 0,000 < 0.05$ ). Thus, there is a difference in the comparison between costs and benefits on the application of the international financial reporting standards for small and medium-sized enterprises between auditors and managers. For managers, the cost in the process of applying the international financial reporting standards is an issue that needs to be concerned, especially for small and medium-sized enterprises, whose economic potential is not strong.

## 5. Conclusion and policy implications

Through the survey of legal factors affecting the application process of the international financial reporting standards for small and medium-sized enterprises, it can be seen that the role of legal documents, the State and tax policy have great influence on auditors and managers. Both managers and auditors assess that the role of professional associations in applying the international financial reporting standards for small and medium-sized enterprises is not high. Especially, the managers are very interested in tax issues in making international financial statements for small and medium-sized enterprises. Inside the business, managers

are most concerned about the cost issue in applying the international financial reporting standards. For small-scale businesses that need to save costs, the application will face many difficulties and may not be appropriate at present when these enterprises cannot meet the requirements. For the auditors, they are more optimistic about the benefits that the international financial reporting standards for small and medium-sized enterprises bring about. The Government should issue within its jurisdiction an appropriate financial mechanism or plans to address differences between accounting standards, financial mechanisms and tax policies. The State and enterprises should have the consensus of opinion that the information disclosed to users such as investors, creditors, employees, suppliers, .. must comply with accounting standards. Managers need to care about financial statements which must comply with accounting standards. Managers and auditors also need to improve the perception that financial reporting information is not for tax authorities, but is useful in decision making by business owners and related parties. Next, the role of professional associations is also a factor to consider in the accounting development process. The development of professional organizations is an opportunity for accountants to exchange, learn and it is also an environment to detect inadequacies in setting accounting standards. The Ministry of Finance should have a policy mechanism to help professional associations develop, which will promote the application of the international financial reporting standards for small and medium-sized enterprises.

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