



ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

**THE IMPACT OF INTERNATIONAL FINANCIAL
REPORTING STANDARD (IFRS) ADOPTION ON KEY
FINANCIAL RATIOS – THE CASE OF PRIVATE COMMERCIAL BANKS IN
ETHIOPIA**

**A Thesis Submitted to Addis Ababa University
College of Business and Economics in Partial Fulfillment of the Requirements
for the Degree of Master of Science in Accounting and Finance**

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**June, 2019
Addis Ababa, Ethiopia**

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Declaration

I, Manalebih Mequanint, declare that this thesis entitled “the Impact of International Financial Reporting Standard (IFRS) Adoption on Key Financial Ratios – the case of Commercial Banks in Ethiopia” is my original work and has not been submitted to Addis Ababa University or any other institution of higher learning as a project work and all sources of information have been duly acknowledged.

I have carried out the thesis work independently under the supervision of the thesis advisor, Degefe Duressa (PhD).

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Confirmation

This is to certify that Manalebih Mequanint has carried out this thesis work on the topic entitled the Impact of International Financial Reporting Standard (IFRS) Adoption on Key Financial Ratios – the case of Commercial Banks in Ethiopia under my supervision. This work is original in nature and submitted for the partial fulfillment of the requirements for the award of the Degree of Masters of Science in Accounting and Finance.

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Abstract

This study examines the impact IFRS adoption on key financial ratios on commercial banks in Ethiopia with objectives of ascertaining the role of IFRS for quality accounting information, identifying the sources of differences in financial reporting experienced by banks, examining whether the differences between GAAP and IFRS exist. The study employs a quantitative research approach based on financial information's and figures collected from banks annual audited reports. Sixteen banks were selected out of eighteen commercial banks. To understand the impact of IFRS adoption on banks financial ratios and figures, data were collected and summarized in excels, test and analyzed in SPSS. Figures and ratios were tested and analyzed through descriptive statistics, test of equality of means, median and variances and regression analysis. The descriptive statistics result indicates most of the range of values is larger in IFRS compared to that in GAAP. The test equality of means and medians results not statistically rejected for all figures .IFRS adoption does not change significantly, at the aggregate level. The median value of revenue indicates that there is no difference in Revenue between GAAP and IFRS, and Revenue does not have any impact on differences between ratios. Some financial statement figures decreased and others increase after the transition. Profit for the year increase and inconsistent to the research problems that profit decreases after the transition from GAAP to IFRS by banks. The IFRS values are not fully explained by GAAP in regression analysis. The study suggests that at the aggregate level, the analysis of medians and means of IFRS values is generally reliable; the volatility of accounting figures in IFRS is generally higher than GAAP. Various adjustments affect the differences between financial statement figures and ratios in IFRS and GAAP. It may be prudent to rely on cash flows to avoid the subjectivity inherent to accounting adjustments. IFRS adoption is new to Ethiopia, the impact of IFRS on financial statement figures, ratios, and earnings may not be observed and understood at this time and it needs further studies by taking more trend data in the future.

Key words: Banks, Financial Ratios, Financial Statements, IFRS

Acknowledgement

First, I thank the almighty God for guiding me all through the study. I would like to forward the deepest of my appreciation and gratitude to my advisor Degefe Duressa (PhD) for all his expert advice, guidance and encouragement during the development of my capstone. I would also like to thank bank staffs those who provide me appropriate report and documents. Finally, I want to say thank you to everyone who helped me during this study.

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Acronyms

AABE	Accounting and auditing Board of Ethiopia
ACCA	Association of Chartered and Certified accountants
FASB	Financial Accounting Standards Board
GAAP	General Accepted Accounting Principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
ROSC	Report on the Observance of Standards and Codes
SME	Small and Medium Enterprise
SPSS	Statistical package for social science
ICAA	Institute for Certifying Accountants and Auditors

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

International Financial Reporting Standards (IFRS) is the new dominant set of accounting standards developed under a rigorous due diligence process and now used in more than 120 countries around the world, including Australia, Brazil, Canada, the European Union, South Africa, Nigeria and many others (Tohmastu, 2013). It is also implemented in Ethiopia since 2017.

The Supporters of IFRS adoption argue that benefits will flow from expanded financial statement disclosures, improved measurement and recognition practices, and the narrowing of differences in company reporting arising when a variety of national GAAP is used (Schipper, 2005; Whittington, 2005). The acceptance is also based on the concept of convergence of accounting standards to minimize areas of differences in reporting formats across international borders.

Proponents of the globalized accounting standards also present numerous arguments and perceived economic benefits associated with the adoption of IFRS in to local jurisdictions. These arguments could be reasonable to countries with capital markets with a notion that IFRS is predominantly designed for capital market oriented economies (Zori, 2015)

The quality of financial reporting is essential to the need of users who require them for investment and other decision-making purposes (Fashina and Adegbite, 2014). Financial reports can only be regarded as useful if it represents the economic substance of an organization in terms of relevance, reliability, comparability, understandability, timeliness and simplifies interpretation of accounting numbers (Kenneth, 2012). If the IFRS adoption era, most countries had their own standards with local bodies responsible for developing and issuance of the local standards even if some of them align largely with the International Accounting Standards (IAS).

In Africa 19 of the 53(36%) countries have adopted IFRS. The momentum of Africa appears to be much slower than that of the rest of the world Jeff Van Rooyen (2011). A trustee of the International Financial Reporting standards Foundation and also an African saw the value of economic globalization for continent by stating the following: “The whole world is converging.

Africa needs to be part of this. In the case of Ethiopia is moving toward implementing IFRS within the next five years, this paper to assess the IFRS adoption progress in Ethiopia and investigate factors that motivate Ethiopia to adopt IFRS, and advantages and challenges ahead of IFRS adoption in Ethiopia. This study makes an effort to bridge this gap and tries to study the Ethiopian data with reference to IFRS adoption, benefits of IFRS for Ethiopia, challenges faced by the stakeholders in the process of adoption of IFRS, and the factors that affect the adoption. (IFRS, 2016).

Following the effects of globalization and the World Bank & IMF joint study of the Ethiopian accounting system (ROSC, 2007), now Ethiopia has already embarked on adopting IFRS formally in her accounting system by issuing proclamation No.847/2014 for financial reporting and regulation No. 332/2014 “for the establishment and determination of the procedure of the accounting and auditing board of Ethiopia”. As per the World Bank report (ROSC, 2007), significant gaps were indicated in the Ethiopian accounting system and financial reporting infrastructures and legal frameworks. Strong financial infrastructures and legal frameworks in a given jurisdiction could be prerequisites or preconditions that would be required for the effectiveness of IFRS adoption and implementation.

According to World Bank on the Report on the Observance of Standards and Codes (ROSC), there is no specific set of accounting regulations in Ethiopia and therefore accounting practices vary across institutions (World Bank, 2007).

But now the first financial reporting Federal state regulatory body is established for the first time in Ethiopia by regulation entitled Council of Ministers Regulation to provide for the establishment and to determine the procedure of the Accounting and Auditing Board of Ethiopia (Council of Ministers Regulation No. 332/2014) pursuant to Article 4(1) of the Financial Reporting Proclamation No. 847/2014. Accordingly, provision of Article 3(1) of this regulation describes that “The Accounting and auditing Board of Ethiopia (AABE) is hereby established as an autonomous government organ having its own legal personality.” AABE consists of 12 members which includes one representative from each of various Ministries.

1.2 Statement of the problem

Many countries have faced challenges in their decisions to adopt IFRS, its wide spread adoption has been promoted by the argument that the benefits outweigh the costs. Many jurisdictions have cultural, legal, or political obstacles to an immediate full adoption of IFRS (Wayne, 2010). Recently there has been a push towards the adoption of IFRS developed and issued by the International Accounting Standards Board (IASB). IFRS are attracting significant scholarly attention especially in markets where decision making on its adoption is approaching (Thi Phana and Mascitellib, 2014). There are some conducted researches, for example, a study to investigate the effects of IFRS adoption on foreign direct investment and Nigeria economy (Okpala 2012), The Impact of International Financial Reporting Standards (IFRS) Adoption on Financial Reporting Practice in the Nigerian Banking Sector (Matthew A.2015), Implementation of IFRS in Ethiopian Banks: An Assessment of Banks' Reluctance To Implement It, (P.Fareedmastan Zinabu G. A.Anuradha, 2015) and IFRS Adoption Progress in Ethiopia (Teferi D., J.S. Pasricha, 2016).

Various studies have been conducted to assess the impact of adoption of IFRS on key financial ratios in different countries and some of them are mentioned as follows.

A critical maintained hypothesis that undergirds the Barth et al. analysis is that adoption of IAS/IFRS constrains firms' accounting choices including discretionary accruals. Citing theoretical work by Ewert and Wagenhofer (2005), which shows that applying accounting standards that limit management's discretion should result in higher variability in accounting earnings, Barth et al. (2008) predict that firms that adopt IAS/IFRS will exhibit more volatile earnings (less smoothing) than firms applying domestic standards. If adoption of IAS/IFRS standards deters earnings management, they also predict Early Adopter firms will exhibit a lower (higher) frequency of small positive earnings (large negative earnings) in the post-adoption period relative to the pre-adoption period and relative to Non-IAS Control Firms. Consistent with their predictions, Barth et al. (2008) find that early IAS/IFRS-adopting firms exhibit less earnings smoothing, higher frequency of large losses and slightly lower (but insignificant) frequency of small positive earnings in the post-adoption period relative to the pre-adoption (local GAAP) period, but they find no significant over-time changes for the Non-IAS Control

Firms. Based on these findings, Barth et al. (2008) conclude that IAS/IFRS adoption deters earnings management (smoothing)

Christensen et al. (2015) argue that firms' orientation to external versus internal financing affects their incentives to adopt IAS/IFRS early and to be more transparent (less earnings management) in their reporting. Early adoption of IFRS and a commitment to greater transparency reflects a tradeoff for managers of losing their informational advantage over parties external to the firm versus the benefits from being able to attract external financing to exploit growth opportunities. These arguments lead Christensen et al. to predict that firms with greater insider orientation will be less likely to adopt IFRS early. Consistent with this prediction, they find that firms that delayed adoption (resisters) have more bank ownership (where information asymmetries are resolved through private channels), higher long-term leverage, issue equity less often, and have a higher proportion of shares that are closely held. They also find that firms that delayed IAS/IFRS adoption have lower analyst following, suggesting these firms face less demand for transparent information from the capital market.

Ahmed et al. (2013) compare earnings management (smoothing) metrics for a sample of 1631 Late and Mandatory Adopter firms from 21 countries that adopted IAS/IFRS standards for the first time in 2005 to firms from non-IFRS countries (largely firms from the US). They find that firms that adopted IAS/IFRS standards in 2005 exhibit greater earnings smoothing and lower frequency of large negative earnings relative to the benchmark control firms in the post-adoption period, consistent with greater earnings management (smoothing).⁶ Interestingly, they find that both IFRS adopters and benchmark control firms exhibit a significantly lower likelihood of reporting small positive earnings in the postadoption period relative to the pre-adoption period, which is inconsistent with greater earnings management. However, the difference between treatment and control samples is not significant suggesting that the decreased incidence of small positive earnings in the post-adoption period is more likely due to general economic trends than to newly-adopted accounting standard.

The government of Ethiopia passed the Financial Reporting Proclamation and Regulation in 2014 for the establishment and determination of the procedure of the Accounting and Auditing Board of Ethiopia which is in charge of coordinating the implementing IFRS in the country. Accordingly, banks, insurance companies and public enterprises are ordered to comply with the International Financial Reporting System (IFRS) within the deadline set for 2018.

After implementing of IFRS by commercial banks in Ethiopia, some banks complained that some key financial ratios are affected by the adoption of the IFRS and profits were declined compared to report prepared under GAAP basis in 2017/18. Zemen bank complained that its profit declined by 26 million birr (Reporter Amharic, Nov28, 2018), Dashen Bank (Reporter Amharic, Dec 2, 2018), and Bank of Abyssinia (BoA Annual report 2018).

Fewer numbers of studies have been carried out on the impact of IFRS adoption on profit and key financial ratios in Ethiopia. This study motivates the researcher because of the absence of studies in the area. This study makes an attempt to bridge this gap and tries to study the impact of IFRS on key financial ratios and financial statement figures by making survey and analysis to the case of commercial banks in Ethiopia.

1.3 Research Objective

1.3.1 General Objective

The main objective of this study was to compare the Impact of Adoption of International Financial Reporting Standards (IFRS) on financial statement figures via key financial ratios in the case of private commercial banks in Ethiopia.

1.3.2 Specific Objective

- 1) To compare debt ratio, return on assets (ROA), comprehensive-ROA, net profit margin, asset turnover, and the operating cash flow ratio between IFRS and GAAP results.
- 2) To identify the categories of adjustments in IFRS based financial reporting experienced by banks due to the changes in the requirement.

1.4 Research Hypothesis

The following research hypotheses were developed and tested.

H₁: There is a significance difference between IFRS and GAAP on debt ratio, return on assets (ROA), comprehensive-ROA, net profit margin, asset turnover, and the operating cash flow ratio.

H₂: The adoption of IFRS does not any significant effect on debt ratio, return on assets (ROA), comprehensive-ROA, net profit margin, asset turnover, and the operating cash flow ratio.

