iBusiness, 2024, 16, 160-172
https://www.scirp.org/journal/ib
ISSN Online: 2150-4083
ISSN Print: 2150-4075

The Impact of Accounting Standards Convergence on Cross-Border Investment Decisions

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How to cite this paper: Ma, Y. R. (2024). The Impact of Accounting Standards Convergence on Cross-Border Investment Decisions. *iBusiness, 16,* 160-172.
https://doi.org/10.4236/ib.2024.164011

Received: September 24, 2024
Accepted: November 25, 2024
Published: November 28, 2024

Abstract

This study analyzes the impact of accounting standards convergence on cross-border investment decisions. The research reviews the theoretical foundations of accounting standards convergence, including information economics, agency theory, and institutional theory. Through systematic analysis, the study constructs a theoretical framework for how accounting standards convergence influences cross-border investment decisions. The research finds that accounting standards convergence may affect cross-border investment decisions through multiple theoretical mechanisms: based on information asymmetry theory, standards convergence can reduce information disparities between investors and investee companies, facilitating investment decisions; according to transaction cost theory, standards convergence lowers information processing costs for financial statement users, benefiting cross-border investment; from an institutional theory perspective, standards convergence provides a unified institutional environment for cross-border investment, reducing uncertainty caused by institutional differences. The study also points out the complexities of the impact of standards convergence on cross-border investment, such as differences in standards implementation quality and cultural influences. To address these complexities, the study proposes a multi-level analytical framework that considers country characteristics and institutional environments. The research also explores the interaction between standards convergence and other economic factors (such as corporate governance and legal systems), providing directions for future research.

Keywords

Accounting Standards Convergence, Cross-Border Investment, Information Asymmetry, Transaction Costs, Institutional Theory

1. Introduction

In recent years, with the deepening of economic globalization, cross-border investment activities have become increasingly frequent, and international accounting standards convergence has become a focal point of attention in both academic and practical circles. As the basic rules for companies to provide external financial information, accounting standards and their international convergence have had a profound impact on cross-border investment decisions. Accounting standards convergence aims to eliminate differences in accounting practices between different countries, improve the comparability and transparency of financial reporting, and thus provide more useful decision-making information for investors. However, accounting standards convergence is a complex process involving multiple theoretical perspectives and influence mechanisms. Information economics theory suggests that accounting standards convergence can reduce information asymmetry and lower information acquisition costs for investors (Barth et al., 2008). Agency theory posits that unified accounting standards can help mitigate principal-agent problems and improve corporate governance (Armstrong et al., 2010). Institutional theory emphasizes that accounting standards convergence creates a unified institutional environment for cross-border investment, reducing uncertainty caused by institutional differences (Soderstrom & Sun, 2007). Despite theoretical research pointing out the potential advantages of accounting standards convergence, empirical research results are not entirely consistent. Some studies have found that accounting standards convergence indeed promotes cross-border investment (DeFond et al., 2011), while others indicate that the effects of standards convergence are moderated by various factors, such as implementation quality and legal environment (Daske et al., 2008). These inconsistent results suggest that we need a deeper understanding of the specific mechanisms and boundary conditions through which accounting standards convergence affects cross-border investment decisions.

This study aims to construct a comprehensive theoretical framework to systematically analyze the impact pathways of accounting standards convergence on cross-border investment decisions and explore relevant moderating factors. By integrating multiple theoretical perspectives, this research will provide new insights into understanding the complex relationship between accounting standards convergence and cross-border investment, while also providing a theoretical foundation and research directions for future empirical studies.

