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## Introduction

As we all know, Ethiopia has already formally adopted IFRS. The significant Public Interest Entities (PIEs) have all completed the conversion to IFRS, some, probably majority of, the other PIEs have also gone through the conversion while majority of the Small & Medium Enterprises (SMEs) have not yet begun the journey. Hence, as the IFRS conversion is still knocking at doors of almost all three categories of entities, even those which have completed the initial conversion process, it will still be useful to discuss the benefits and challenges of adoption of IFRS and other key points to consider in the process.

IFRS are issued by the International Accounting Standards Board (IASB), and they specify exactly how accountants must maintain and report their accounts. As we globalise, the significance of convergence with International Financial Reporting Standards (IFRS) increases because financial information prepared and audited according to National Accounting Generally Accepted Accounting Principles (NGAAP) no longer satisfies the needs of users whose decisions are more international in scope. Hence, lot of countries have already moved from the NGAAP towards the IFRS, of which common accounting rules define what information must be disclosed in financial statements and how transactions must be reported.

Though it is claimed that cost of implementation was very high and accounts and business managers faced some challenges in the implementation of the standards, the benefit derived from its implementation outweighed the challenges.

## Statement of the problem

The compliance challenge with the adoption of IFRS has been a significant focus of many organizations' conversion efforts. Many firms perceived that IFRS adoption has resulted in an ongoing increase on annual accounting and compliance costs. Consequently, it is found that some companies continue to follow the accounting treatments under past NGAAP. Hence, it becomes necessary to outline the benefits and the associated challenges to enhance understanding of stakeholders about the decision involving adoption of IFRS.

## Benefits of IFRS Adoption

IFRS leads to high-quality, transparent, and comparable financial information. This is useful for international organizations, as it helps investors, creditors, financial analysts, and other users of financial statements thoroughly assess the performance of their investment.

Generally, among the benefits identified in several studies performed are:

i) The increase in the level of comparability between the financial statements and the improvement of the transparency level. Businesses using similar standards to prepare financial statements enhance transparency and can more accurately compare with each other.

ii) IFRS Standards strengthen accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. As a source of globally comparable information, IFRS Standards are also of vital importance to regulators around the world.

iii) It creates more flexibility. Using a philosophy that is based on principles, instead of rules, this set of standards will have the goal of arriving at a reasonable valuation with various ways to accomplish tasks. This would give businesses the freedom to adopt IFRS to their specific situations, which will result in financial statements that are more easily read and useful.

iv) The industry is able to raise capital from foreign markets at lower cost if it can create confidence in the minds of foreign investors that their financial statements comply with globally accepted accounting standards.

v) IFRS Standards contribute to economic efficiency by helping investors to identify opportunities and risks across the world, thus improving capital allocation. For businesses, the use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs.

## Challenges of IFRS Adoption

Few studies have given contradictory views questioning the relevance of IFRS adoption in developing and emerging economies.

- Rong-Ruey (2006) argued that one single set of accounting standards cannot reflect the differences in national business practices arising from differences in institutions and cultures. In countries where the quality of governance institutions is relatively high, IFRS adoption is likely to be less attractive as high-quality institutions represent high opportunity and switching costs to adopting international accounting standards.
- Sawan and Alsagga (2013) have found that cultural, political and business differences may also continue to impose significant obstacles in the progress towards a single global financial communication system because a single set of accounting standards cannot reflect the differences in national business practices arising from differences in institutions and cultures.

## Wider Implications of Transitioning to IFRS—Matters to Consider

The transition to International Financial Reporting Standards (IFRS) or to

International Public Sector Accounting Standards (IPSAS), which are accounting standards and guidance for use by public sector entities, has been an increasingly significant feature of global financial reporting in the last decade. At this time, more than 120 countries require or permit the use of IFRS, or financial reporting standards substantially based on or converged with IFRS, by some or all of their reporting entities. The International Accounting Standard Board (IASB) is confident that the use of IFRS will grow in the next decade and organizations including the World Bank, the G-20, and the International Organization of Securities Commissions (IOSCO) support the concept of harmonization of corporate reporting.

