

Expected benefits and challenges of adopting IFRS- A focus on Saudi Arabia

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Abstract: The Kingdom of Saudi Arabia (KSA) is soon set to join 130+ countries across the globe in the application of International Financial Reporting Standards (IFRS). Today, all companies in Saudi Arabia, other than banks and insurance companies, must follow accounting standards generally accepted in KSA as issued by the Saudi Organization for Certified Public Accountants (SOCPA). Banks and insurance companies are regulated by the Saudi Arabian Monetary Authority (SAMA-the Saudi Arabian central bank) and are already required to comply with IFRS. This is taking place against the assumption that IFRS are irrelevant to developing countries. And that those developing countries adopting it are doing so because IFRS is a product with “network effects.” This contradiction and the question of the relevance of IFRS to Saudi Arabia are examined and explored in this study, using the perception of users and preparers of accounting information and drawing from the economic theory of network. The results of the descriptive study showed that IFRS adoption in Saudi Arabia will have the potential to be beneficial to a wide range of stakeholders. In an era of globalization of businesses and markets, financial information prepared and audited according to national accounting Generally Accepted Accounting Principles (GAAP) no longer satisfies the needs of users whose decisions are more international in scope. Saudi Arabia has recognized the need to participate in the opportunities offered by globalization and consequently, SOCPA approved an IFRS Convergence Plan.

Keywords: Saudi Arabia, International Financial Reporting Standard, Stakeholders, Challenges, network effects

1. INTRODUCTION

The Kingdom of Saudi Arabia (KSA) is soon set to join 130+ countries across the globe in the application of International Financial Reporting Standards (IFRS). Today, all companies in Saudi Arabia, other than banks and insurance companies, must follow accounting standards generally accepted in KSA as issued by the Saudi Organization for Certified Public Accountants (SOCPA). Banks and insurance companies are regulated by the Saudi Arabian Monetary Authority (SAMA-the Saudi Arabian central bank) and are already required to comply with IFRS Deloitte IAS Plus (2011). In an era of globalization of businesses and markets, financial information prepared and audited according to national accounting Generally Accepted Accounting Principles (GAAP) no longer satisfies the needs of users whose decisions are more international in scope. Saudi Arabia has recognized the need to participate in the opportunities offered by globalization and consequently, SOCPA approved an IFRS Convergence Plan, called the “SOCPA Project for Transition to International Accounting & Auditing Standards.” Under this convergence plan, all listed companies are required to adopt IFRS for financial periods beginning on or after January 1, 2017, and all other entities for financial periods beginning on or after January 1, 2018. Unlisted entities may opt for an early adoption of IFRS from January 1, 2017. SOCPA is in the process of adopting IFRS for small- and medium-sized entities (SMEs) to be effective in 2018 for use by non-publicly accountable entities. Since Saudi Arabia joined the Group of Twenty Finance Ministers and Central Bank Governors (G20) in 2009, the adoption of IFRS has been viewed as an important milestone in the country’s future economic development and has been working towards this end ever since. The convergence of national GAAP with IFRS (Fontes et al, 2005, p. 416) promises “transparent, comparable and consistent financial information” to guide investors in making

“optimal investment decisions” (Jacob and Madu, 2004, p. 357.) Increased foreign direct investment and enhanced quality reporting, transparency and comparability are some of the key benefits that the country will enjoy from IFRS adoption.

2. REVIEW OF LITERATURE

Many researchers have studied the impact of IFRS adoption in several countries.

Daske and Gebhardt (2006) concluded that IFRS have increased the quality of financial reporting. They also found out that there is a positive relationship among transparency, firm size, independent board membership, and public subsidiaries. It has been pointed out that implementation of IFRS and corporate governance has positive impact on transparency of financial statements and disclosure. They have also found out that among the firms that implement IFRS there is a strong relationship between liquidity and level of disclosure in banking sector.

Daske et al. (2008) investigated the economic consequences of mandatory International Financial Reporting Standards (IFRS) reporting around the world. They analyzed the effects on market liquidity, cost of capital.

Byard et al. (2010) examined the effect of the mandatory adoption of International Financial Reporting Standards by the European Union on financial analysts' information environment. They investigated firm that had already had voluntarily adopted IFRS at least two years prior to mandatory adoption date. They found that analysts' absolute forecast errors and forecast dispersion decrease only for those mandatory IFRS adopters located in countries with both strong enforcement regimes and domestic accounting standards that differ significantly from IFRS.