1.5 Significance of the study

The study would have many advantages for all practitioners and academicians by providing useful information about International Financial Reporting Standards adoptions on key financial statement figures and ratios. Findings of this study provide valuable information to investors, financial institutions and analysts as well as companies other than commercial banks, which still considering IFRS adoption and its impacts on financial statements and ratios, and to those who are not sure about the accounting consequences, and overall advantages and disadvantages. It will be also important for academic purpose by providing information in regard to statement of the problem. The study could also be used as an initiation for those who are interested to conduct a detailed and comprehensive study regarding to the impact of IFRS adoption to financial figures and ratios in Ethiopia.

1.6 Scope of the Study

This study focuses on the impact of IFRS adoption on selected commercial banks on financial statement figures and key financial ratios. The study focused on Commercial Banks in Ethiopia, based on audited financial statement for comparison of financial ratios under both GAAP and IFRS for the comparative year prior to IFRS adoption and the restated figures after IFRS adoption.

This includes 16 banks that are operated under the National Bank of Ethiopia and the unit of analysis for this study was annual audited financial reports that has issued by each commercial bank for the year ended July 07, 2018 or Sene 30, 2011 E.C.

1.7 Organization of the Research

Generally, the research is organized into five chapters. The first chapter presents background which continued statement of the problem and continued with the research questions, objective of the study, significance of the study, scope of the study and organization of the paper. The second chapter deals with the literature review and conceptual framework of the study. The third chapter is research methods, sample size and sampling methods, method of data collection, method of data analysis, data quality assurance and etc. The fourth chapter handles data presentation, analysis and interpretation. The fifth chapter wind ups the paper by summary of major findings, conclusion and recommendation.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

In this chapter the researcher included the background about the International Financial Reporting Standards (IFRS); IFRS adopted and used by financial institutions, the researcher also investigates about the factors that impact key financial ratios in adoption of IFRS and the relationship between the IFRS and its impact on key financial ratios on selected commercial banks.

2.2 International Financial Reporting Standards

IFRS are accounting rules (“standards”) issued by the International Accounting Standard Board (IASB), an independent organization based in London, UK. Before the inception of IASB, international standards described as International Accounting Standards (IAS) were issued by the IASB’s predecessor organization, the IASC, a body established in 1973 through an agreement made by professional accountancy bodies from Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland, and the United States of America. In 1997 after nearly 25 years of achievement, IASC recognized that to continue to perform its role effectively, it must find a way to bring about convergence between national accounting standards and practices and high-quality global accounting standards. The new Standards setting body was renamed as International Accounting Standards Board (IASB) and since April 2001, it has been performing the rulemaking function. Components of IASB structure contain- IASB, IASC Foundation, International Financial Reporting Interpretations Committee (IFRIC), previously Standing Interpretations Committee, SIC under IASC), Standards Advisory Council (SAC) and Working Groups. The IASB is better funded, better-staffed and more independent than its predecessor

Definition of IFRS is standards and rules for reporting financial information, as established and approved by the Financial Accounting Standards Board (FASB). IFRSs are issued by the International Accounting Standards Board (IASB), formerly known as International Accounting Standards Committee (IASC).

The main objective of the IASB is “to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions” (Epstein & Mirza, 2002).

To bridge the gap between accounting standards among countries, the IASC was founded in 1973 by a group of professional accounting practitioners. The IASC was to formulate uniform and Global accounting standards aimed at reducing the discrepancies in international accounting principles and reporting practices. In this light, the IASC was established. Since its establishment the IASC has actively been championing the uniformity and standardization of accounting principles for over two decades (Carlson, 1997). In April 2001, the IASB took over the setting of International Accounting Standards from the IASC. Thenceforth, the IASB updated the already existing International Accounting Standards and referred to them as International Financial Reporting Standards (IFRS).

IASB mission is to develop International Financial Reporting Standards (IFRS) that bring transparency, accountability and efficiency to financial markets around the world. IASB work serves the public interest by fostering trust, growth and long-term financial stability in the global economy (IFRS, 2015).

- IFRS brings transparency by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.
- IFRS strengthens accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. Our Standards provide information that is needed to hold management to account. As a source of globally comparable information, IFRS is also of vital importance to regulators around the world.
- IFRS contributes 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. (IFRS, 2015)

For many years, each country has had its own system of accounting standards and principles; however, as many companies became international, the workload to report financial statements multiplied. Not only were companies required to report financial statements using their home country's standards; but the company would also be required to report financial statements using the standards of all countries that were listed as exchanges (The unification of international accounting standards, 2007).

The IAS/IFRS (International Accounting Standards/International Financial Reporting Standards) consists of a set of international accounting principles, the adoption of which aims at establishing clear rules originally within the European Union to draw up comparable and transparent annual reports and financial statements (Cardozzo, 2008). Their adoption represents an essential element to obtain an integrated, competitive and attractive beyond the European capital markets. With the increasing internationalization of trading activities amongst countries of the world, necessitated by globalization, brings changes of the adoption and adaptation of local accounting practices and harmonizing it with that of the International Financial Reporting Standards (IFRS). According to (Nkundabanyanga, 2004) IFRS are accounting standards set up with an aim of harmonizing accounting procedure across the world.

IFRS are body of prescriptive rules and guidelines with global reach and appeal which provide direction and guidance on how business enterprises in a globalized world could achieve the goal of proper record keeping, transparency, uniformity, comparability and enhancing public confidence in financial reporting (Tendeloo and Vanstraelen, 2005). Thus, failure on the part of the firm to apply the requirements of IFRS would result in inconsistencies, lack of accountability and transparency, distortion in financial reports, which in turn results into poor financial reporting practices and dissemination of accounting information that is of less value to any particular group of users.

This is because the preparation and presentation of financial statements will be bereft of objectivity, reliability, credibility and comparability, and thus results in fraudulent business practices which subsequently lead to business failure and become devastating on the national economy (Atu et al., 2014).

According to IASB (2009), the IASB achieves its objectives primarily by developing and publishing IFRS and promoting the use of those standards in general purpose financial statements and other financial reporting. Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions. The term "financial reporting" encompasses general purpose financial statements plus other financial reporting.

IFRS set out recognition, measurement, presentation and disclosure requirements dealing with transactions and other events and conditions that are important in general purpose financial statements. They may also set out such requirements for transactions, events and conditions that arise mainly in specific industries. IFRS are based on the Framework, which addresses the concepts underlying the information presented in general purpose financial statements. The objective of the Framework is to facilitate the consistent and logical formulation of IFRS. It also provides a basis for the use of judgment in resolving accounting issues (IASB, 2009)

The globalization of international financial markets across the globe, the idea of adopting a common language for financial reporting to enhance international comparability has become widespread (Jeanjean and Stolowy, 2008). Countries have permitted their domestic companies to use International Financial Reporting Standards (IFRS), an international reporting language in recent years (Li, 2010).

The momentum of Africa appears to be much slower than that of the rest of the world (Jeff 2011). In the case of in our country review on accounting standards in Ethiopia conducted by World Bank and IMF in 2007, "Reports on Observance of Standards and Codes (ROSC)", indicated various issues in accounting standards in Ethiopia.

Following the effects of globalization and the World Bank & IMF joint study of the Ethiopian accounting system (ROSC, 2007), now Ethiopia has already embarked on adopting IFRS formally in its accounting system by issuing proclamation No.847/2014 for financial reporting and regulation No. 332/2014 “for the establishment and determination of the procedure of the accounting and auditing board of Ethiopia”. As per the World Bank report (ROSC, 2007), significant gaps were indicated in the Ethiopian accounting system and financial reporting infrastructures and legal frameworks. Strong financial infrastructures and legal frameworks in a given jurisdiction could be prerequisites or preconditions that would be required for the effectiveness of IFRS adoption and implementation.

Accordingly, as part of the World’s move towards financial reporting harmonization and global economic integration, and the improvement of the Ethiopian accounting and auditing practices, the World Bank provided policy recommendations to reconstruct the financial reporting and regulatory landscape in a way that is suitable to the adoption of IFRS and ISA. Specifically, the ROSC team recommended the issuance of the financial reporting proclamation and regulation as antecedents to IFRS adoption and as steps for the improvement of the Ethiopian financial reporting infrastructure and legal frameworks which would be important pillars for the adoption of IFRS in the Ethiopian economic environment whereby Ethiopia will have better financial reporting system that supports its economic activities.

The gaps indicated in this report are in the basic antecedents or preconditions of IFRS adoption. The policy recommendations provided by the World Bank are preconditions that are required to be implemented to institutionalize the Ethiopian financial reporting infrastructures and set up the regulatory frameworks in the context of IFRS adoption to integrate Ethiopia into the global economic system.

Currently, the IFRS adoption in Ethiopia, basically, being in its beginning stage is expected to have various issues to be studied and clarified based on international best practices and literatures. Hence, the IFRS adoption processes, rationales and debates for IFRS adoption in Ethiopia, implications and the way forward issues, and the impact of IFRS adoption on financial ratios are some of the untapped potential research areas that need to be clarified and articulated based on empirical evidences.

Having said so far, the researcher aims to explore the impact of IFRS adoption on key financial ratios in Ethiopia with a particular focus on the commercial banks, related issues and implications in reference to literatures, international best practices and Ethiopian contextual factors and in turn provide recommendations and insight potential research areas for further study.

2.3 Financial Institution in Ethiopia

The government of Ethiopia as a nation has expressed an initiative to integrate the financial statements of its companies with international standards. In our country most of organizations use GAAP for their financial reporting and there are very few companies use IFRS and among them most of the companies are financial institutions currently government enforce companies to use IFRS in their financial reporting. (Financial Institutions Audit Reports) Intention of the government to implement IFRS in Ethiopian share companies, including Banks and Insurance, is manifested by the issued Proclamation No. 847/2014 December 5, 2014 called “Financial Reporting Proclamation of Ethiopia” which obliges companies to follow IFRS in their financial statement presentation. The National Bank of Ethiopian (NBE) and the Securities and Exchange Commission also adopted this date for compliance and has issued guidance compliance circulars to ensure full implementation of IFRS in Ethiopia.

There are no extra requirements for banks and insurance companies for preparation of their annual financial statements. Banks and insurance companies are subject to regulatory laws and directives issued by the National Bank of Ethiopia, but there are no extra requirements in these laws or directives for preparation of annual financial statements. The applicable requirements for preparation of annual financial statements for banks and insurance companies are those provided in the Commercial Code.

The Commercial Code has no requirement for compliance with any defined accounting standards. Banks and insurance companies are public interest entities which should be subjected to high standards of financial reporting (World Bank, 2007).

Auditors for insurance companies are not subjected to any additional requirements other than the provisions of the Commercial Code.

The Proclamation for Licensing and Supervision of Insurance Businesses No.86/1994 states that the auditors for insurance companies shall have powers, functions, and duties; and be subject to liabilities and penalties under the Commercial Code. There are no other regulations for auditors of insurance companies (World Bank, 2007).

The Income Tax Law requires taxable income of businesses to be determined on the basis of financial statements prepared according to generally accepted accounting standards. The Income Tax Proclamation No. 286/2002 states that taxable business income shall be determined per tax period on the basis of the profit and loss account, or income statement, which shall be drawn in compliance with generally accepted accounting standards. The problem in this case is that ‘generally accepted accounting standards’ is not defined, and there are no accounting standards set or adopted in the country (World Bank, 2007).

2.4 Approaches to IFRS Adoption

Adoption of IFRS is more than just an accounting exercise. This is because accounting and reporting represent only a small part of the conversion efforts (AABE 2015). A country can change its existing accounting system to a globally recognized accounting standard called IFRS either by totally replacing or customizing it with IFRS over time. The first approach is known as adoption or ‘big bang’ approach while the latter is called a convergence approach. ‘Big bang’ approach is a strategic decision to adopt IFRS on a single date or, perhaps, a series of dates applied to companies of different sizes. Under this approach, once IFRS are adopted, all IFRS standards should be complied while preparing financial statements and the existing accounting standard should be replaced with IFRS; while in Convergence approach, gradual movement is made towards IFRS through customizing with the existing accounting standards and IFRS are applied gradually.

Converging a few local standards to IFRSs each year can allow local preparers and auditors to learn a few topics at a time rather than immersing themselves in the full set of IFRSs and convergence approach can also allow time for necessary changes in local legal frameworks (IFRS, 2013).

2.5 IFRS and Financial Reporting Quality

The quality of financial reporting is indispensable to the need of users who require them for investment and other decision-making purposes (Fashina and Adegbite, 2014). Financial reports can only be regarded as useful if it represents the “economic substance” of an organization in terms of relevance, reliability, comparability, understandability, timeliness and simplifies interpretation of accounting numbers (Kenneth, 2012). Before the IFRS adoption era, most countries had their own standards with local bodies responsible for developing and issuance of the local standards even if some of them align largely with the IAS.

However, all these studies refer to voluntary adoption of IAS/IFRS, which might be the result of corporate incentives to increase transparency. For instance, documents that the decision to report under IFRS is positively related to corporate size, the number of foreign equity markets on which the firm’s shares are traded and the additional issuance of equity shares (Ashbaugh, 2001). Similar findings are reported by (Cuijpers and Buijink, 2005) and (Gassen and Selhorn, 2006).

For a sample of European non-financial firms that voluntarily adopted IFRS, document that foreign listing and geographical dispersion of operations are important drivers. Findings therefore suggest that companies voluntarily shifting to IFRS have incentives to improve transparency and the quality of financial reporting (Cuijpers and Buijink, 2005). Along the same lines argued that foreign mutual fund ownership is significantly higher among IFRS adopters, which suggests a voluntary switch to IFRS aimed at attracting foreign investors by providing them with both more information and information that is more familiar to them (Covrig et al., 2007).

2.6 The impact of IFRS Adoption on Accounting Figures

Accounting theory argues that financial reporting reduces information asymmetry by disclosing relevant and timely information (Sun and Soderstorm, 2007). In general, “the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions” (<http://www.ifrs.org>).