Thousands of companies, public sector entities, and other organizations have gone through a transition to IFRS-based financial reporting in the last decade, and many more thousands will do so in the next few years. The huge advantage that relatively late adopters of IFRS have is that they can learn from the experience of those that have already gone through the transition. Early adopters of IFRS faced a significant learning curve, and those yet to move to IFRS can capitalize on their experiences in terms of developing an appropriate transition strategy.

While these accounting-related issues are undoubtedly significant matters to be considered, the wider implications of moving to adopt IFRS have a tendency to pose the greatest difficulties and be more likely to result in unforeseen consequences, but with careful planning, the transition can also bring benefits and opportunities.

Some of the wider implications that should be considered in planning the transition include the following:

1. Impacts on business processes at the business-unit level, particularly the need to capture information for disclosure under IFRS;
2. The need for systems changes and internal control enhancements to ensure rigor in applying the new financial reporting requirements and in dealing with transitional adjustments;
3. The changes to internal information systems and reporting that may be considered necessary;
4. Implications for performance measurement due to changes in how profit is measured, and knock-on effect on bonuses and remuneration packages;
5. Implications for how liquidity and solvency are measured, and impact on debt covenants and other agreements;
6. Planning for tax implications and identifying whether the tax treatment of items will differ from the accounting treatment;
7. The need to educate finance staff and some non-finance personnel to ensure they are IFRS literate and know how to respond to requests for information;
8. Managing investor relations and communicating with external stakeholders regarding the changes they will see in the financial statements;
9. Estimating the cost of the transition, and ensuring there is sufficient budget and funding for the project; and
10. Considering the need to secure executive-level sponsorship for the transition project, so that it is not perceived as "an accounting problem" and that the transition team is fully supported in their activities.

This is not an exhaustive list of wider implications and many more may be relevant, especially in a large, multi-national organization, particularly those with a complex group structure, or where there are additional regulatory requirements in relation to the transition.

Proper planning is therefore essential to ensure that these wider implications are identified and for an appropriate response to be developed.

## More Than Accounting and Financial Reporting

Without question, IFRS will affect the general ledger and the financial statements. But in a relative sense, the accounting and financial reporting may be the easy part.

In other words, CFOs should expect that IFRS will impact a wide range of business functions beyond financial reporting. These may include changes to management's internal reporting, data gathering and IT systems, the use of key performance indicators, the content of employee and executive compensation plans, the activities of investor relations, changes to policies and procedures and the resultant impacts on internal control documentation and certification requirements.

How IFRS adopters handle the nonfinancial aspects of the conversion may be a far more accurate indicator of your success. Among the areas warranting attention are:

1. Human Resources: As noted, IFRS involves much more than reorganizing the chart of accounts. It represents a change that cascades well beyond the finance department. Consequently, human resources issues may be a major concern. A conversion project will place increased demands on your personnel, which may come at a time when you are least able to handle it.

2. Legal: The ripple effects of conversion to IFRS will surely be felt by IFRS adopter's legal department. Many contracts will need to be re-examined for possible effects and some contracts may need to be renegotiated and restructured. As with other employees, education and retraining will come into play for the legal team.

3. Regulatory: Banks and capital markets institutions have a number of local, national, and international regulatory requirements that can trip up even the most sophisticated enterprise. Thus, the prospect of adding IFRS to the existing collection of regulatory acronyms (Accounting and Auditing Board of Ethiopia (AABE), Anti- Money Laundering (AML), etc.) may seem daunting. But IFRS holds even greater promise of collaboration among various regulatory bodies.

4. Tax: The tax considerations associated with a conversion to IFRS, like the other aspects of a conversion, are complex. This will be explained more later.

5. Treasury: Moving to a global financial reporting model may open up access to new sources of capital. Many banks and capital market institutions are already faced with volatility in their own debt and volatility in their ability to access additional capital. IFRS reporting will not significantly change those considerations.