2. Theoretical Foundations of Accounting Standards Convergence

2.1. Information Economics Perspective

Information economics provides an important theoretical foundation for understanding the impact of accounting standards convergence on cross-border investment decisions. This theory emphasizes the key role of information in economic decision-making, especially in situations where information asymmetry exists. In the cross-border investment environment, the information gap between investors and investee companies is particularly significant, mainly stemming from geographical distance, language barriers, and differences in accounting standards. Accounting standards convergence helps reduce this degree of information asymmetry by unifying the rules for preparing and disclosing financial reports. Specifically, unified accounting standards improve the comparability of financial statements, making it easier for investors to compare the financial conditions and operating performance of companies from different countries (Barth et al., 2008). This enhanced comparability not only reduces investors' information processing costs but also improves their efficiency in understanding and using financial information. Furthermore, accounting standards convergence may improve the quality of financial reporting, as internationally accepted accounting standards usually include stricter disclosure requirements and higher accounting quality standards. High-quality financial information can more accurately reflect the economic substance of enterprises, thus helping investors make more informed investment decisions (DeFond et al., 2011).

However, the information economics perspective also points out that the effects of accounting standards convergence may be influenced by various factors, such as the quality of standards implementation and management's reporting incentives (Pruthi & Koul, 2019; Ra & Lee, 2018). These factors can significantly affect the effectiveness of accounting standards convergence in reducing information asymmetry and improving the quality of financial reporting. Accounting standards convergence affects cross-border investment decisions by influencing the information environment. This theoretical mechanism provides important insights for understanding the relationship between accounting standards convergence and cross-border investment but also suggests that we need to consider the moderating effects of other relevant factors.

2.2. Transaction Cost Theory Perspective

Transaction cost theory provides another important perspective for analyzing the impact of accounting standards convergence on cross-border investment decisions. This theory emphasizes that various transaction costs exist in economic activities, which affect the decision-making behavior of economic entities. In the field of cross-border investment, due to differences in accounting standards between countries, investors need to spend substantial time and resources to understand and process financial information from different accounting systems, constituting significant transaction costs. Accounting standards convergence can effectively reduce these transaction costs by unifying accounting practices across different countries (Khurana & Michas, 2011). Unified accounting standards reduce the costs for investors to learn and adapt to multiple sets of accounting standards when making cross-border investments. This includes not only direct learning costs but also potential losses that might arise from misunderstanding or misinterpreting different accounting standards. Accounting standards convergence also lowers the information processing costs for financial statement users. When all companies adopt the same accounting standards, investors can more easily compare the financial conditions and operating performance of companies from different countries, thereby improving decision-making efficiency. This improvement in efficiency is reflected not only at the individual investor level but may also produce broader market effects, such as improving market liquidity and lowering the cost of capital. However, transaction cost theory also reminds us that accounting standards convergence itself may generate new transaction costs, such as standards conversion costs and ongoing compliance costs. Therefore, when assessing the net effect of accounting standards convergence, it is necessary to weigh these costs and benefits. Overall, the transaction cost theory perspective provides important insights into understanding how accounting standards convergence affects cross-border investment decisions by reducing information processing and interpretation costs.

2.3. Institutional Theory Perspective

Institutional theory provides a macro-level analytical framework for understanding the impact of accounting standards convergence on cross-border investment decisions. This theory emphasizes that the behavior of organizations and individuals is profoundly influenced by their institutional environment. In the context of cross-border investment, accounting standards in different countries can be viewed as an important institutional arrangement. Accounting standards convergence is essentially a process of institutional convergence, aiming to create a more unified and predictable institutional environment for cross-border investment (Soderstrom & Sun, 2007). From an institutional theory perspective, the impact of accounting standards convergence is mainly reflected in the following aspects:

1) It reduces uncertainty caused by institutional differences. When investors face financial reports using unified accounting standards, they can better understand and predict companies' financial conditions and operating performance, thereby reducing investment risk.

2) Accounting standards convergence may enhance the legitimacy and credibility of institutions. Adopting internationally accepted accounting standards, especially IFRS, can be seen as a signal indicating that a country or company is committed to improving the transparency and quality of financial reporting (Judge et al., 2010). This signal may increase investor confidence and promote cross-border investment.

3) Institutional convergence may lead to imitation effects. As more and more countries adopt unified accounting standards, other countries may face pressure to follow this trend to avoid being at a disadvantage in international capital markets.