There is a widely held belief by proponents of International Financial Reporting Standards (IFRS), that financial statements prepared for this purpose meet the common needs of most potential users (Barth et al. 2007). In principle, to provide a high-quality financial statement, which satisfies the above description, a company needs to be aware who the potential user is. In particular, we distinguish the following types of users: shareholders, investors; creditors; suppliers and trade creditors; employees; competitors; government and public.

Moreover, every user requires different type of information about the same item, as all of them have different needs, for instance, shareholders use the information from the financial statements in order to determine a company's financial position, and whether or not they are going to invest or disinvest in it; creditors use the information provided in financial statements to assess the capability of a company to repay its debt in the long-term; suppliers want to assess the capability of the firm to repay their invoices in the short-term before they decide to grant short-term credit; employees use financial statement data to get an idea about the financial health of the company; government use financial statements for several purposes, including for determining taxable income, controlling compliance with regulation or making decisions about government grants to certain industries. However, in most cases, not all the information required is likely to be included in the financial accounts, or is included, but in improper way. In principal, several common characteristics need to be satisfied.

Jendrichovska (2008) states that accounting information needs to be directed to the particular user, and due to this several general points emerge about the necessary features and general qualitative characteristics of accounting. Qualitative characteristics are the attributes that are crucial for decision usefulness (Obaidat A. 2007).

According to Jendrichovska (2008), accounting information needs to be relevant, as the accounting report must give the user what he/she wants and be useful for decision-making purposes. Information has the quality of relevance when it influences the economic decisions of users by helping them to evaluate past, present or future events or confirming or correcting, their past evaluations (Ibidem, p. 142).

Other important aspects of high-quality accounting are understandability and reliability of financial statements. According to Alexander et al. (2009), an essential quality of the information provided in financial statements is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, as they also point out, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

Further, as noted above, to be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended on by users to represent faithfully that which it purports to represent or could reasonably be expected to represent. However, information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading. Jendrichovska (2008) also believes that the information should be complete and objective, as it should provide a total picture of the reporting business, which implies a large and complex collection of data. More importantly, according to her, reports should not be biased by personal perceptions (information contained in financial statements must be neutral).

Another requirement is timeliness, as the information should be conveyed to the user in time for use to be made from it, because if there is undue delay in the reporting of information it may lose its relevance. However, the most vital aspect in her view is comparability of financial information, which generally brought about the idea of common accounting standards. Simply speaking, users must be able to compare financial statements of an entity through time in order to identify trends in its financial position and performance.

More importantly however, users must also be able to compare the financial statements of different entities in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way for different entities. This is without doubt the crucial issue the IASB needs to focus on.

Additionally, Alexander et al. (2009) list some other important qualitative characteristics (namely sub-characteristics) like, materiality, prudence and substance over form. In their view, the relevance of information is also affected by its nature and materiality. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. However, as they believe, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have to be useful. Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. If information is to represent faithfully transactions and other events that it purports to represent it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

A substantial number of qualitative characteristics can be identified and all of them have some stake in the overall result – high quality financial statements. In practice, it is hard to clearly state which characteristic is most important and which less, that is why, a balancing between qualitative characteristics is often necessary (Jendrichovska, 2008). Therefore, the aim of standard setters is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial statements. However, the relative importance of the characteristics in different cases is a matter of professional judgment (Alexander et al. 2009).

To satisfy all those aspects International Accounting Standards Board (IASB) is working to constantly develop and standardize financial reporting, so all financial statements can be understandable and capable to supply accurate and reliable information to all interested parties and due to this, give them a chance for better decision-making.

Sun and Soderstrom (2007) summon that historically, legal systems combined with other political and economic differences, created a vast diversity of accounting systems, which makes meaningful comparison of financial reports across borders difficult. Due to this, accounting practices, regulations and the mode of volume of regulations, were different. However, in today's global economy, higher integration, instant communication, and a global capital market, this situation has changed sharply (Alexander et al. 2009).

According to Lantto and Sahlström (2009) about 7000 publicly traded European firms were obligated to adopt IFRS in 2005. For some companies this is radical change, which application requires a considerable effort. But, this considerable effort is going to be rewarded, because as Dunne et al. 2008 state, the idea to adopt IFRS by UE countries is supported by the following benefits: improvements of investor protection, capital market more accessible for foreign investors, improved comparativeness, comprehensiveness, and quality of the financial information. However, those are only general and long-term effects caused by adoption of IFRS.

To fully understand the reason of those long-term effects, an analysis in determining the impact of IFRS adoption on accounting numbers need to be performed. To make this analysis more effective, first of all, the theoretical background and origins of national differences in accounting need to be introduced, as it will ease the understanding and reasoning of the differences in national GAAPs.

In the next sub-chapter, I describe the reasons of international accounting differences in general and the global process of harmonization. Further, I focus on the reasons of international accounting differences between GAAP and IFRS by pointing out standards where differences are noticeable. This gives the reader better understanding of the general accounting principles under GAAP and IFRS as well as an indication of possible differences in financial statements numbers.

2.7 International Accounting Differences

Although accounting standards are crucial determinants of financial reporting quality, they differ across countries producing differences in financial statements quality around the world. Simply, we can interpret international accounting differences as a different option adopted by different nations to address the same accounting issues (Alexander *et al.* 2009). Dunne *et al.* (2008) addressed some aspects, which to high extent may produce the international accounting differences. So, they believe that financial reporting is influenced by: the development of the capital markets in a country, the role of finance, the role of state, the accounting profession, commercial law and taxation.

Further, Ding *et al.* (2007), state that a commonly held belief is that such differences reduce the quality and the relevance of accounting information. Moreover, due to the differences in accounting systems, the comparability of financial information published by companies using different sets of standards is at a very low level and because of this low quality, which eventually is unfavorable for shareholders and other external stakeholders.

Companies are becoming more and more international, and to finance their international expenditures they are willing to raise capital on the different capital markets worldwide (Alexander *et al.* 2009). That is why, an increasing number of internationals insist on more harmonization of accounting standards, which, as it was mentioned earlier, would increase the comparability of financial information and would create more transparency for the users of financial information. As a result, the information asymmetry between stakeholders and the companies would decrease, which ultimately will enhance the market participant's wealth by lowering the cost of capital and creating new opportunities for diversification.⁶ Briefly, both sides (companies as well as all external stakeholders) are better off.

The information provided by annual statements is used for decision-making purposes, and due to different accounting standards, legal systems, culture, this information may be communicated in a different way, and very often might be misleading when comparing financial statements under two different accounting standards (Daske *et al.* 2008). On the other hand, useful accounting information presented in annual reports, is the information which can be compared to the certain benchmark (i.e. other companies). To compare financial reports, which are the reflection of transactions and events as recorded under a particular accounting policy, it is crucial that the accounting policies do not differ to such an extent that the comparison of financial reports is meaningless.

However, as it will be shown in the subsequent section, despite the widespread process of harmonization initiated by International Accounting Standards Committee (IASC) and followed by International Accounting Standard Board (IASB) the national differences in accounting standards still play a role.

2.7.1 Origin of National Differences

As it was noted earlier, historically, accounting and reporting grew up largely independently and often very differently in different countries. Practice, regulation and especially the mode of regulation differed often very greatly (Jindrichowska J., 2004).

Generally, according to Alexander *et al.* (2009), financial reporting is a way of communication between sender and receiver. In the past, this form of communication was straightforward, because was only based on internal basis, for instance, owner of the company would get an insight into his/her income and capital. However, from the early 1800s, increasing number of companies encountered some problems to finance their new business activities and generally to grow, because of limited financial resources (Alexander, 2009). The solution was a capital market which enabled every firm to gather additional capital outside the company. Due to this, as more and more stakeholders were interested how the company is performing, how strong financially it is, external financial reporting started to evolve, to eventually satisfy all interested parties.

However, at that time, the capital markets were not so integrated as they are today, moreover, every country have had different national characteristics and due to this, a standard setter have chosen accounting policies that best fitted their national environments. In this case, over the time, those national differences in financial reporting have become problematic due to the process of globalization of financial markets, because the external reporting provided only the information within the borders of a specific country (Alexander et al. 2009). That is why, the idea of harmonization of accounting standards appeared, with the main goal of building a new common standard reporting, which would be acceptable around the world, and which would provide forward-looking information that could improve the predictive ability of financial statements for users and enable a better analysis of company performance.

The recent empirical evidence suggests that the main causes of differences in accounting standards are: provision of finance, the existing legal system and cultural differences between societies. A further exploration of those factors can provide insight into differences in the economic consequences of changing accounting principles across countries. That is why, it is crucial to describe them in more details.

a) Provision of Finance

The difference in providers of finance creditors/investors versus equity/outside is the key cause of international differences in financial reporting. As it was noted earlier in this thesis, in the past companies faced the problem to develop and to finance new business activities. On one hand, companies in countries like Germany, France, Italy or Belgium relied on debt as an additional source of financing, and that is why, banks became the major supplier of extra funds in these countries. On the other hand, countries like United Kingdom or USA relied more on equity, thus shareholders provided a necessary funds. Due to this, as we can see now, in those countries capital markets are much more developed than in those where banks were a leading provider of capital.

In countries where equity is used by companies as a main source of additional financing, financial statements will have an investor or shareholder orientation, therefore the interest of this investor class dominates, and financial reporting is typically geared towards meeting the needs of these users, and due to this is required to provide a high quality accounting information to simply enable potential shareholders to make the best investment decisions.

On the contrary, in countries where centralized and familial ownership prevail and where companies rely more on debt financing, lower accounting quality is identified (Alexander et al. 2009). The reason is that debt-oriented companies care only about creditors (banks) as they are considered to be the main recipients of corporate financial statements and that is why; create reports only to satisfy their needs, for instance, to show that they are able to pay off their debt. In this environment the primary users are less interested in detailed financial statements as they have direct access to detailed information regarding a company's performance (Dunne et al., 2008).

In contrast, a market-oriented companies which rely on equity to finance their business activities, and where every single shareholder is in part the owner of the firm, are required to include more information to, first of all, satisfy existing shareholders, and secondly, to attract new.

Generally, we can state that in those countries with the strong capital market influence and strong investor protection, the quality of accounting information is higher than in countries with a creditor orientation (Ibidem, p. 23)

b) Existing Legal System

We can distinguish two existing legal systems: a common law system and a code law system, which were originated in different parts of the world.¹¹ Lantto and Sahlström (2009) investigated that the differences in legal systems to some extent produce the differences between IFRS and Generally Accepted Accounting Principles (GAAP) of continental European countries, and that is why, existing legal system is another very important and influential aspect which affect the differences in accounting standards worldwide.

The code law system originated in Roman law and has developed in continental Europe (in countries like, Germany, France, Italy, Belgium and so on). This system is characterized by wide sets of rules which aim is to provide guidance in all possible situations. Due to this, a company's law in this system is very detailed and heavily regulated. Moreover, accounting regulation in a code law country is in the hands of government, and due to this the legal provisions govern, to varying degrees, the financial reporting process. In this case, in countries with code law system, the standards are not compulsory, but they have an integrative and interpretative function with respect to the provisions of the law (Dunne *et al.*, 2008). In contrast, the common law system, which was originated in England, can be simply described as a legal system that is developed case by case and does not prescribe general rules that could be applied in several cases. In general, in a common law situation accounting rules are not a part of the law, because accounting regulation is in hands of professional organization of the private sector.

This means that financial reporting is less heavily regulated by statute and permits the exercise of judgment, although legal organization holds that compliance with accounting standards is necessary to satisfy the general requirements of the law (Dunne *et al.*, 2008). Consequently, common law countries, which are characterized by an efficient equity market, are likely to exhibit greater shareholder protection and higher level of transparency than code law countries because their public shareholders are more willing to provide funding to companies (Ding *et al.* 2007).

Moreover, in their study, Ding *et al.* (2007) and Hope (2007) confirmed the importance of legal systems. They also reported that this fundamental difference in legal origin has an impact on the role played by accounting information.

They explained that in common law countries firms deal with other parties such as investors at arm's length, which generated demand for information on firm performance and that is why, we can expect a high accounting quality in this case. On the other hand, in code law countries, there is a greater degree of insider owners, such as banks, who get the information directly from management – or may even participate in firm decision making through board membership (Hope, 2003). Consequently, accounting quality is lower than in countries with common law system. This legal system is a leading one in countries like, United Kingdom, United States, Australia, Canada or New Zealand.

c) Cultural Difference

According to Hope (2003) it is obvious that the environment in which firm operates affects financial reporting and disclosures. Finch (2009) defined culture as ‘the collective programming of the mind which distinguishes the members from one human group from another’. Moreover, he noted that each human group shares its own social norms, consisting of common characteristics, like for instance a value system.

Generally, researches indicate that another cause of variation between national accounting systems are cultural differences.¹² Furthermore, it is said that cultural differences is also a very important and influencing factor on reporting and disclosure behavior with regard to financial statements, as accounting values, which are based on unique social values in a particular country affect accounting systems.

There are huge cultural differences and there is no doubt that reducing those differences is a very demanding and time-consuming process, even in the globalized and integrated economy. To show existing cultural differences, Hofstede (2008) in his large-scale cross-cultural study classified countries according to the cultural differences he observed in his study. In his view, the main cultural differences between countries are:

- Individualism versus collectivism
- Large versus small power distance
- Strong versus weak uncertainty avoidance
- Masculinity versus femininity

We need to be aware that local values still, to high extent affects financial reporting, and due to this produce differences between financial statements in different countries. However, this impact is gradually reduced due to more and more globalized economy. Understanding the importance of cultural differences is a crucial factor which needs to be taken into account in the international accounting harmonization process, to eventually ensure the comparability of international financial reporting impact is gradually reduced due to more and more globalized economy. Understanding the importance of cultural differences is a crucial factor which needs to be taken into account in the international accounting harmonization process, to eventually ensure the comparability of international financial reporting.