6. Information Technology: IFRS is expected to have wide-ranging effects at different levels of the IT systems architecture. The realignment of an institution's

information systems will pose a real challenge for IT (along with the rest of the organization). Virtually all applications and interfaces in the system architecture can be affected, from the upstream or source of data to the farthest end of the reporting tools. As such, time and resource needs may be significant. As you plan changes to your IT systems, you will need to take into account external factors such as local and international regulations, financial consolidation of subsidiaries, stock markets, and external auditors. This business transformation should not be considered as a one-step project. It may be necessary to implement short-term initiatives strategically designed to institute an effective long-term solution for your institution.

## Time for Leadership

You are in an enviable position, because you possess knowledge that many others in your institution may not: the movement toward IFRS is inexorable; and the initiative involves multiple corporate functions, not solely finance. You have a choice: either sit back and wait for it to happen (with all the attendant uncertainty and risk) or mobilize your company to attempt to maximize the benefits and minimize the obstacles.

In other words, it's time for leadership. By starting now, you will likely spread out your costs, get the jump on your competition, and reel in scarce talent before it vanishes. You can improve your processes and systems. You can integrate with other initiatives, such as an ERP upgrade or a merger or acquisition. Most important, you can do it on your own terms, at a pace that suits your company and its circumstances.

There are major demands on financial and human resources at banks and capital markets institutions. An IFRS project cannot be a distraction from the primary activities of your business. It must be integrated, coordinated, and aligned. It should start soon with some preliminary questions and a carefully drawn roadmap; and it ends somewhere in the next decade when you report for the first time under a single unified standard. Whether the journey from here to there is rocky or smooth may be entirely up to you.

## Business and financial reporting considerations

### Impact of IFRS conversion on external financial reporting

Converting to IFRS will have far-reaching effects on the way financial reporting is conducted. Some of the key impacts include:

a) ***Impact on bottom line*** —Companies should expect a change in earnings and financial position;
b) ***Potential for increased volatility of reported results*** — Adopting IFRS could result in increased volatility of reported financial results, depending on circumstances;
c) ***Increased volume and complexity of financial disclosures;*** and
d) ***Increased transparency and comparability –*** As use of IFRS becomes more embedded and experience in applying IFRS grows, increased transparency and comparability are benefits that should become more pronounced as the deadline for IFRS conversion approaches.

## Implications of IFRS conversion for the business

The changes driven by IFRS will not be restricted to the finance function. Converting to IFRS will not merely be a technical accounting exercise but more a widespread change management exercise that will impact many areas of the business. Any business function required to prepare financial information, or impacted by financial information, has the potential for change including, but not limited to:

a) IT and Data Systems (IT);
b) Executive and Employee Compensation Plans (Human Resources);
c) Foreign Exchange and Hedging Activities (Treasury);
d) Corporate Income Taxes (Taxation);
e) Ratios and Financial Covenants (Finance and Treasury);
f) Internal Controls and Processes (Finance);
g) Investor Relations and Communication to Capital Markets (Finance and Investor Relations); and
h) Management Reporting (Finance).

All these being said, it is important to note that each company's concerns and the extent to which IFRS will impact them will be different. For some, the impacts will be pervasive; for others, they may be minimal.

## IFRS Conversions: What CFOs Need to Know and Do?

### Impact of IFRS conversion on management reporting

IFRS will influence the way management runs the business and assesses performance. One of the significant trends reported in Europe was the increased use by management of "non- IFRS" measures (i.e., performance indicators not defined under IFRS) when communicating business performance to the market.

The changes to accounting policies expected from applying IFRS and the need to record and classify information in specific ways to comply with the new standards may impact the financial information generated by the business. Management reporting formats and processes will need to be reviewed and updated accordingly. In addition, management will need to give some consideration to impacts on the key performance indicators used for measuring success and reviewing trends.

## Impact of IFRS conversion on tax reporting and tax filings

Tax reporting in financial statements under IFRS will likely change. Converting to IFRS may impact the deferred taxation accounting of the business, particularly in relation to the value of timing differences and the time frame over which these are expected to reverse. Given this different time frame, the corresponding tax rates applicable to these timing differences may significantly impact the effective tax rate borne by the business and, consequently, the net reported earnings.

Consequently, as businesses convert to IFRS for financial reporting purposes, the CFO will need to assess whether this new accounting framework is a reasonable foundation to use as the basis for the income tax calculation or whether some alternate approach will lead to a truer picture of taxable profit.