DeFond (2011) reported that Proponents of IFRS argue that mandating a uniform set of accounting standards improves financial statement comparability that in turn attracts greater cross-border investment. Their study examined changes in foreign mutual fund investment in firms following mandatory IFRS adoption in the European Union in 2005. They found that foreign mutual fund ownership increases as mandatory IFRS adoption leads to improved comparability. They also found that that mandatory IFRS adoption results in a greater increase in foreign investment among companies in countries with strong implementation credibility.

Wang (2011) found that countries typically allow a long implementation window when switching to IFRS, providing a lengthy window of opportunity during which financing decisions can be made and acted upon prior to the resolution of this information asymmetry.

McAnally (2010) considered one important accounting issue, namely equity based compensation, and studied how IFRS conversion will affect financial statements and the quality of reported data. They found that IFRS generally improves the relevance, and the quality, reported data.

Hellman (2011) stated that adoption of International standards in Sweden originated from a need to ensure a satisfactory development of accounting practice in the multinational firms. They reported that empirical research suggests that the quality of the international accounting standards is high and that IFRS adoption is associated with capital market related economic benefits.

In addition, He et al. (2011) found that there could be some unintended consequences of mandatory IFRS adoption. They indicated that the move towards Fair Value Accounting would improve transparency but it would be beneficial only when the fair value could be known or if it could be measured efficiently which is not the case in China as the information on fair value of many assets may not be available. Consequently, with the absence of active markets for nonfinancial assets, earnings may be managed to avoid reporting losses especially in regions with weaker enforcement institutions.

3. STATUS OF IFRS ADOPTION IN SAUDI ARABIA

Very few studies are available regarding the IFRS adoption in Saudi Arabia or even the GCC countries. Almotairy and Als Salman (2011) is among the pioneering studies in this regard where they have identified the main challenges facing the adoption of IFRS in Saudi Arabia. They have indicated that Saudi Arabia is the only member in the Gulf Cooperation Council (GCC) that does not require IFRS for all listed companies. Alqahtani (2010) has indicated that only banks and insurance companies listed on the Saudi Stock Exchange are required to use IFRS while all other companies in Saudi Arabia are prohibited to do so. These companies must use the Saudi Accounting Standards (SAS) that are issued by the Saudi Organization for Certified Public Accountants (SOCPA).

4. RESEARCH METHODS

This is a descriptive study in which questionnaire was used to collect data in order to determine the perception of two main groups, one representing the preparers of annual reports (represented by finance managers of quoted firms in Saudi Arabia) and the other representing users of annual reports (that is investors represented by financial analysts). Finance managers were selected as respondents because they are deemed to be knowledgeable about IFRS and could provide a preparer’s perspective on its adoption. Similarly, the Investment analysts were chosen over other users for three reasons, thus: First, Investment analysts are identified in the literature as the principal users of financial reports (Schipper, 1991; Bercel, 1994;) Secondly, the work of investment analysts requires that they have the accounting knowledge to enable them to analyze the reports and make decisions (Baker, 1998). Thirdly, provision of information that meets the needs of the analysts is considered as also meeting most of the needs of other users . Based on the above, it could be implied that the intensity of using a company’s financial report is higher for analysts than for other users. The questionnaire was administered to a total of 187 preparers who met the conditions specified below- The firm in which they are employed is listed and active on the Saudi Arabian Stock Exchange in the last ten years i.e (between 2005 and December, 2015) and the industry that the firms belong has at-least three firms. Also, the questionnaire was administered to each of the two hundred and twenty five (220) investment analyst firms identified from the list of Capital Market Operators compiled by the Saudi Arabian Stock Exchange. The questions required the respondents to answer on a five-point Likert scale anchored by (5) indicating very strong and (1) very weak. On this scale, a score of 5 or 4 indicates that the item is perceived to be essential while a score of 3 or 2 indicates that the item is perceived to be fairly important, but not essential, while a score of 1 indicates that the item could be disregarded for being unimportant. The questionnaire attempted to probe the preparers’ and users’ perceptions on the usefulness of the adoption of IFRS in different areas of operations of organizations. To obtain a score for these questions, the mean score was calculated. A total number of 78 questionnaires were returned by the preparers out of which 74, representing 39% were useable. For the users, 65 questionnaires were returned out of which 45, representing 20% were found useable. While a 38% response rate is generally considered satisfactory in studies of this nature (Stainbank and Peebles, 2006), a response rate of 20% for the user group means that not much significant statistical inference can be made with regard to the user group.