As the companies have become more and more internationalized, the national differences play a less significant role in financial reporting. Nowadays, for large companies the location of the company is no longer the sole influencing factor on the reporting behavior of the company (Jindrichowska J., 2004). However, this is not always the case.

2.7.2 Differences in Accounting System

As we can conclude from the previous sub-chapters of this thesis, the differences in cultural, economic, legal and political environments produce different accounting systems, and obviously similar environments produce similar accounting systems.

That is why, in this section I focus on differences in accounting systems by describing two elements that characterize accounting systems: the organization of accounting regulation and the organization of the accounting profession. Those two elements are very important factors showing how accounting systems have developed in particular countries, and due to this indicate the possible differences in financial reporting.

In countries where shareholders are the main providers of capital, we can expect that the financial statements are prepared in a way, in which information about a company's financials is detailed and with a high quality. Due to this every potential investor or existing shareholder can, for instance, evaluate the company and based on the evaluation decide whether it is worth to invest or not.

Generally, to make sure that the financial information provided by the company is trustful, professional accountants are hired to check the quality of the information on the shareholder's behalf and that is why, professional accountants have started to play a major role in the standard-setting process (Jorison A.2009).

On the other hand, in countries with a credit orientation and code law system the government is a main user of financial information as in those countries the annual accounts are often used for tax purposes. Ding et al. (2007) investigated that a stronger, more developed accounting profession is more likely to be associated with the development of more rigorous and sophisticated accounting standards, than in countries with a weak accounting profession.

Taking into account all the information provided so far, we can state that there are countries in which accounting regulation is in the hands of the private sector, for example, the UK, the USA, the Netherlands or Australia. In these countries private standard setting goes together with a shareholder's orientation of the financial information published, and in most countries, common law system. In contrast, there are countries in which the government plays a major part in accounting regulation, and this system is observed in many continental European countries. In those countries, detailed accounting rules are embodied in the law, normally the company law.16 However, due to compulsory introduction of IFRS a substantial number of countries with diverse backgrounds, now operate in similar settings with regard to accounting regulation (Dunne et al. 2008).

That is why, there is no doubt that for some countries (especially with credit orientation and code law system) the adoption of market-oriented IFRS may be problematic and more importantly, may produce some differences in accounting numbers (Iantto and Sahlström 2009).

2.7.3 Characteristics and Differences in National GAAP

In general, the difference in accounting systems produces different national or domestic accounting standards. To illustrate it more widely, and at the same time conclude the main Causes of differences, we should consider the following points:

2.7.3.1 Shareholder orientation versus Stakeholder orientation

In countries with widespread ownership there is a need for high-quality published financial information (Alexander et al. 2009). This is simply due to the fact that all existing as well as potential shareholders do not have access to internal information, which is necessary to evaluate a financial health of the company. Moreover, every shareholder is, to some extent a co-owner of the company and has a legal right to be fully informed. On the other side, we have countries where companies are mostly financed by debt, and in these countries, financial statement information is usually not fully disclosed, as the main receivers are creditors and also, the government.

2.7.3.2 Fairness versus Legality

In common law countries the aim of financial reporting is a fair representation of the financial situation of the company. In the UK this is translated into the ‘true and fair view’ (Ibidem, p. 31) In contrast, in code law countries financial reporting is focused on compliance with the legal requirements and tax law.

2.7.3.3 Conservatism versus Accruals

In countries in which financial reporting is more creditor-oriented (in most cases code law system), and used mostly for tax purposes, valuation values will be more conservative or prudent than in countries with a shareholder orientation (common law system) (Dunne et al. 2008). These two approaches may lead to a different choice in accounting practices.

Generally, conservative accounting is often regarded as a system in which lower profits are reported than under the system driven by accrual accounting – anticipate no profits, but anticipate all losses (Watts, 2002). The most common practices of conservative accounting are: choosing LIFO as opposed to FIFO accounting for inventory, rapid write-offs of intangibles or expensing (as opposed of being capitalized) of start-up costs. It is worth noting, that due to the extensive use of depreciation and provisions, companies which use a conservative accounting, are able to increase results in periods with weak economic performance.

2.7.3.4 Consolidated Accounts

In countries where financial reporting has a strong shareholder orientation, the practice of preparing and publishing consolidated financial statements emerged much earlier than in code law countries, which usually are creditor-oriented. Due to this, in the shareholder-oriented countries consolidated financial statements are much better developed.

2.7.3.5 Deferred Taxation

In countries with no direct link between tax income and accounting income, the practice of recording deferred taxes on the balance sheet is well-established and common practice. For countries in which there is no strong link between accounting income and tax income, the practice of recording and calculating a deferred tax is relatively new. What is more, in the individual accounts of companies in those countries the amounts recorded under deferred taxes will be rather small.

In the 1980s through the enactment of the Fourth Directive in European Union countries and in the 1990s under the pressure of globalization of capital markets, national accounting practices started slowly to move towards each other (Alexander et al. 2009). This development is still going on and some differences have already become less noticeable or have almost disappeared for certain categories of companies or for certain financial statement items. Recently, more and more companies have sought dual listing (national GAAP and additionally IFRS), as this move has enabled them to enter the capital market abroad and due to this acquire more capital for further development (Ding et al. 2007).

Also, a large number of multinational companies have fully switched to IFRS, as they perceive it as a long-term benefit and, as empirical research results show, the capital markets usually react positively to the voluntary switch, as in general, capital markets believe that IFRS adoption results in a reduction in information asymmetry between firms and investors. Moreover, as more information is incorporated into the financial statements under IFRS, the financial information is becoming more predictable, which eventually improves accuracy of analyst's earnings forecasts and due to this, investors are able to make a better as well as less risky investment decisions (Ashbaugh and Pincus, 2000).

Consequently, IFRS adoption is a kind of win-win strategy, because converting to high-quality accounting standards like IFRS enables investors to make better investment decisions, and for companies it gives an opportunity to attract international capital, as they are able to increase a comparability of their financial information worldwide. Due to this, they can get an additional capital, which is necessary to grow faster. However, according to Brice (2009), there are also some other important long-term benefits from the point of view of the company:

- IFRS potentially better reflect the underlying economics of a transaction;
- IFRS facilitate improved communications with analysts, investors, financial markets and other users of financial statements;
- IFRS improves customer recognition;
- IFRS reduces the political costs of transacting business abroad
- the conversion process in an appropriate time to re-engineer information system, internal management reporting and internal performance measures;
- It is an excellent opportunity to ensure that financial information is obtained in the most effective and efficient way.

But we need to be aware that disadvantages also exist. Barth et al. (2007) found that after IFRS adoption firms have higher variance of changes in net income, a higher ratio of variance of changes in net income to variance of changes in cash flows, higher correlation between accruals and cash flows, lower frequency of small positive net income and higher frequency of small losses.

In general, the possible disadvantages of IFRS adoption are:

- the introduction of IFRS will change the reported results and financial position of the business and potentially introduce greater volatility into reporting thus making it more difficult to judge a company's performance;
- IFRS conversion is likely to place additional burdens on existing resources;
- IFRS can be more complex to apply on an ongoing basis especially with rapid changes in requirements;
- Generally, the conversion to IFRS will have a unique repercussion for each country, depending on how each national GAAP differ.

According to many recent papers IFRS introduce a high-quality accounting (Alexander et al. 2009; Dunne et al. 2008; Barth et al. 2007; Armstrong 2010; Iatridis 2010; Li 2010; Sun and Soderstrom, 2007). That is why, we can state that International Accounting Standards (IAS) can be defined as follows: ‘Financial reporting quality relates to the usefulness of financial statements for contracting, monitoring, valuation and other decision-making by investors, creditors, managers, and all other parties connected to the firm’.²² Generally, the more qualitative accounting standards, the more they are useful to all interested stakeholders. What is more, due to high quality standards, companies are also better off. It is worth to add that, empirical and theoretical evidence suggest that higher disclosure quality is generally beneficial for companies as it makes obtaining capital cheaper (Christensen et al., 2007).

Moreover, as Iatridis (2010) noted in his study, the higher quality of IFRS financial reporting would enhance the credibility of firm’s financial statements, and would in turn provide lenders with more certainty and information about the ability of firms to timely meet their financial obligations, leading thus to better borrowing terms.

However, despite the global harmonization process of reporting practices, we can still notice some national influences of reporting practices (see Lantto and Sahlström, 2009), which means that there are still some challenges to face for IASB. There is no doubt, that due to those differences, the comparison of financial statements worldwide might be misleading, and all investors, analysts, managers should take it into account in their decision-making process.

The quality of accounting is determined by the quality of the accounting standards chosen (Sun and Soderstrom, 2007) and in this case, the IASB should continue to improve the quality of IFRS, so financial reporting under IFRS will become increasingly value relevant and reliable, and that all previously stated benefits are in place. This eventually will ease the process of elimination of national differences as more and more companies (as well as national regulators), will switch to IFRS to benefit from it.

2.8 The Process of Harmonization

Proponents of harmonized international standards claim that if all firms follow the same set of accounting standards, external financial reports of firms would provide uniform disclosures and more useful accounting information to investors (Ding et al. 2007). Not only the process of harmonization of financial reporting practices will reduce diversity, but also facilitate cross-listing and cross-border investment (Sun and Soderstrom, 2007).

Sir David Tweedie the first and the current chair of the IASB, considered that a more uniform approach to standard setting would gain investor confidence and help multinationals achieve benefits in the preparation of their financial reports by using one approach to income measurement (Dunne et al. 2008). He argues that a company's cost of capital would be reduced as a result of applying IFRS because investors would be able to understand all company's reporting rules (Dunne et al. 2008).

A further argument in favor of IFRS is that the provision of more forward-looking information may improve the ability of users to monitor management performance, as the introduction of fair value allows for better assessment of manager ability. Eventually, due to smoother communication between managers, shareholders and other interested parties, agency costs would become lower, which will lead to lower cost of debt financing (Iatridis, 2010). In general, to achieve all those benefits, the process of harmonization needs to accelerate and according to Das et al. (2009), this is going to happen in the coming years, as convergence initiatives are now working much more effectively than ever before.

There are a number of definitions describing the process of harmonization. Jindrichowska (2004) describes accounting harmonization as a common movement among accounting regulators, standard-setters and educators in different nations towards the same goal. This clear description indicates that to achieve the goal and eventually introduce one set of accounting standards worldwide, a lot of different parties need cooperate closely with each other and what is also very important, factors like, and cultural differences need to be eliminated or at least minimized. That is why, even though the process of harmonization has started many years ago, the differences are still noticeable.

Interestingly, as some researchers suggest, the national characteristics are so strong, that they are even visible under one accounting system (IFRS), for instance, IFRS do not prescribe a particular format for the presentation of the income statement. Consequently, as different formats of income statements are allowed, cultural differences may to some extent affect the income statement's presentation under IFRS, which ultimately might decrease the level of comparability between countries (Hossfeld Ch., 2011).

From the 1970s on, a movement towards harmonization of financial reporting started slowly to emerge. First attempt of making financial reports more comparable across countries was made by the European Commission (EC). The Fourth Directive enacted in 1978, and the Seventh Directive, enacted in 1983, were the most influential directives during the early stages of financial reporting convergence within the European Union. The most important effects of both directives are the adoption of TFV (True and Fair View) and relaxation of book-tax conformity for consolidated accounts (Sun and Soderstrom, 2007).

Further, from the 1990s under pressure from multinational companies seeking dual listing to attract capital, the request of one set of GAAPs to be applied, not only within EU, but worldwide emerged. However, as attempts for worldwide harmonization and standardization are undertaken, national institutional differences still influence, to some extent, the output of the financial reporting process and that is why, there is still a lot to do, to minimize, and eventually eliminate these differences. The European Commission's directives were the first step towards accounting harmonization and provide useful insight into the difficulties of the process.

Following the European Commission, The International Accounting Standard Board (IASB) and its predecessor the International Accounting Standard Committee (IASC) pursue the harmonization of fully transparent and equity market friendly international accounting system, which is widely viewed as reflecting a common law system (Ball et al. 1999). Generally, IASB is an independent, not-for-profit private sector organization working in the public interest. The IASB is responsible for the development and publication of IFRSs, including the IFRS for Small and Medium Enterprises (SMEs) and for approving interpretations of IFRSs as developed by the IFRS Interpretations Committee (formally called IFRIC).

To improve financial communication, by providing reliable, understandable and comparable reports, which satisfy the interest of all the users of financial reports, the IASB engages closely with stakeholders around the world, including investors, analysts, regulators, business leaders, accounting standard setters, and the accountancy profession to create a set of financial reporting policies which require increased disclosure and strict choices of measurement methods (Ashbaugh and Pincus, 2000). In principal, the IASB's objectives are:

- To develop, in the public interest, a single set of high quality, understandable and enforceable global standards that require high quality, transparent and comparable information;
- To promote the use and rigorous application of those standards;
- To take account of the special needs of SMEs and emerging countries;
- To bring about convergence of national accounting standards, IAS and IFRS to high quality solutions.