However, institutional theory also reminds us to pay attention to the complexities of accounting standards convergence. Institutional environments differ between countries, and simply adopting unified accounting standards may not completely eliminate these differences. For example, legal systems, enforcement quality, and cultural factors may all affect the actual implementation of accounting standards. Therefore, from an institutional theory perspective, when assessing the impact of accounting standards convergence on cross-border investment decisions, it is necessary to consider broader institutional environment factors. Institutional theory provides us with a more macro perspective, helping us understand how accounting standards convergence influences cross-border investment decisions by shaping the institutional environment, while also reminding us to pay attention to the complexities of this process and potential institutional resistance.

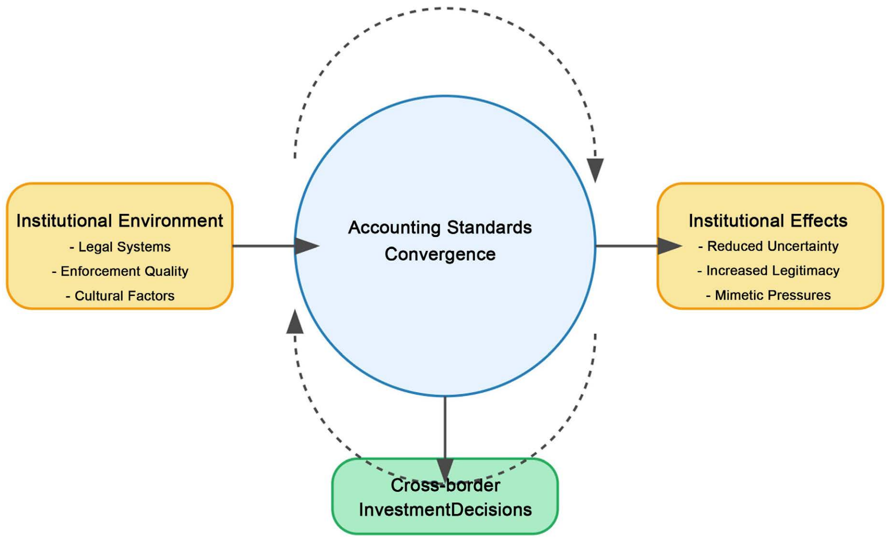

Figure 1. Impact mechanism of accounting standards convergence from an institutional theory perspective. Source: adapted from Odin et al., 2023.

Figure 1 illustrates the conceptual framework for understanding the relationship between accounting standards convergence and cross-border investment decisions from an institutional theory perspective. The figure clearly demonstrates how the institutional environment influences the process of accounting standards convergence, and how this convergence affects cross-border investment decisions by producing various institutional effects. At the same time, the circular arrows in the figure also indicate that this is a dynamic, mutually influential process.

2.4. Literature Review of Accounting Standards Convergence

Previous research has extensively examined the effects and implications of accounting standards convergence. Studies have shown that the adoption of International Financial Reporting Standards (IFRS) has led to significant improvements in financial reporting quality and comparability across countries (Armstrong et al., 2010). Research by DeFond et al. (2011) found that IFRS adoption increased foreign mutual fund ownership, particularly when the adoption led to greater comparability with other countries in the same industry. Empirical evidence also suggests that the benefits of accounting standards convergence are not uniform across all adopting countries. Daske et al. (2008) documented that capital market benefits around IFRS adoption occurred only in countries with strict enforcement regimes and where firms had incentives to be transparent. This finding highlights the importance of considering institutional factors when evaluating the impact of accounting standards convergence. In the context of emerging markets, Wang (2016) examined the reforms in cross-border investment and financing, highlighting how accounting standards convergence facilitates international capital flows. The study emphasized that successful implementation of unified accounting standards requires supporting institutional infrastructure and regulatory frameworks.