5. SURVEYS RESULTS

The first question probed the advantages which preparers and users consider companies will derive from the adoption of IFRS. The results for this question are shown in Table 1.

Table 1: BENEFITS OF ADOPTING IFRS TO COMPANIES

		Preparers n= 74		Users n=43	
		Mean	Rank	Mean	Rank
1	Minimizing cost of capital	3.47	4	3.86	2
2	Quality management information and quick decision making	3.69	3	3.60	4
3	Improved risk management	2.40	9	3.26	7
4	Minimizing audit fee	3.87	2	3.76	3
5	Improved internal audit	3.10	6	3.27	6
6	Ease of using one consistent reporting standard in subsidiaries from different countries	4.35	1	4.45	1
7	Facilitated mergers and acquisitions	2.86	8	2.56	9
8	Enhanced competitiveness	3.15	5	3.45	5
9	Better access to capital, including from foreign sources	2.40	7	2.68	8

Field Survey

The preparers and the users both agree that ease of using one consistent reporting in subsidiaries from different countries is the most useful benefit of IFRS. They also agree on the benefits Enhanced competitiveness and Improved internal audit which ranked fifth and sixth among the nine variables respectively. They however differ in their ranking of the other factors. The preparers and users consider improved risk management facilitated mergers and acquisitions as the least benefit to be derived from adoption of IFRS.

The second question probed the benefits to investors of the adoption of IFRS in Saudi Arabia from the perception of both preparers and users of financial reports. These results are shown in Table 2 below

Table 2: BENEFITS FOR INVESTORS

		Preparers n= 74		Users n=43	
		Mean	Rank	Mean	Rank
1	Easier access to financial reporting	3.53	4	3.65	5
2	More timely financial reports	4.36	1	4.55	2
3	Ease of comparison among companies	3.69	3	3.86	4
4	Good understanding of risk and return	4.08	2	4.59	1
5	Improved confidence in the information presented	3.45	6	3.50	6
6	Quality information for decision making	3.54	5	4.10	3

Field Survey

From Table 2, it is observed that preparers chose more timely financial reports as the most important benefit, which is ranked second by the users as well followed good understanding of risk and return. This is followed by Ease of comparison among companies which is ranked third by the preparers and fourth by the users. The preparers and users ranked improved confidence in the information presented as the least benefit to be derived from the adoption of IFRS. The overall results show that the preparers and users are quite positive that IFRS adoption will be beneficial to the investors. The third question sought to ascertain the benefits of IFRS adoption to policy makers from the stand point of the preparers and users of financial reports. The results are shown in Table 3.

Table 3: BENEFITS FOR POLICY MAKERS (MANAGEMENT)

		Preparers n= 74		Users n=43	
		Mean	Rank	Mean	Rank
1	Better planning	3.21	3	3.50	3
2	Quality information for control and decision making purposes	4.56	1	4.32	2
3	Promotion of cross-border investment	3.58	2	4.38	1
4	Better access to the global capital markets	2.60	4	3.34	4
5	More effective Saudi capital market.	2.57	5	2.80	5

Field Survey

The preparers ranked quality information for control and decision making purposes as the greatest benefits policy makers will derive from the adoption of IFRS while for the users it is ranked second. Similarly, the preparers ranked promotion of cross-border investment as the second most important benefit while the users ranked the same factor as the most important. For the other benefits, both the preparers and users are unanimous in their rankings. However, the users are slightly more positive in their perception of IFRS being beneficial in terms of better decision making purposes and realistic planning experiences. The fourth question probed the perception of preparers and users concerning the benefits of IFRS adoption to national regulatory bodies. The results are shown below.

Table 4: BENEFITS FOR NATIONAL REGULATORY BODIES

		Preparers n= 74		Users n=43	
		Mean	Rank	Mean	Rank
1	Improved ability to attract and monitor listings by foreign companies	2.53	4	3.05	4
2	Quality information for market participants	3.67	1	3.50	3
3	Enhancing standards of financial disclosure	3.43	3	4.56	1
4	Improved regulatory oversight and enforcement	3.58	2	3.66	2

Field Survey

Though the preparers and users are unanimous in their ranking that the adoption of IFRS will lead to improved regulatory oversight and enforcement, they however differ in respect of other benefits. Whereas the preparers ranked quality information for market participants, for the users, Enhancing standards of financial disclosure ranked first. prominent eight factors which could potentially lead to successful adoption of IFRS were considered and the results are shown below.