In 1989 the Framework for the Preparation and Presentation of Financial Statements was issued by IASB. This conceptual framework which applies to the financial statements of all commercial, industrial and business reporting entities is considered as a guide to standard setting, so that standards are formulated on a consistent basis and not in an ad hoc manner. Moreover, through the framework, the IASB is willing to identify good practices from which principles are derived. Due to this, all international standard-setters are able to comply with IFRS, and more importantly, introduce an accounting standard in their jurisdictions which are consistent with IFRS. Ultimately, the IASB's conceptual framework is an effective tool to accelerate the global process of harmonization. In general, the purpose of the framework is stated as follows:

- To assist the board of IASB in the development of future IASs and in its review of existing IASs;
- To assist the board of IASB in promoting harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by IASs;
- To assist national standard-setting bodies in developing national standards;
- To assist preparers of financial statements in applying IASs and in dealing with topics that have yet to form the subject of an IASs;

- To assist auditors in forming an opinion as to whether financial statements conform with IASs;
- To assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with IASs;
- To provide those who are interested in the work of the IASB with information about its approach to the formulation of accounting standards. (Alexander D., Britton A., Jorisson A., 2009).

Additionally, the Framework discusses the various assumptions of accounting statements to show the rules on which accounting standards are built. The underlying assumptions are: accrual basis and going concern. As those are the fundamental aspects of IFRSs, it is worth to review them more closely.

In order to meet the objectives of IASB, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognized when they occur (and not, like many recent accounting principles states, as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis informs users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about the transactions and other events that is most useful to users in making economic decisions.

Therefore, under IFRS, the financial events are likely to be incorporated in a more timely fashion in the financial statements (Iatridis, 2010).

Another fundamental assumption is going concern. Generally, financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. That is why, it is assumed that the entity has neither the intention nor the need to liquidate or restrain materially the scale of its operations. However, if such an intention or need exist, the financial statement may have to be prepared on a different basis and, if so, the basis used is disclosed (Ibidem, p. 141).

All accounting standards are prepared in a way, that the information about company's performance is reliable and of high quality.

As many researchers suggest, IFRS adoption is beneficial for the company as this application is positively welcomed by investors. And again, this is mostly because of the fact that, based on IASB framework, IASs are created in a deliberate and standardized way, and are aimed to fully satisfy all interested parties. Moreover, what was also mentioned earlier, as all financial statements under IFRS include more reliable and high-quality information, the company's cost of capital will decrease, as it is less risky to invest in the entity which is transparent (Li, 2010 and Armstrong et al., 2010). More and more firms recognize this benefit, and that is why, not only in Europe but also on a worldwide scope more and more companies are switching to IFRS, for instance, Australia and New Zealand have now to comply with IFRS. Moreover, there are also some countries where the domestic GAAP is identical to the IFRS, for example, South Africa, Singapore, the Philippines and Hong Kong (Ibidem, p. 37).

All in all, over 100 countries now use IFRS and there is no doubt that a worldwide use of IFRS increases and will be increasing in near future, since regulatory authorities in a number of countries have decided to move toward compulsory application of IFRS for listed groups. Alexander et al. (2009) in his book listed those countries. Consequently, he noticed that IFRS adoption increases in Asia as well as in the Americas, for instance, in Korea, from 2009 any company can choose to apply IFRS, and from 2011 the adoption has become mandatory for all listed companies.

Furthermore, from 2009 all Chinese central-level state-owned enterprises and large to mid-scale companies adopted new Chinese's accounting standards that comply with IFRS. What is more, in Brazil, all banks need to comply with IFRS from 2009 onwards, and listed companies from 2010 onwards. This process is gradually spreading to different parts of the world.

However, as Dunne et al. (2008) noticed, there are a number of countries which still have not signed up to use the IASB's standards. The US is one major economy that have not yet agreed to adopt IFRS. Instead, it kept its own standards issued by the Financial Accounting Standard Board (FASB). But, the Securities and Exchange Commission (SEC), which oversees the FASB, has been supportive of cooperation between the IASB and FASB to minimize differences

between the different accounting rules. Consequently, significant progress towards the harmonization of international accounting standards has been made. This suggests that many commentators and companies have identified potential benefits of IFRS adoption (Dunne et al. 2008).

This sub-chapter has provided a brief background of history and understanding behind current international accounting developments, with an emphasis on the increasing importance of IASB. Thirty years ago, the EU started with the harmonization of financial reporting. The EU changed its accounting strategy in the mid-1990s and started to back the efforts of the IASC and later the IASB. The new accounting strategy of the EU, the acceptance by the International Organization of Securities Commission (IOSCO) of International Accounting Standards (IASs) for listing purposes and the change in the structure in the international standard setter in 2001 paved the way for the IASB to become a global standard setter.

The process of harmonization is still continuing, and there is no doubt that it will take a lot of time and efforts to completely harmonize accounting standards worldwide. According to many recent papers, at this moment in time, we can still notice some differences between IFRS and national GAAP. In some cases, those differences are quite substantial, like for instance, between IFRS and continental Europe countries (see Lantto and Sahlström, 2009), but in other cases, the logic says that the differences should be less substantial or not present at all like in the case of IFRS and GAAP which are both shareholder-oriented. But, is this really the case? Is it really no differences between IFRS and GAAP?

To find the answer for his questions, in the next sub-chapter I take a closer look on IFRS and GAAP and try to explain a possible difference in accounting standards, which eventually may have an impact in financial statements items.

2.9 Major differences between U.S. GAAP and IFRS applications

While the wide adoption of IFRS in Europe and other non-U.S. countries created the need for quality, consistent, harmonized set of international standards in the U.S., it is easier said than done. In its July 2012 Work Plan, the SEC created a list of the major differences between U.S. GAAP and IFRS applications and these are presented as follows.

Rules versus principles-based standards: The fundamental difference between the two sets of accounting standards is that the U.S. GAAP is a more detailed, rules-based set of standards while the IFRS is more of a principles-based set of standards. Therefore, E.A. Hlaciuc, V.A. Grosu, M.A. Socoliuc and G.A. Maciuca (2014) point out that the fundamental rules versus principles-based nature of the U.S. GAAP and IFRSs respectively, have resulted in differences in terms of some definitions of financial accounting terms and concepts, their recognition, assessments, alternatives, lack of requirements or recommendations, as well as differences in presentation.

Revenue recognition: The current revenue recognition guidelines for U.S. GAAP are very detailed, elaborate and industry-specific. On the other hand, for IFRS, there are two primary revenue standards and four revenue-focused interpretations, most of which can be broadly interpreted and applied without industry-specifications (PWC or Price Waterhouse Coopers, 2014). For example, “U.S. GAAP guidance on software revenue recognition requires the use of vendor-specific objective evidence (VSOE) of fair value in determining an estimate of the selling price” unlike IFRS (PWC, 2014). Another example is that contingent pricing is not recognized as revenue (till the contingency is resolved and the revenue amount is fixed and realizable) unlike IFRS and therefore this impacts the timing and amount of revenue recognized under the two standards (PWC, 2014).

Research and development: As per U.S. GAAP, all research and development costs are expensed, while under the IFRS, certain research and development costs are allowed to be capitalized. This can cause significant differences in the timing and capitalization of research and development costs thereby impacting the subsequent amortization of the assets over their useful lives.

Impairment: As per U.S. GAAP, when assets are impaired, the treatment is considered permanent, while as per IFRS, impaired assets may be revalued.

Certain nonfinancial liabilities: Unlike IFRS, U.S. GAAP has a higher threshold for recognizing a probable contingent liability, as well as costs associated with disposal (as in a restructuring).

Inventory: As per U.S. GAAP, cost of inventories can be computed using LIFO (Last in first out), FIFO (First in first out) or weighted average method. However, under the IFRS, cost of inventories cannot be computed using LIFO. This non-allowance of LIFO could have a significant impact on the operating results (and income taxes payable) for cross-border companies following the IFRS in the U.S.

Measurement of certain asset classes: Unlike IFRS, U.S. GAAP does not allow capitalization of certain types of assets, like the capitalization of internally developed intangibles and some property, plant and equipment. U.S. GAAP also allows the cost model to measure investment properties (unless the company meets certain criteria), unlike the IFRS, which allows for cost or fair value.

Income Taxes: For income taxes, fundamental differences exist in methodologies used under U.S. GAAP and IFRS. For instance, U.S. GAAP specifically addresses certain Uncertain Tax Positions (UTPs), while IFRS uses the general contingency model, which not only creates differences in the amounts of taxes, but also requires different disclosure requirements for UTPs.

Property, plant and equipment (PP&E): As per U.S. GAAP, PP&E are depreciated as a whole unit for its useful life, while under IFRS, “asset componentization” is allowed (where the total cost of an item can be depreciated separately over different useful lives).

Other general problems within the IFRS community of users: The principles-based approach of IFRS standards often creates inconsistency in the interpretation and application of the principles. Some of the other general problems within the IFRS community of users include – picking and choosing (for instance, several countries have accepted portions of the IFRS and not all the standards), potential of undue influence by the individuals and firms that are funding the IASB (International Accounting Standards Board), unenforceability aspect of principles-based IFRSs (when compared to the rules-based US GAAP), unequal application and enforcement of the IFRS amongst the users, and finally the inconsistent auditing approaches amongst the IFRS users.

The need to harmonize the differences required understanding the differences in the conceptual frame-work upon which the standards were based. In 2006 the IASB and FASB started the Conceptual Frame-work Project, to revise and unify the conceptual frameworks and the process is still ongoing, with 2015 marking the start of the fourth phase of conceptual framework project. “The FASB believes that, over time, the ultimate goal of convergence is the development of a unified set of high quality, international accounting standards that companies worldwide would use for both domestic and cross-border financial reporting” (McEnroe & Sullivan, 2014, p. 19). Therefore, the total convergence of US GAAP and IFRS is delayed till all the above differences and issues can be investigated and resolved completely to the satisfaction of FASB and IASB.

2.10 Impact of IFRS on Financial Statements and Ratios

IFRS adoption can affect several items of financial statements. In this study, I focus the analysis on items that have a direct impact on the measurement of liquidity, profitability and cash flow. Accordingly, I use figures from the Statement of Financial Position (total assets, total liabilities, shareholders’ equity, non-controlling interest); income statement (net operating revenues, profit/loss for the year), statement of comprehensive income (comprehensive income/loss) and statement of cash flows (net operating cash flow). These figures allow constructing a set of financial ratios that includes the debt ratio, return on assets (ROA), comprehensive-ROA, net profit margin, asset turnover, and the operating cash flow ratio as shown in Table 2.1.

Financial Statement Figures and Financial Ratios	
Figures and Ratios	Source or Formula
Total assets	Statement of Financial Position
Total liabilities	Statement of Financial Position
Non-controlling interest (NCI)	Statement of Financial Position (within liabilities or shareholders' equity or in between)
Shareholders' equity	Statement of Financial Position
Net Operating income	Income statement
Net profit or loss	Income statement
Comprehensive income or loss	Statement of comprehensive income
Net operating income	Statement of cash flows
Financial ratios	
Debt ratio	Total liabilities (excluding NCI when presented in-between equity and liabilities) divided by Total assets
Return on assets (ROA)	Net profit/loss divided by Total assets
Comprehensive-ROA	Comprehensive income/loss divided by Total assets
Net profit margin	Net profit/loss divided by Net operating income
Asset turnover	Net operating income divided by Total assets
Operating cash flow ratio	Net operating cash flow divided by Current liabilities

Table 2.1: Financial Statement Figures and Financial Ratios

2.11 Theoretical Framework

Stewardship theory

The stewardship theory emphasizes the principal- steward relationship believed to have its roots in the fields of psychology and sociology. It grew out of the seminal work of Donaldson and Davis (1989, 1991) and was developed as a model where senior executives act as stewards for the organization and in the best interests of the principals (Olson, 2008).

The principal- steward relationship is a relationship of trust and was developed as an alternative to the agency theory. In the light of corporate governance, Donaldson & Davis (1991) suggest that stewardship theory focuses essentially on empowering structures and supports the mechanism of CEO duality which will enhance effectiveness and produce, as a result, superior returns to shareholders than separation of the roles of chair and CEO. The utility of the steward represented by the Chief Executive Officer is maximized when organizational objectives are achieved rather than self -serving objectives (Garcia-Meca& Sanchez-Ballesta, 2009).

Empirical Evidence

Only few studies provide preliminary empirical evidence of differences between IFRS and GAAP as they transpire in company's financial reporting in Ethiopia. Blanchette, Racicot and Girard (2011) report a significantly higher variance of several ratios in IFRS compared to the same ratios in Canadian GAAP for a sample of companies that adopted IFRS before 2010 (i.e. early adopters). Interestingly, the report also finds that a ratio based on cash flow figures does not show a significant difference, consistent with the idea that cash flows are generally not affected by variations in the application of accounting standards.

A study based on information published by Canadian real estate companies in 2011 confirms that IFRS adoption has created volatility in earnings and variability in key metrics (Salman and Shah, 2011). This study reports that real estate assets increase in IFRS with the use of current market values; and debt balances are likewise higher in IFRS. But since assets have generally increased more than liabilities under the new reporting regime, the impact of IFRS adoption manifests through a reduced level of the average debt-to-worth ratio. Furthermore, net earnings of real estate companies are higher on average in IFRS while no significant impact on cash flows is found.

The European Union adopted IFRS in 2005. Lantto and Sahlström (2009) examine the impact of IFRS adoption on key financial ratios of a continental European country – Finland. They find that liquidity ratios decreased under IFRS, while leverage and profitability ratios increased. Additional liabilities arose mainly from lease accounting, employee benefit obligations and financial instruments, and higher profits were primarily due to business combinations.