3. Mechanism Analysis of Accounting Standards Convergence Impacting Cross-Border Investment Decisions

3.1. Information Asymmetry Reduction Mechanism

Accounting standards convergence influences cross-border investment decisions by reducing information asymmetry, which is a core mechanism. In the cross-border investment environment, there are significant information disparities between investors and investee companies, stemming not only from geographical distance and language barriers but also from differences in accounting standards between countries. Accounting standards convergence, especially convergence towards International Financial Reporting Standards (IFRS), effectively reduces this degree of information asymmetry by unifying the rules for preparing and disclosing financial reports. Unified accounting standards improve the comparability of financial statements. When companies from different countries adopt the same accounting standards, investors can more easily compare their financial conditions and operating performance, thus making more informed investment decisions (Brochet et al., 2013). Accounting standards convergence is usually accompanied by stricter disclosure requirements, which increase the transparency of corporate financial information. More comprehensive and detailed information disclosure allows investors to gain a deeper understanding of a company's operating conditions and risks, reducing the uncertainty brought about by information asymmetry. Unified accounting standards may improve the quality of financial reporting. Internationally accepted accounting standards, such as IFRS, usually contain stricter accounting treatment and valuation rules, which may limit management's earnings management behavior and improve the reliability of financial information (Barth et al., 2008). However, the effect of accounting standards convergence on reducing information asymmetry may be influenced by various factors, such as the quality of standards implementation and corporate governance levels. For example, even if unified accounting standards are adopted, significant information asymmetry may still exist if implementation quality is poor. Therefore, when assessing the impact of accounting standards convergence on information asymmetry, it is necessary to consider broader institutional and company-level factors.

3.2. Transaction Cost Reduction Mechanism

Accounting standards convergence influences cross-border investment decisions by reducing transaction costs, which is another important mechanism. In the cross-border investment environment, due to differences in accounting standards between countries, investors need to spend substantial time and resources to understand and process financial information from different accounting systems, constituting significant transaction costs. Accounting standards convergence, especially convergence towards International Financial Reporting Standards (IFRS), can effectively reduce these transaction costs by unifying accounting practices across different countries. Unified accounting standards reduce the costs for investors to learn and adapt to multiple sets of accounting standards when making cross-border investments. When all companies adopt the same accounting standards, investors only need to master one set of standards to analyze and compare companies from different countries, greatly reducing learning costs (Khurana & Michas, 2011). Accounting standards convergence lowers the information processing costs for financial statement users. Unified accounting standards make financial information easier to understand and compare, allowing investors to analyze the financial conditions of different companies more quickly and accurately, thereby improving decision-making efficiency. Accounting standards convergence may lower investors' risk assessment costs. When companies adopt internationally accepted accounting standards, investors can more easily assess companies' risk profiles, reducing potential losses that might arise from misunderstanding or misinterpreting different accounting standards. However, it should be noted that accounting standards convergence itself may generate new transaction costs, such as standards conversion costs and ongoing compliance costs. Therefore, when assessing the net impact of accounting standards convergence on transaction costs, it is necessary to weigh these costs and benefits. By reducing the costs of information acquisition, processing, and interpretation, accounting standards convergence can lower the overall transaction costs of cross-border investment, thereby promoting cross-border investment activities.

3.3. Institutional Environment Improvement Mechanism

Accounting standards convergence influences cross-border investment decisions by improving the institutional environment, which is an important macro-level mechanism. From an institutional theory perspective, accounting standards can be viewed as an important institutional arrangement, and accounting standards convergence is essentially a process of institutional convergence. This process improves the institutional environment for cross-border investment through multiple pathways, thereby influencing investment decisions. Firstly, accounting standards convergence reduces uncertainty caused by institutional differences. When different countries adopt unified accounting standards, it provides a more unified and predictable institutional environment for cross-border investors. This institutional consistency reduces the institutional risks faced by investors and increases their confidence in foreign markets (Soderstrom & Sun, 2007). Secondly, adopting internationally accepted accounting standards, especially IFRS, can be seen as a signal indicating that a country or company is committed to improving the transparency and quality of financial reporting. This signal may enhance the legitimacy and credibility of institutions, attracting more cross-border investment. Furthermore, accounting standards convergence may lead to institutional imitation effects. As more and more countries adopt unified accounting standards, other countries may face pressure to follow this trend to avoid being at a disadvantage in international capital markets. This imitation effect may further promote the global convergence of accounting standards, creating a more unified global investment environment (Judge et al., 2010). It should be noted that the effect of accounting standards convergence on improving the institutional environment may be influenced by various factors, such as legal systems, enforcement quality, and cultural factors. For example, even if unified accounting standards are adopted, their actual effect may be limited if there is a lack of effective enforcement mechanisms. Therefore, when assessing the impact of accounting standards convergence on the institutional environment, it is necessary to consider broader institutional backgrounds and supporting measures.