Table 5: KEY SUCCESS FACTORS FOR IFRS ADOPTION

		Preparers n= 74		Users n=43	
		Mean	Rank	Mean	Rank
1	Dependable analysis provided by the public and the press	4.66	2	4.51	5
2	Self enforcement by companies	4.50	5	4.55	3
3	Professional system of corporate governance	4.58	3	4.05	7
4	Professional support with IFRS experience	4.56	4	4.32	6
5	Executive and board support	4.78	1	4.64	2
6	Sufficient funding	3.80	8	4.53	4
7	Trained workforce	4.00	6	4.78	1
8	Having technology in place to support the conversion	3.84	7	3.76	8

Field Survey

From the results presented in the Table, it is evident that preparers and users are not unanimous in their rankings. The preparers ranked executive and board support as the most important factor while the users ranked it as the second. This is closely followed by dependable analysis provided by the public and the press as the second for the preparers, whereas the users consider Trained workforce as the most important. The preparers ranked sufficient funding as the least important factor while the users ranked the having technology in place to support the conversion as the least factor. Overall, the mean scores for each of the factors and for both the preparers and users are quite above the average, suggesting that they are positive that the factors listed have potential to lead to successful adoption of IFRS.

The next question probed the perception of preparers and users in terms of the challenges of the adoption of IFRS. The results are presented in table 7.

Table 6: CHALLENGES OF IFRS ADOPTION

		Preparers n= 74		Users n=43	
		Mean	Rank	Mean	Rank
1	Ethical environment	4.12	4	4.23	3
2	Retention of key employees	4.56	3	4.34	2
3	Complexity of conversion	4.00	5	3.89	4
4	Compliance and enforcement	4.65	2	3.65	5
5	Training and funding	4.76	1	4.65	1

Field Survey

The results presented in Table 7 show that the preparers and users differ in their ranking of the challenges of the adoption of IFRS in six issues raised. They are unanimous that the training and funding is the most important challenge for the successful adoption of IFRS. This should not be surprising because availability of trained personnel and funding is the most important issue for adopting IFRS in the country . The result also show that retention of qualified employees will be a challenge as it is ranked third and second respectively by the preparers and users. In this early stage of IFRS, poaching of staff, especially accounting personnel might be pronounced due to the dearth of such personnel.

6. CONCLUSION

By presenting the results of a questionnaire survey addressed to preparers and users of financial reports (represented by Financial officers and Financial analysts respectively), this study has provided evidence of the potential benefits and

challenges of the adoption of IFRS in Saudi Arabia. The results show that the introduction of IFRS in Saudi Arabia will result in a number of important benefits for a wide range of stakeholders. The benefits of ease of using one consistent reporting standard in subsidiaries from different countries will accrue to companies while investors will benefit, amongst others, more confidence in the information presented in financial statements which they can understand and use. For policy makers (management), the adoption of IFRS will create better access to the global capital markets and a higher standard of financial disclosure for national regulatory bodies. Similarly, other stakeholders would benefit from overall better reporting and information on new and different aspects of the business. The benefits will be largely driven by a number of potential success factors which include among others professional support with IFRS experience and self enforcement by companies. The benefits and potential success factors notwithstanding, there are a number of challenges to be faced in the process of adoption of the new standard. These among others include ethical environment and the ability to protect qualified and competent employees from being poached by other companies. Against the backdrop of the objectives of this paper, the following recommendations are hereby suggested:

7. RECOMMENDATIONS AND SUGGESTIONS

- (a) As the time table for the adoption of IFRS in Saudi Arabia has been determined, updating this research to take account of the areas of differences in perception between preparers and users may provide further useful information.
- (b) Saudi Arabia's adoption of IFRS should be supported as a matter of national urgency to enable full attainment of the country's economic potential.
- (c) Saudi Organization for Certified Public Accountants (SOCPA) should expedite approvals and processes required for formal adoption of IFRS as national accounting standard in Saudi Arabia.
- (d) The education, sensitization, and communication to stakeholders of issues associated with IFRS should commence in earnest.
- (e) A rigorous IFRS capacity building program should be embarked upon by all regulatory bodies, firms and training institutions in order to provide the needed manpower for IFRS implementation.

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