A study undertaken by Marchal, Boukari and Cayssials (2007) examines the impact of IFRS adoption in France and finds small variations of shareholders' equity following the adoption of IFRS, but an increase in financial leverage and profitability. The study notes that fair value accounting was not adopted for long-lived assets except for one-time adjustments on transition (according to IFRS 1), investment property and financial instruments. In the subsequent part of this study, I will investigate if this is really the case.

CHAPTER THREE: RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

The goal of this study is to examine whether there are differences in accounting numbers, and due to this key accounting ratios after conversion from GAAP to IFRS. Moreover, I want to confirm Lantto and Sahlström's (2009) statement, that there are no substantial differences between IFRS and accounting standards in GAAP. To do this, the ratios before and after the conversion need to be calculated, and eventually a statistical test need to be performed to check whether those differences are significant. The main purpose of this study is to evaluate the impact of adoption of international financial reporting standards (IFRS) on key financial ratios on commercial banks in Ethiopia.

3.2 Research Design

This study followed an explanatory research design in order to explain knowledge or information about the impact of IFRS adoption on key financial ratios in case of commercial banks in, which is a new and less explored research area in the context of Ethiopia. An explanatory research design was employed to use flexible strategies that could enable to develop better insights about the impact of IFRS adoption on key financial ratios in Ethiopia.

To capture the effects of IFRS adoption on financial statements, accounting figures are computed under IFRS and are compared, with accounting figures computed under the GAAP at the same date or period. IFRS 1 specifies the requirements for an entity that adopts and applies IFRS for the first time. This includes the requirement that an entity's first financial statements in IFRS include at least one year of comparative information restated to IFRS. This rule allows for the comparison of accounting figures in IFRS and GAAP for the year prior to the transition to IFRS. As a result, the comparison between IFRS and GAAP can be done using the original 2017/18 financial statements in GAAP and the 2017/18 statements retrospectively adjusted to IFRS which are presented as part of financial statements published in 2018 (in cases when the shift to IFRS occurred in 2018).

3.3 Research Approach

As per Creswell (2003) there are three approaches that are used in conducting a given research. These are quantitative, qualitative and mixed research approach. Quantitative research approach focuses primarily on the construction of quantitative data, and quantitative data is a systematic record that consists of numbers constructed by researcher utilizing the process of measurement and imposing structure (Kent, 2007). The quantitative research approach employs measurement that can be quantifiable (Bryman & Bell, 2007). In mixed research approach inquirers draw liberally from both qualitative and quantitative assumptions (Creswell, 2009). To see the adoption the impact of IFRS on key financial ratios in the case of commercial banks in Ethiopia I used the quantitative method design.

3.4 Sources and Methods of Data Collection

The data used for this study were obtained from secondary sources. The secondary data were collected from commercial banks annual audited report prepared in IFRS and GAAP from the annual bulletin. The statement of financial position, statement of profit or loss and other comprehensive income, statement of cash flows and other relevant information from their annual financial statement reports were reviewed. Financial statements figures were summarized in excel and ready for SPSS analysis. Various publications and research paper regarding to the research topics.

In order to understand the impact of the new IFRS reporting annual reports from commercial banks for pre- and post-IFRS implementation were analyzed. Every entity which is moving from its national GAAP or (U.S GAAP) is obligated to apply the requirements of IFRS 1 - *First time adoption of International Financial Reporting Standards* (PwC,2005), which determines the procedures that an entity must follow when it adopts IFRS for the first time. According to IFRS 1 an entity's first IFRS financial statements are the first annual financial statements in which the entity adopts IFRS, by an explicit and unreserved statement in those financial statements of compliance with IFRS.

IFRS 1 also requires an entity to explain how the transition from GAAP to IFRS affected the reported financial position, financial performance and cash flows. In practice, this is done in a transition note attached to financial statements which contains reconciliations and explanations. The present study uses these transition notes to identify differences between financial statements figures derived under GAAP and IFRS.

3.5 Population

Currently there are 18 commercial banks that are registered and operated under National Bank of Ethiopia in Ethiopia. Except Commercial Bank of Ethiopia and Development Bank of Ethiopia all banks are private commercial banks, however the two banks are Government banks. Therefore, out of the total number of entire populations of banks I decided sixteen private commercial banks samples for the study. The two government banks have no audited financial report during this study.

3.6 Sample Selection

Survey sampling is the process of choosing, from a much large population, a group about which the researcher wish to make statements so that the selected part will represent the total group (Leedy, 1989). The population considered in this study is the number of commercial banks in Ethiopia which adopt IFRS and issue a report in 2017/18. I try to investigate 100% of the population, but due to lack of complete data, I prefer to focus on the 16 samples from the total to get rich evidence.

3.7 Data Collection Procedures

Annual audited financial reports were collected from banks website, and for those not found in their website, I collect from their head office. The financial statements in IFRS were retrieved for the year of transition to IFRS while those in GAAP were retrieved for the prior year. The data collection followed a three-step process: first, IFRS figures which correspond to comparative figures presented for the year prior to the shift were collected from IFRS financial statements (i.e. Statement of financial position, income statement, statement of comprehensive income/loss, and statement of cash flows). Second, GAAP figures were collected from original GAAP statements (published in the year prior to the shift) for the same date and period.

Third, the reconciliations and explanations provided in the transition notes to IFRS statements were used to further detail differences observed in the values collected through steps 1 and 2.

To exhibit a full impact of IFRS adoption on commercial banks, I selected six financial ratios. Following Lantto and Sahlström (2009), I investigate Capital adequacy liquidity ratio, debt ratio, Return on Asset (ROA), Comprehensive Return on Asset, Net Profit Margin (NPM), Asset Turnover and Operating Cash Flow for both reports prepared under IFRS and GAAP.

Generally, I calculate the difference between GAAP-based ratios and IFRS-based ratios (IFRS ratio – GAAP ratio), and test the statistical significance of the differences using non-parametric - Wilcoxon Signed-Rank Test. I also calculated the test of equality of means, medians and variations for both IFRS and GAAP based reports. Finally, I will explain how the financial statement items changed after the conversion to IFRS, and eventually, which of them caused the major changes in the selected financial ratios.

Due to this two-step process, I will be able to explain how the financial statement items changed after the conversion to IFRS, and eventually, which of them caused the major changes in the selected financial ratios

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND CONCLUSION

4.1 Introduction

This chapter presents the data analysis, the research findings or results, and based on the results the researcher gives discussion on the findings and also gives some interpretation of the result. In order to presents findings and the discussion about the impact of international financial reporting standards (IFRS) on the key financial ratios of commercial banks in Ethiopia; the researcher uses different form of tables and figures and qualitative analysis done in prose.

4.2 Analysis of Differences

The distribution of differences between IFRS and GAAP values is analyzed for each financial statement figure by looking at the range of values (i.e. minimum and maximum differences) and the number of observations within that range where differences are below and above zero. This analysis is done for each figure from financial statements.

To analyze the impact of IFRS adoption on financial statements, we first compare means, medians, and variances of selected accounting figures and financial ratios computed under IFRS and GAAP. Equality of means, medians and variances are tested using t-tests, Wilcoxon/Mann-Whitney tests (tie-adjusted), and F-tests respectively. The study tests the following;

- Mean of IFRS values is equal to mean of GAAP values
- Median of IFRS values is equal to median of GAAP values
- Variance of IFRS values is equal to variance of GAAP values

4.3 Analysis and Discussions of the Results

4.3.4 Descriptive Statistics

The general characteristics of financial statement figures tested are presented in Table 4.1 below. The size of financial statement figures under IFRS and GAAP for the banks in the sample varies considerably: total assets range from ETB 2.06 Billion to ETB 40 billion in IFRS (ETB 2.06 billion to ETB 41.9 billion in GAAP) while net operating income range from ETB 171.56 million to ETB 2.72 billion in IFRS and ETB 67.7 million to ETB 1.35 billion in GAAP.

Total liabilities range from ETB1.68 billion to ETB 34.6 billion in IFRS (ETB 1.63 billion to 37.16 billion in GAAP) whereas the level of shareholders' equity extends from ETB 385.42 million to ETB 5.42 billion in IFRS (ETB 422.96 million to ETB 4.81 billion in GAAP). Other commercial banks characteristics likewise present considerable range in values. Net profit/loss for the year varies from negative ETB 30.17 million to ETB 951.22 million in IFRS (ETB 50.84 million to ETB 1.002 billion in GAAP) while the figures for comprehensive income/loss extend from negative ETB 7.01 billion to positive ETB 951.22 million in IFRS (ETB 38.13 million to 1.002 billion in GAAP). Finally, net operating cash flow ranges from negative ETB 3.33 billion to ETB 2.58 billion in IFRS (ETB 225.56 million to ETB 2.56 billion in GAAP). Overall, most of the range of values is larger in IFRS compared to that in GAAP.

Descriptive Statistics for Figures of Financial Statements and Financial Ratios under IFRS and GAAP									
Financial Statement Figures Under IFRS									
	N	Minimum	Maximum	Sum	Mean	Median	Std. Deviation	Skewness	Kurtosis
Total Assets	16	2065703000.00	40026791000.00	260068508000.00	16254281750.00	13599287000.00	11026871685.37	.835	.165
Total Liabilities	16	1680280000.00	34602754000.00	225072485000.00	14067030312.50	12080047500.00	9587816186.72	.771	.042
Shareholders Equity	16	385423000.00	5424037000.00	35026021000.00	2189126312.50	1549111500.00	1495390212.44	1.164	.641
Sales	16	179773000.00	2841341000.00	18246944000.00	1140434000.00	1036230000.00	750111410.69	.904	.493
Profit for the year	16	30173000.00	951586000.00	5793780000.00	362111250.00	307391500.00	250209720.74	1.096	1.038
Comprehensive income	16	-7018000.00	951220000.00	5293349000.00	330834312.50	291013500.00	264473295.33	1.090	1.046
Net operating cash flows	16	-3330862000.00	2579131000.00	15525139000.00	970321187.50	1118637000.00	1338422943.38	-2.318	7.283
Valid N (listwise)	16								
Financial Ratios Under IFRS									
	N	Minimum	Maximum	Sum	Mean	Median	Std. Deviation	Skewness	Kurtosis
Debt Ratio	16	.78	.92	13.68	.8553	.8606	.03410	-.365	.507
Return on Assets	16	.01	.03	.36	.0225	.0228	.00403	.009	-.084
Comprehensive ROA	16	.00	.03	.33	.0205	.0220	.00701	-1.722	4.773
Net profit margin	16	.17	.39	4.99	.3117	.3205	.05199	-1.340	2.906
Asset turnover	16	.06	.09	1.16	.0724	.0708	.00781	.775	-.447
Operating Cash flows ratio	16	-.17	.17	1.38	.0866	.1129	.08677	-1.981	4.545
Valid N (listwise)	16								
Financial Statement Figures Under GAAP									
	N	Minimum	Maximum	Sum	Mean	Median	Std. Deviation	Skewness	Kurtosis
Total Assets	16	2062905410.00	41974865174.00	259717091990.00	16232318249.38	13634417865.00	11137137714.27	.920	.535
Total Liabilities	16	1639944435.00	37165526890.00	226582707250.00	14161419203.13	12077146659.00	9955451909.10	.921	.534
Shareholders Equity	16	422960975.00	4809338284.00	33134384800.00	2070899050.00	1591354367.50	1233962062.92	.856	.033
Sales	16	240952709.00	3415093660.00	20644002632.00	1290250164.50	1270388619.00	878639870.18	1.123	1.251
Profit for the year	16	50839955.00	1002939134.00	5728998676.00	358062417.25	279330680.00	257783300.06	1.186	1.286
Comprehensive income	16	38129966.00	1002939134.00	4697299579.00	293581223.69	239015254.50	239829845.85	1.831	4.419
Net operating cash flows	16	225565264.00	2561573107.00	18789822016.00	1174363876.00	1058948494.00	737423254.51	.565	-.803
Valid N (listwise)	16								
Financial Ratios Under GAAP									
	N	Minimum	Maximum	Sum	Mean	Median	Std. Deviation	Skewness	Kurtosis
Debt Ratio	16	.78	.91	13.70	.8561	.8630	.03834	-.632	-.323
Return on Assets	16	.01	.03	.36	.0226	.0230	.00484	-.136	1.149
Comprehensive ROA	16	.01	.03	.29	.0178	.0175	.00458	.400	.408
Net profit margin	16	.14	.39	4.49	.2804	.3005	.07199	-.390	-.641
Asset turnover	16	.06	.12	1.34	.0834	.0765	.01841	.623	-1.007
Operating Cash flows ratio	16	.01	.31	1.85	.1157	.1255	.07058	.974	2.894
Valid N (listwise)	16								

Table 4.1: Descriptive statistics for figures of financial statements and ratios

Financial ratios likewise show a wide range of values. The debt ratio ranges from 0.78 to 0.92 in IFRS (with a mean of 0.856 and a median of 0.860), and from 0.78 to 0.91 in GAAP (with a mean of 0.856 and a median of 0.863). ROA in IFRS ranges from positive 4.03 % to 9 % (with a mean of 2.25% and a median of 2.28%) while ROA in GAAP ranges from negative 13.6 % to positive 4.84 % (with a mean of 0.226 and a median of 0.230). The operating cash flow ratio ranges from negative 0.17 to positive 0.17 in IFRS with a mean of 0.0866 and a median of 0.1129 ; this is compared to a range of positive 0.01 to 0.31 in GAAP, with a mean of 0.1157 and a median of 0.1255. Finally, the net profit margin in IFRS ranging from positive 0.17 to 0.39 with a mean of 0.3117 and median of 0.3205 respectively. On the other hand the net profit margin in GAAP ranges from positive 0.14 to 0.39 with a mean of 0.2805 and median of 0.3005 respectively. The net profit margin range both for IFRS and GAAP are almost the same. It is however clear that the mean of net profit margin is not reliable for testing as a small denominator effect amplifies the statistics (for example, losses under the numerator divided by low sales under the denominator biases the ratio downward).