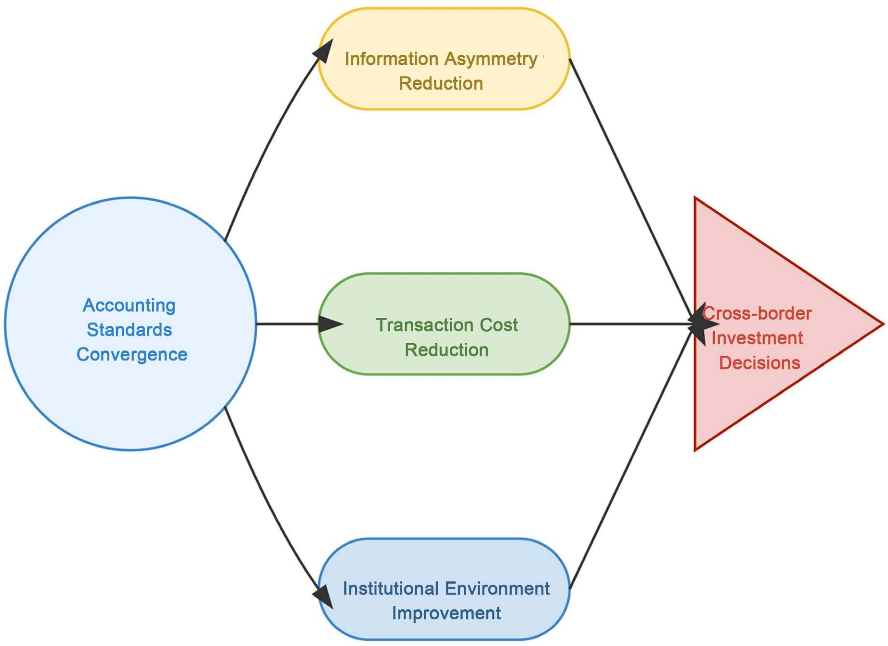

Figure 2. Main mechanisms of accounting standards convergence impacting cross-border investment decisions. Source: Adapted from Ra & Lee, 2018.

Figure 2 illustrates the main mechanisms through which accounting standards convergence impacts cross-border investment decisions. The figure clearly demonstrates how accounting standards convergence influences cross-border investment decisions through three main mechanisms: reducing information asymmetry, lowering transaction costs, and improving the institutional environment. This visual representation helps us better understand the interrelationships between these mechanisms and their comprehensive impact on investment decisions.

4. Analysis of the Complexities in the Impact of Accounting Standards Convergence on Cross-Border Investment Decisions

4.1. The Impact of Differences in Standards Implementation Quality

The impact of accounting standards convergence on cross-border investment decisions is not straightforward; one important complexity factor is the difference in standards implementation quality. Although countries may have adopted unified accounting standards, such as International Financial Reporting Standards (IFRS), the actual implementation quality of these standards may vary between countries. This variation can significantly affect the effectiveness of accounting standards convergence. Differences in standards implementation quality may affect the comparability of financial information. In theory, unified accounting standards should improve the comparability of financial reports from companies in different countries. However, if the implementation quality is low in some countries, it may lead to inconsistent financial reporting quality, thereby reducing comparability (Christensen et al., 2013). In this situation, investors still need to expend additional effort to understand and adjust financial reports from different countries, partially offsetting the expected benefits of accounting standards convergence. Implementation quality differences may affect investor confidence. If investors are aware that the implementation quality of standards is low in certain countries, they may be skeptical of the financial reports from companies in these countries, thus affecting their investment decisions. This distrust may lead to distortions in capital allocation, which is detrimental to the effective operation of global capital markets. Differences in standards implementation quality may lead to new information asymmetries. Local investors familiar with the implementation environment of a specific country may be able to interpret financial information more accurately than foreign investors, potentially creating new information advantages. This contradicts the original intention of accounting standards convergence to reduce information asymmetry (Ball, 2006). Therefore, when assessing the impact of accounting standards convergence on cross-border investment decisions, we cannot focus solely on the formal convergence of standards but must also consider substantive differences in implementation quality. This complexity suggests that to fully realize the benefits of accounting standards convergence, we need to pay attention to both the formulation and implementation of standards, and strive to narrow the gap in implementation quality between different countries.