## Comparison with competitors and industry peers

Companies often compare themselves to industry norms and peers, from both a strategic and a business focus as well as from a measurement and results basis. Most companies will want to know what their peers are doing as it relates to IFRS and, specifically, the financial reporting decisions that are being made. This is especially challenging when the selection of accounting policies is influenced by local industry practices and peer group comparisons, both of which are themselves in a state of transition. On the other hand, due to global acceptance of IFRS, availability of information on accounting practices for specific industries may be more readily available. At the same time, investors and market analysts will also want to be aware of the differences in decisions made by peer companies so they can take into account these differences when making decisions.

To remain true and consistent with the IFRS objectives of comparability and transparency, CFOs will need to assess the accounting principles selected by industry peers. Although not all companies within the same industry will select identical policies, management's analysis would not be complete without this peer assessment.

## IFRS training for finance personnel

Based on the experience of other jurisdictions that have converted to IFRS, a shortage of trained resources is a significant challenge companies will face. Addressing the organization's skill requirements should therefore be an immediate priority for management. For most companies, following the initial impact assessment stage, training is the next big milestone, which should be completed as early as possible in the conversion cycle.

At the same time, due to high demand for IFRS trained resources, the CFO may also decide to develop succession plans for key IFRS-trained technical resources and revisit the company's compensation strategy to better mitigate the risks of losing their key finance people.

## Risks and opportunities

### Risk of fraud and misstatement associated with converting to IFRS

The conversion to IFRS is one of the most fundamental changes in financial reporting in Ethiopian history. The potentially pervasive nature of the changes at the accounting, functional, transactional and internal control levels increase the risk of both misstatement and fraud.

A robust system of internal controls is a company's best method of ensuring reporting integrity and minimizing the risk of misstatement and fraud. A period of change, such as one encountered during an accounting conversion, could lead to modifications in the design and effectiveness of internal controls, hence increasing risk. Following an initial IFRS impact assessment, the next steps entail mapping the significant accounting and financial reporting areas impacting the current internal controls over financial reporting.

## Identifying other key risks associated with converting to IFRS

Today's financial reporting environment has little tolerance for mistakes, and it will be important for companies to get the conversion right the first time. Errors and misstatements as well as missed reporting deadlines present a significant risk to companies which are converting. CFOs should consider what could go wrong and the likely impact and set in place mitigation and management strategies.

## Taking advantage of opportunities presented by the conversion to IFRS

The conversion to IFRS presents potential opportunities that CFOs may wish to examine further. The IFRS accounting framework contains numerous instances in which multiple accounting options are permitted. This creates opportunities for CFOs to identify and select options that may result in a more appropriate representation of their financial results and position. However, proper account must be taken of any "global consensus" regarding specific accounting options for their industry lest a company may be seen to be diverging from the norm.

## The role of the auditor in the conversion process and the need for a third-party advisor

Many companies will engage a third-party advisor to assist with the conversion process. CFOs cannot, however, delegate away their reporting responsibilities or their responsibilities over the selection of appropriate accounting policies. Some companies will seek assistance directly from their auditors, whereas others will turn to another service provider.

In many cases, the auditor will be able to assist management in various ways. The auditor knows the business, management and current policies. Generally, the auditor should be able to provide diagnostic and training services, advice on alternative accounting options, assist with the interpretation of IFRS, and observe and review project progress.

The extent to which companies request assistance from their auditors will depend on several factors. Obviously, auditors cannot perform services that would be considered proscribed services. Whatever non-proscribed services are offered will depend on maintaining auditor independence, including the perception thereof. Auditors should not be perceived as assuming a management role or auditing their own work.

Lastly, the degree of auditor assistance determined to be appropriate will be a function of the scope of service limitation philosophy as it pertains to auditors providing non-attest services.

Notwithstanding the above, the company's objectives should be to avoid surprises in the audit process. As such, auditors should at a very minimum be involved in reviewing and commenting on (or accepting) management's analyses of accounting alternatives and the selection of appropriate accounting policies. In addition, management or the audit committees may ask the auditor for observations regarding management's assessment of the conversion issues, timeline and risks.