It should be noted that most of the data does not follow a normal distribution; there are differences between means and medians; minimum and maximum values also differ noticeably in some cases; skewness and kurtosis are high. Therefore, minimum and maximum values of data as well as their variance in addition to parametrical and non-parametrical tests on means and medians are analyzed to account for the apparent non-normality.

4.3.5 Comparison of Means, Medians and Variances at the Aggregate Level

Tests of Equality

Overall, no significant differences are found between financial statement figures and ratios prepared under IFRS and GAAP when the analysis is based on the comparison of means and medians. As presented in above Table 4.2, the equality of means and the equality of medians are not statistically rejected for all figures and ratios, except one asset turnover its p-value is 0.036 which is less than 0.05 or (5%) significance level for the year; as such, Hypotheses 1 and 2 are not rejected. This suggests that IFRS adoption does not change significantly, at the aggregate level, the central values (means and medians) that describe the financial position of Commercial Banks in Ethiopia as is reported in their financial statements.

Test of equality Means for Financial Statement figures and Financial Ratios						
Financial Statement Figures						
	N	IFRS	GAAP	Difference	% cahange	Equality of means (P-Value)
Total Assets	16	16254281750.00	16232318249.38	21963500.63	0.14%	.996
Total Liabilities	16	14067030312.50	14161419203.13	-94388890.63	-0.67%	.978
Shareholders Equity	16	2189126312.50	2070899050.00	118227262.50	5.71%	.809
Sales	16	1140434000.00	1290250164.50	-149816164.50	-11.61%	.608
Profit for the year	16	362111250.00	358062417.25	4048832.75	1.13%	.964
Comprehensive income	16	330834312.50	293581223.69	37253088.81	12.69%	.679
Net operting cash flows	16	970321187.50	1174363876.00	-204042688.50	-17.37%	.597
Valid N (listwise)	16					
Financial Ratios						
	N	IFRS	GAAP	Difference	% cahange	Equality of means (P-Value)
Debt Ratio	16	0.86	.86	0.00	-0.10%	.951
Return on Assets	16	0.02	.03	-0.01	-31.23%	.914
Comprehensive ROA	16	0.02	.05	-0.03	-56.05%	.213
Net profit margin	16	0.31	.28	0.03	11.12%	.169
Asset turnover	16	0.07	.13	-0.05	-42.25%	.036
Operating Cash flows ratio	16	0.09	.57	-0.48	-84.77%	.306
Valid N (listwise)	16					

Table 4.2: Test of equality of means for financial statement figures and ratios based on SPSS output and excel

Based on the independent t-test of SPSS output in the above table, the means of IFRS items do not differ significantly from those in GAAP, the volatility of several figures and ratios does not reflect a significant difference and most of the p-values are greater than 0.05 or 5% except asset turn over in the financial ratio part and its p-value is 0.036 and less than 0.05. The equality of means of IFRS and GAAP ratio is statistically rejected for the asset turn over items from the financial ratio for which the variance in GAAP is higher than in IFRS.

Test of equality of Medians for Financial Statement figures and Financial Ratios						
Financial Statement Figures						
	N	IFRS	GAAP	Difference	% cahange	Equality of medians (P-Value)
Total Assets	16	13599287000.00	13634417865.00	-35130865.00	-0.26%	0.077
Total Liabilities	16	12080047500.00	12077146659.00	2900841.00	0.02%	0.004
Shareholders Equity	16	1549111500.00	1591354367.50	-42242867.50	-2.65%	0.454
Sales	16	1036230000.00	1270388619.00	-234158619.00	-18.43%	0.021
Profit for the year	16	307391500.00	279330680.00	28060820.00	10.05%	0.804
Comprehensive income	16	291013500.00	239015254.50	51998245.50	21.76%	0.21
Net operting cash flows	16	1118637000.00	1058948494.00	59688506.00	5.64%	1
Valid N (listwise)	16					
Financial Ratios						
	N	IFRS	GAAP	Difference	% cahange	Equality of medians(P-Value)
Debt Ratio	16	.8606	.8630	0.00	-0.28%	.210
Return on Assets	16	.0228	.0230	0.00	-0.78%	1.000
Comprehensive ROA	16	.0220	.0175	0.00	25.43%	.077
Net profit margin	16	.3205	.3005	0.02	6.65%	1.000
Asset turnover	16	.0708	.0765	-0.01	-7.43%	.454
Operating Cash flows ratio	16	.1129	.1255	-0.01	-10.08%	1.000
Valid N (listwise)	16					

Table 4.3: Test of equality of medians for financial statement figures and ratios based on SPSS output excel

Table 4.3 presents the median values of the financial statement figures and financial ratios prepared under GAAP and IFRS, and the median values of the differences between them and the percentage change. The results from above table 4.3 calculated under median values are more reliable compared to differences and percentage changes calculated under total amount shown in table 4.5. Those results are consistent with the outcome obtained by Goodwin et al. (2008). In their study, they indicated that after transition from Australian GAAP (common law) to IFRS, on average, liabilities increased and equity decreased. Furthermore, the results from Table 4.3 are also consistent with Lantto and Sahlström's (2009) study, which on the other hand, was based on code law country (Finland). They stated that in general, after switching to IFRS all income statement items reported a positive change (increase in income statement profits) and balance sheet items a negative change (i.e. increase in debt and decrease in equity), however the change of debt ratio is negligible in this case.

In Table 4.5, the percentage change of Revenue (Sales) after the transition to IFRS is -18.43%, which means that the median value of Revenue is smaller under IFRS. However, this difference is not significant. So, this outcome states that usually there is no difference in Revenue between GAAP and IFRS, and more importantly, that Revenue does not have any impact on differences between ratios.

There is a variation in revenue change when it migrates from GAAP to IFRS within the sample. Out of the sample of 16 commercial banks, revenue decreases from -0.07% to -28.77% and increases from 2.62% to 7.11%, and also 56% of commercial banks revenue show increment, whereas 44% of banks revenue decreases when it converts from GAAP to IFRS. The median difference between IFRS and GAAP for total assets and total liabilities is -0.26% and 0.02% respectively. The statistical test confirms this result, reporting that there is no statistically significant difference between GAAP-based and IFRS-based total assets and liabilities.

The results from Table 4.3 also show that, the difference in comprehensive income under GAAP and IFRS is very high (21.76%) comparing to other financial statements figures mentioned earlier; however the difference is statistically insignificant at the 5% level. The reason for this substantial difference may be caused by favorable IFRS standards, like for instance, IAS 19 – *Employee Benefits*, or IAS 16 – *Property, plant and equipment*. One financial ratio affected by Comprehensive Income is Net Profit Margin. So, as the difference in revenue under GAAP and IFRS is fairly low, but more importantly it is not statistically significant, at 5% significance level. We can state that the 21.76% increase in Comprehensive Income caused 6.65% increases in the net profit margin. Again, this conclusion is consistent with Lantto and Sahlström's (2009) results. Further, Table 4.3 also shows that Shareholder Equity value decreased by 2.65% under IFRS. Again, this outcome is consistent with Lantto and Sahlström's (2009) results.

Based on level of significance, the medians of IFRS items also do not significantly differ from GAAP except liability and sales figures in the financial statement whose P-value is 0.004 and 0.021 respectively and lower than the P-value 0.05 or 5%. The equality of medians of IFRS and GAAP figures is statistically rejected for the two items from the balance sheet – total liabilities and sales for which the variance in IFRS is greater than GAAP for total liabilities and the variance of GAAP is greater than IFRS for sales figures.

Test of equality of variances for Financial Statement figures and Financial Ratios					
Financial Statement Figures					
	IFRS	GAAP	Difference	Difference(W)	Equality of Variances (P-Value)
Total Assets	11026871685.37	11137137714.27	-110266028.90	-0.01%	.997
Total Liabilities	9587816186.72	9955451909.10	-367635722.38	-0.14%	.941
Shareholders Equity	1495390212.44	1233962062.92	261428149.52	-3.70%	.516
Sales	750111410.69	878639870.18	-128528459.49	-2.51%	.690
Profit for the year	250209720.74	257783300.06	-7573579.32	-0.09%	.866
Comprehensive income	264473295.33	239829845.85	24643449.47	-0.96%	.705
Net operating cash flows	1338422943.38	737423254.51	600999688.87	-36.60%	.402
Financial Ratios Under					
	IFRS	GAAP	Difference	Difference(W)	Equality of Variances (P-Value)
Debt Ratio	0.034097046	0.038341394	0.00		.480
Return on Assets	0.004031527	0.00484252	0.00		.595
Comprehensive Net profit margin	0.00701279	0.004578482	0.00		.300
Asset turnover	0.051993453	0.071985068	-0.02		.100
Operating Cash flows ratio	0.007807287	0.018410029	-0.01		.000
	0.086769204	0.070583018	0.02		.537

Table 4.4: Test of equality of variances for financial statement figures and ratios based on SPSS output excel

The variance of all other figures from financial statements is higher in GAAP than IFRS and the P-values are greater than 0.05 or 5%. There is heterogeneity for the variances of financial ratios. The IFRS and GAAP variance is the same for debt ratio and return on assets. On the other hand the variance of GAAP is higher than IFRS for net profit margin and asset turn over and also the variance of IFRS greater than GAAP for operating cash flows. This is consistent (though less pronounced) with the results of a previous study that examined early adopters of IFRS in Canada and showed higher volatility of financial ratios in IFRS compared to those in GAAP (Blanchette, Racicot and Girard, 2011).

Financial ratios also show some volatility as discussed above. The equality of variances of IFRS and GAAP metrics is statistically rejected for asset turnover ratio. While the variance of most financial ratios its variance in IFRS is greater than GAAP or closer to GAAP, but for some ratios the variance is significantly lower in IFRS.

When we see the ratio of variance for operating cash flow the p-value 0.537 is greater than 0.05 or 5% and it is significantly higher value and not rejected.

In Blanchette, Racicot and Girard (2011), the operating cash flow ratio was one of the few ratios for which the equality of variances computed under IFRS and GAAP was not rejected significantly. This is consistent with the fact that cash flows are generally not affected by accounting methods.

Given that the variance of several IFRS figures is significantly higher than the variance of GAAP figures (as discussed above), Variance of IFRS values is equal to variance of GAAP values is rejected, at least partially, with a note that mixed effects are observed on ratios.

Percentage Change in Financial Statement Figures				
Financial statement items	Sum under GAAP	Sum under IFRS	Difference	%change
Total Assets	259,717,091,990.00	260,068,508,000.00	351,416,010.00	0.14%
Total Liabilities	226,582,707,250.00	225,072,485,000.00	(1,510,222,250.00)	-0.67%
Shareholders Equity	33,134,384,800.00	35,026,021,000.00	1,891,636,200.00	5.71%
Sales	20,644,002,632.00	18,246,944,000.00	(2,397,058,632.00)	-11.61%
Profit for the year	5,728,998,676.00	5,793,780,000.00	64,781,324.00	1.13%
Comprehensive income	4,697,299,579.00	5,293,349,000.00	596,049,421.00	12.69%
Net operating cash flows	18,789,822,016.00	15,525,139,000.00	(3,264,683,016.00)	-17.37%

Table4.5: Percentage Change in Financial statement figures based on excels calculation.

Table 4.5 illustrates a sum and percentage change of selected financial statement items under GAAP and IFRS. All those items were necessary to calculate the ratios presented in Table 4.2, 4.3 and 4.4 above. As we can see, on one hand, Sales, Total Liabilities, and Net operating cash flows decreased after the transition from GAAP to IFRS. But on the other hand, Total Assets, Shareholders Equity, Profit for the year and Comprehensive Income increased after the conversion. Especially, we should take a closer look into Comprehensive Income as the increase 12.69% and it is significant. Profit for the year also increase to 1.13% but it is insignificant. This is inconsistent to the research problems that those commercial banks complain that their profit decreases after the transition from GAAP to IFRS.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This study wanted to explore the impact of International Financial Reporting Standards (IFRS) adoption on key financial ratios of commercial banks in Ethiopia. Therefore this chapter gives the summary of the research finding, conclusions, recommendations and suggestions for further research based on the results in chapter four.

5.1. Summary of Findings

This study attempted to examine the impact of IFRS adoptions on key financial ratios to the commercial banks in Ethiopia. This study also provides evidence on differences in accounting numbers after the switch from GAAP to IFRS. However, as there is no convincing evidence showing whether IFRS adoption and implementation affected commercial banks and other entities financial figures and ratios, the study is performed to ultimately fill this gap .The results of the study provide important insights on the impact of International Financial Reporting Standards (IFRS) adoption on key financial ratios of commercial banks in Ethiopia and also to other entities. The research finding is summarized as follows.

This study is conducted on the commercial banks in Ethiopia to generate information about the impact of International Financial Reporting Standards (IFRS) adoption on key financial ratios to those banks. The data has collected from the bank's annual audited report and summarized in to excel, test and analyzed in SPSS. To test the hypotheses, the financial statement figures and ratios are tested and analyzed through descriptive statistics, test of equality of means, median and variances. Regression analysis also used to test the relationship between IFRS and GAAP values for the financial statement figures and ratios.