4.2. The Moderating Role of Cultural Factors

Cultural factors play an important moderating role in the impact of accounting standards convergence on cross-border investment decisions, constituting another layer of complexity. Although accounting standards may converge in form, deep-seated cultural differences may affect the interpretation and application of standards, thus influencing the actual effect of accounting standards convergence. Different cultural backgrounds may lead to varied understandings of accounting concepts and principles. For example, in conservative cultures, there may be a tendency towards more prudent accounting treatments, while in more aggressive cultures, there may be a preference for more optimistic financial reporting (Gray, 1988). These cultural differences may result in variations in the practical application of accounting standards even when the same standards are adopted by different countries, affecting the comparability of financial information. Cultural factors may influence management's financial reporting motivations and behaviors. In individualistic cultures, management may be more inclined to use financial reporting to showcase individual performance, while in collectivist cultures, there may be a greater focus on maintaining organizational and social harmony (Hofstede, 2001). These differences may affect earnings management behaviors and information disclosure strategies, thereby influencing the quality and reliability of financial reporting. Cultural differences may affect how investors interpret and use financial information. Investors from different cultural backgrounds may have different understandings of and reactions to the same financial information, which may lead to differences in investment decisions (Beugelsdijk & Frijns, 2010). For instance, investors from high uncertainty avoidance cultures may tend to interpret financial information more conservatively, while those from low uncertainty avoidance cultures may be more willing to take risks. The complexity of these cultural influences suggests that when assessing the impact of accounting standards convergence on cross-border investment decisions, we need to consider the moderating role of cultural factors. It also emphasizes that in advancing the process of global accounting standards convergence, we need to focus on how to accommodate accounting practices and investment behaviors under different cultural backgrounds while unifying standards.

4.3. The Influence of Economic Development Levels

The level of economic development is another important factor affecting the impact of accounting standards convergence on cross-border investment decisions, adding to the complexity of this relationship. Countries at different levels of economic development may face different challenges and opportunities when adopting and implementing unified accounting standards, which in turn affects the role of accounting standards convergence in cross-border investment. The level of economic development may influence a country's ability to adopt and implement high-quality accounting standards. Developed economies typically have more mature accounting professions, more sophisticated regulatory systems, and more extensive experience in financial reporting, making it easier for them to adapt to and implement complex international accounting standards. In contrast, developing countries may lack the necessary infrastructure and expertise, leading to difficulties in implementation and inconsistent quality. These differences in implementation capabilities may affect the actual impact of accounting standards convergence, thereby influencing investors' decisions.

The level of economic development may affect the cost-benefit analysis of accounting standards convergence. For developed economies, adopting internationally accepted accounting standards may bring significant benefits, such as increasing international investors' confidence and lowering the cost of capital. However, for some developing countries, adopting complex international accounting standards may incur substantial conversion costs and ongoing compliance costs, which may exceed the short-term benefits (Ramanna & Sletten, 2014). These differences in cost-benefit analyses may affect different countries' enthusiasm for adopting and implementing unified accounting standards, thereby influencing the overall effect of accounting standards convergence. Moreover, the level of economic development may influence investors' perceptions of and reactions to countries adopting international accounting standards. Investors may view the adoption of international accounting standards by developed economies as a signal of improved financial reporting quality, while being more cautious about developing countries adopting the same standards. This differentiated perception may lead to preferences in investment decisions, affecting the efficiency of capital allocation on a global scale. When assessing the impact of accounting standards convergence on cross-border investment decisions, it is necessary to consider the specific situations of countries at different levels of economic development and explore how to accommodate these differences in the process of global accounting standards convergence.