Adoption of IFRS in Ethiopia brings both the good and bad news. The overall good news is that the comparability of Ethiopian financial statements internationally may improve since many other countries have already adopted IFRS. There are, however, a number of pitfalls waiting for financial analysts and other users of financial statements. In the short term, the outcome of trend analysis may be distorted as current IFRS statements are compared to pre-changeover GAAP statements. In the longer term, it will be influenced by the application of IFRS which differs (to a larger or lesser extent) from that found in GAAP.

In this study, I try to provide insights on actual effects of IFRS adoption on Ethiopian Commercial Banks. Using information from audited financial statements, through statistical and descriptive analysis in SPSS, the study compares accounting figures and financial ratios computed under IFRS and pre-changeover GAAP for the same period 2017/18 for a sample of 16 private commercial banks registered under National Bank of Ethiopia

According to the descriptive statistics result since the size of the banks in the sample varies considerably and also each financial statement figures in IFRS and GAAP reporting varies. Overall, most of the range of values is larger in IFRS compared to that in GAAP.

Based on the test equality of means and medians result the test equality of means and medians are not statistically rejected for all figures and ratios, however asset turnover statistical rejected for both IFRS and GAAP .This suggests that IFRS adoption does not change significantly, at the aggregate level, the central values (means and medians) that describe the financial position of the banks. IFRS plays significant role in ensuring quality accounting information and also there is relationship between IFRS and GAAP. Therefore, the first two hypotheses not rejected.

The median value of Revenue is smaller under IFRS. However, this difference is not significant. So, this outcome states that usually there is no difference in Revenue between GAAP and IFRS, and more importantly, that Revenue does not have any impact on differences between ratios.

The median difference between IFRS and GAAP for total assets and total liabilities are negligible and the statistical test also confirms that there is no statistically significant difference between GAAP-based and IFRS-based total assets and liabilities.

The level of significance result shows, the medians of IFRS items do not significantly differ from GAAP except liability and sales figures in the financial statement .The equality of medians of IFRS and GAAP figures is statistically rejected for the two items from the balance sheet –total liabilities and sales for which the variance in IFRS is greater than GAAP for total liabilities and the variance of GAAP is greater than IFRS for sales figures.

Given that the variance of several IFRS figures is significantly higher than the variance of GAAP figures (as discussed above), Variance of IFRS values is equal to variance of GAAP values is rejected, at least partially, with a note that mixed effects are observed on ratios.

Based on the analysis of percentage change financial statement figures under GAAP and IFRS Sales, Total Liabilities, and Net operating cash flows decreased after the transition from GAAP to IFRS. But Total Assets, Shareholders Equity, Profit for the year and Comprehensive Income increased after the conversion. Profit for the year also increase for the year. This is inconsistent to the research problems that those commercial banks complain that their profit decreases after the transition from GAAP to IFRS. In the regression model analysis IFRS values are not fully explained by GAAP.

5.2. Conclusion

Based on the analysis and results conclusions are formed at the aggregate and individual bank level. At the aggregate level, means and medians of financial statement figures and ratios are not statistically different under the two accounting regimes. For example, the median of debt ratio is 0.8606 in IFRS and 0.8630 in GAAP; for the ROA it is 2.80% and 2.30% respectively; and for asset turnover it is 0.0708 and 0.0765 respectively. The median for the net profit margin is 0.3205 in IFRS and 0.3005 in GAAP respectively. Therefore the equality of medians is not rejected and it is not merely significant at the 5% level of confidence. These results are potentially reassuring as they imply that databases built from aggregated accounting information are generally consistent in IFRS and GAAP. However, the distribution of data around the central values of means and medians is important in several cases. For instance, the equality of variances in IFRS and GAAP for all financial statement figures in the balance sheet also statistically not rejected. This result reflects low volatility of financial statement figures in IFRS compared to GAAP and is not consistent with prior research in Canada (Blanchette, Racicot and Girard, 2011; Salman and Shah, 2011).

The analysis of the range and magnitude of differences between values computed under IFRS and GAAP finds that assets tend to be higher in IFRS than in GAAP; however, the liabilities are lower in IFRS than GAAP. Sales and operating cash flow decreases from transition of GAAP to IFRS on aggregate level by 11.61% and 17.37% respectively. However, the values of shareholders equity, profit for the year and comprehensive income is higher in IFRS than in GAAP and it increases by 5.71%, 1.13% and 12.69% respectively. This is explained by differences in categories of accounting adjustments, particularly:

- Fair value accounting for investment property is one of the categories that increase assets and profit in IFRS (consistent with IAS 40 that allows fair value accounting through profit);
- Consolidation and strategic investments also other categories of adjustments that affect total assets, total liabilities, profit/loss and comprehensive income/loss. This category reduces profit in IFRS and has a two-sided impact (both decreasing and increasing) on total assets and total liabilities (consistent with variations in the scope of consolidation);
- Impairment and capitalization of property, plant and equipment are among the categories that increase profit (consistent with IAS 16 and IAS 36 which require these adjustments to be allocated through profit).

At the individual bank level, I observe there is no significant difference and variations in every part of financial statements and ratios, and in several categories of accounting adjustments. In the balance sheet, central values (means and medians) of total assets, total liabilities and shareholders' equity are not significantly different in IFRS and GAAP, but individual differences can be considerable. For instance, total assets in IFRS increases by 0.14% when it migrates from GAAP to IFRS and total liabilities decreases by 0.62% when it migrates from GAAP to IFRS. Profitability also increases by 1.13% when it converts from GAAP to IFRS and it is not material.

5.3. Limitation of the Study

The results are subject to limitations which include gradual convergence or transition from GAAP to IFRS is not instantaneous or rapid. There might be a risk of error as the data was collected manually from the bank's annual financial statement and audit report. Inconsistent presentation of transition notes is also another limitation, since there is no uniform format required by IFRS for the presentation of the transition note in the year of IFRS adoption. Hence, the information is not presented in a consistent manner by the banks, reducing the comparability of the data collected. However the sample size includes 16 commercial banks observations out of 18 banks, which is 89% of the population and it is high representative sample. The data collected, analyzed and tested are a one year data, i.e. 2017/18 data. To understand the impact of IFRS adoption on key financial ratios needs more trend data for some years.

Lack of inclusion of Commercial Bank of Ethiopia (CBE) in the study also another limitation. Commercial Bank of Ethiopia has many branches and the financial statement figures are material and it has also high amount of revenues compared to other banks and it might affect the results obtained in the analysis.

5.4. Recommendations

As the major objective of the study is to assess the impact of IFRS adoption on key financial ratio to commercial banks, the following recommendations are forwarded based on the findings and study results mentioned above .

Analysts and future researchers should understand that at the aggregate level, the analysis of medians and means of IFRS values is generally reliable when compared to the analysis of GAAP values. Analysts should also be aware that the volatility of accounting figures in IFRS is generally higher than in GAAP, under ceteris paribus conditions.

Future researchers and analysts should also understand the main categories of adjustments that affect the differences between financial statement figures and ratios derived in IFRS and GAAP.

These categories are:

- Consolidation and strategic investments, in particular the scope of consolidation that can significantly increase (or decrease) the level of assets and liabilities recognized on the Statement of financial position.
- Fair value accounting for investment property with gains/losses directly recognized in profit/loss;
- Pension and other employee benefits that affect liabilities and Other Comprehensive Income (OCI) adjustments;
- Other adjustments such as capitalization and impairment with various effects on financial statements.

Banks and researchers should consider that International Financial Reporting Standard (IFRS) adoption and implementation is new to Ethiopia, the impact of IFRS on financial statement figures, ratios, and earnings may not be observed and understood at this time. In future it will be more observed and understood.

Future trend data in the coming years of period may help to understand and analyze the impact of International Financial Reporting Standards (IFRS) on financial ratios, financial statement figures and earnings in a better way for banks and entities.

The International Financial Reporting Standards (IFRS) is a broader scope of accounting which cannot be dealt with in its entirety in one study alone .The impact of IFRS adoption to key financial ratios ,financial figures and earnings for other entities should be studied further.

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Annex-1

Privat Commercial Banks in Ethiopia Financial Statement Figures under GAAP for the year June 30,2018.							
	Total Assets	Total Liabilities	Shareholders Equity	Sales	Profit for the year	Comprehensive income	Net operting cash flows
Abay Bank	8,624,214,027	7,296,040,829	1,328,173,199	628,975,236	189,793,720	141,445,290	1,044,168,085
Abyisinya Bank S.C	25,324,804,320	22,419,990,375	2,904,813,945	1,779,548,172	540,232,403	400,146,899	1,641,289,907
Addis Int Bank S.C	3,414,604,812	2,657,001,069	757,603,714	377,323,413	92,254,680	69,191,010	328,291,193
Awash Bank S.C	41,974,865,174	37,165,526,890	4,809,338,284	2,849,574,287	1,002,939,134	1,002,939,134	2,561,573,107
Berhan Int Bank S.C	10,488,873,243	8,603,816,867	1,885,056,375	1,164,765,637	348,619,148	261,464,360	1,092,913,276
Buna Int Bank s.c	9,820,013,967	8,467,036,820	1,352,977,147	925,464,067	187,046,906	140,288,179	1,071,719,935
COOP Bank of Oromia	17,724,240,571	16,207,190,458	1,517,050,113	1,525,333,920	207,820,614	154,879,661	2,366,684,974
Dashen Bank S.C	34,624,602,052	30,631,617,913	3,992,984,139	3,415,093,660	756,103,732	567,077,799	225,565,264
Debab Global Bank	2,062,905,410	1,639,944,435	422,960,975	240,952,709	50,839,955	38,129,966	505,145,402
Enat Bank S.C	4,848,281,087	3,939,450,685	908,830,400	298,908,041	99,790,705	73,826,362	608,958,292
Lion Int Bank	10,975,928,809	9,527,045,019	1,448,883,791	801,964,726	268,457,606	201,343,205	1,046,177,053
Nib Int Bank	21,019,709,062	18,065,647,153	2,954,061,908	1,417,847,303	516,443,380	386,132,535	510,007,323
Oromia Int Bank	16,292,906,921	14,627,248,299	1,665,658,622	1,494,067,605	290,203,754	216,566,149	2,065,770,081
United Bank	21,902,917,609	19,387,277,765	2,515,639,934	1,376,011,601	381,715,309	381,715,309	518,545,222
Wegagen bank	20,949,168,439	17,593,381,071	3,355,787,368	1,676,621,682	532,162,590	398,283,443	1,854,266,358
Zemen Bank	9,669,056,487	8,354,491,602	1,314,564,886	671,550,573	264,575,040	263,870,278	1,348,746,544
Total	259,717,091,990	226,582,707,250	33,134,384,800	20,644,002,632	5,728,998,676	4,697,299,579	18,789,822,016
Mean/Average	16,232,318,249	14,161,419,203	2,070,899,050	1,290,250,165	358,062,417	293,581,224	1,174,363,876

Annex-2

Privat Commercial Banks in Ethiopia Financial Statement Figures under IFRS for the year June 30,2018.							
	Total Assets	Total Liabilities	Shareholders Equity	Sales	Profit for the year	Comprehensive income	Net operating cash flows
Abay Bank	8,692,402,000	7,385,334,000	1,307,068,000	636,760,000	190,080,000	140,798,000	1,109,048,000
Abyisinya Bank S.C	25,852,043,000	22,542,140,000	3,339,903,000	1,713,680,000	510,778,000	498,936,000	1,628,837,000
Addis Int Bank S.C	3,441,653,000	2,688,107,000	753,546,000	288,911,000	95,585,000	94,759,000	335,939,000
Awash Bank S.C	40,026,791,000	34,602,754,000	5,424,037,000	2,841,341,000	951,586,000	951,220,000	2,579,131,000
Berhan Int Bank S.C	10,534,690,000	8,698,427,000	1,836,262,000	903,834,000	317,190,000	315,998,000	903,691,000
Buna Int Bank s.c	9,841,342,000	8,483,125,000	1,358,216,000	675,117,000	236,833,000	237,099,000	1,025,179,000
COOP Bank of Oromia	17,766,303,000	16,319,531,000	1,446,772,000	1,208,481,000	338,186,000	337,806,000	2,144,858,000
Dashen Bank S.C	36,000,366,000	30,769,946,000	5,230,420,000	2,432,656,000	814,816,000	816,681,000	679,734,000
Debab Global Bank	2,065,703,000	1,680,280,000	385,423,000	179,773,000	30,173,000	30,004,000	(48,399,000)
Enat Bank S.C	4,875,673,000	3,980,223,000	895,450,000	320,171,000	112,203,000	112,203,000	617,337,000
Lion Int Bank	10,963,718,000	9,576,690,000	1,387,028,000	801,422,000	231,629,000	232,551,000	1,476,488,000
Nib Int Bank	21,112,094,000	18,146,189,000	2,965,905,000	1,361,975,000	493,739,000	494,187,000	1,128,226,000
Oromia Int Bank	16,234,856,000	14,583,405,000	1,651,451,000	1,168,626,000	297,593,000	(7,018,000)	1,969,519,000
United Bank	22,007,039,000	19,524,608,000	2,482,431,000	1,351,974,000	388,586,000	389,558,000	(3,330,862,000)
Wegagen bank	20,897,317,000	17,685,180,000	3,212,137,000	1,673,047,000	518,787,000	382,538,000	1,854,266,000
Zemen Bank	9,756,518,000	8,406,546,000	1,349,972,000	689,176,000	266,016,000	266,029,000	1,452,147,000
Total	260,068,508,000	225,072,485,000	35,026,021,000	18,246,944,000	5,793,780,000	5,293,349,000	15,525,139,000
Mean/Average	16,254,281,750	14,067,030,313	2,189,126,313	1,140,434,000	362,111,250	330,834,313	970,321,188