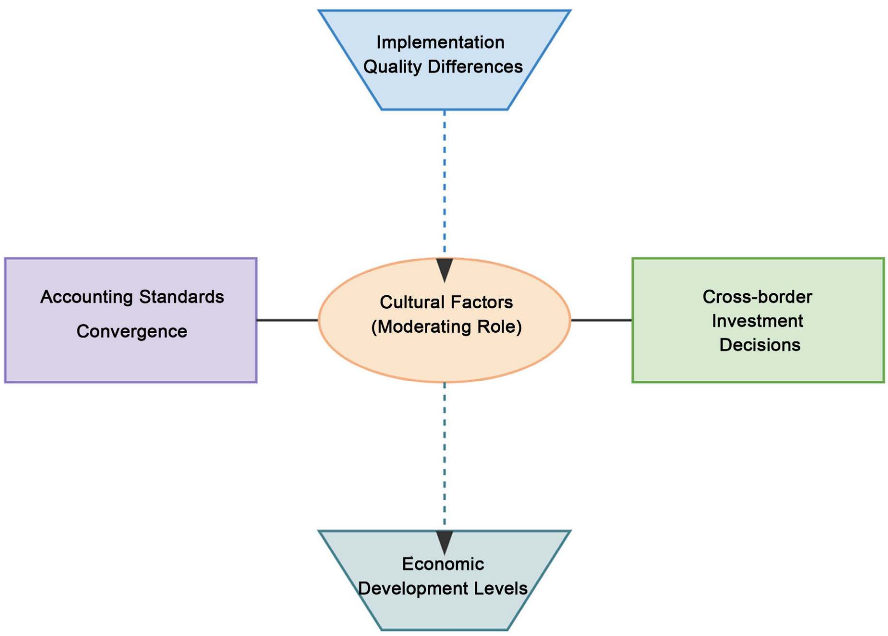

Figure 3. Complexity factors affecting the impact of accounting standards convergence on cross-border investment decisions.

Figure 3 illustrates the complexity factors affecting the impact of accounting standards convergence on cross-border investment decisions. The figure clearly demonstrates how differences in standards implementation quality, the moderating role of cultural factors, and the level of economic development jointly influence the effect of accounting standards convergence on cross-border investment decisions. This visual representation helps us better understand the interrelationships between these complexity factors and their comprehensive impact on investment decisions.

5. Conclusion

This study systematically analyzes the impact of accounting standards convergence on cross-border investment decisions and constructs a comprehensive theoretical framework. The research finds that accounting standards convergence influences cross-border investment decisions through mechanisms such as reducing information asymmetry, lowering transaction costs, and improving the institutional environment. However, this influence is not straightforward but is moderated by various complex factors. Differences in standards implementation quality, cultural factors, and levels of economic development can all affect the actual impact of accounting standards convergence. These findings have important implications for understanding the impact of global accounting standards convergence. They emphasize that in promoting accounting standards convergence, we need to focus not only on the formal unification of standards but also on substantive implementation quality. They remind us that when assessing the effects of accounting standards convergence, we need to consider the cultural backgrounds and economic development levels of different countries. These findings provide a theoretical basis and direction for future empirical research, such as exploring the differences in the effects of accounting standards convergence under different institutional environments, and how to accommodate these differences in the process of global accounting standards convergence. Nevertheless, this study still has some limitations. For example, due to the lack of comprehensive cross-national data, it is difficult to empirically test all theoretical predictions. Future research could further verify and refine the theoretical framework proposed in this study by collecting more comprehensive international data. This study provides new insights into understanding the complex relationship between accounting standards convergence and cross-border investment, while also offering valuable references for policymakers and practitioners.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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