IFRS Accounting Standards discussion fora: IFRS 1 *First-time Adoption of International Financial Reporting Standards*

2023

Addis Ababa, Ethiopia

WORLD BANK GROUP

AABE

Accounting and Audit Board of Ethiopia

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Aims

- Develop a more cohesive understanding of accounting and reporting for first-time adoption of IFRS Accounting Standards in Ethiopia
- Enhance capacity in Ethiopia to apply IFRS 1 *First-time Adoption of International Financial Reporting Standards* more consistently

Applicable version of IFRS Accounting Standards

Unless specified otherwise, the accounting requirements that are the subject matter of this discussion forum are IFRS Accounting Standards as issued by the International Accounting Standards Board that are applicable for annual period beginning on or after 1 January 2023 without early applying new and amended IFRS Accounting Standards that have a later mandatory application date.

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First-time adoption of IFRS

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Issue 1: Conversion from gaap to IFRS

Conversion to IFRS
What do you think?

Conversion to IFRS is both an accounting technical change (applying IFRS 1) and an operational/systems/process/culture change.

What is the process of conversion from gaap to IFRS?

Conversion to IFRS
Summary of discussion

What is the process of conversion from gaap to IFRS?

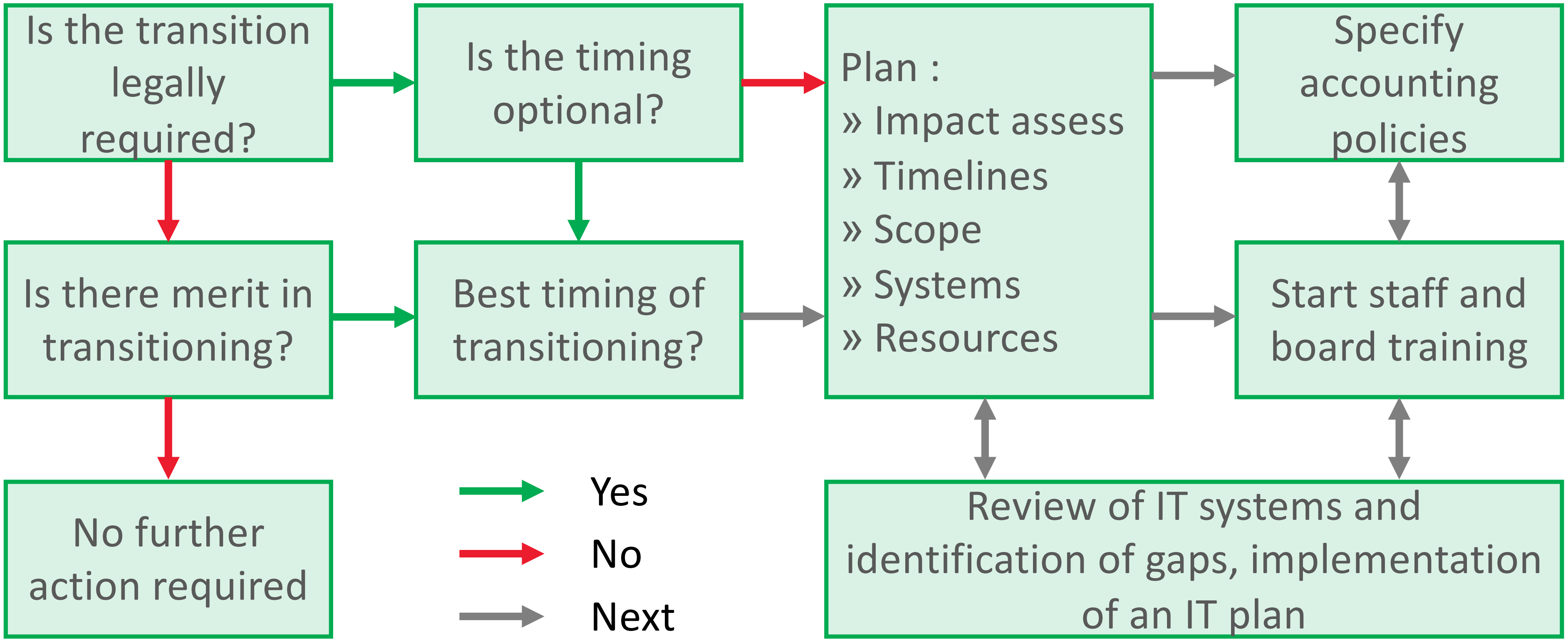
Discussants' consensus view:

There are two interrelated streams that should be considered:

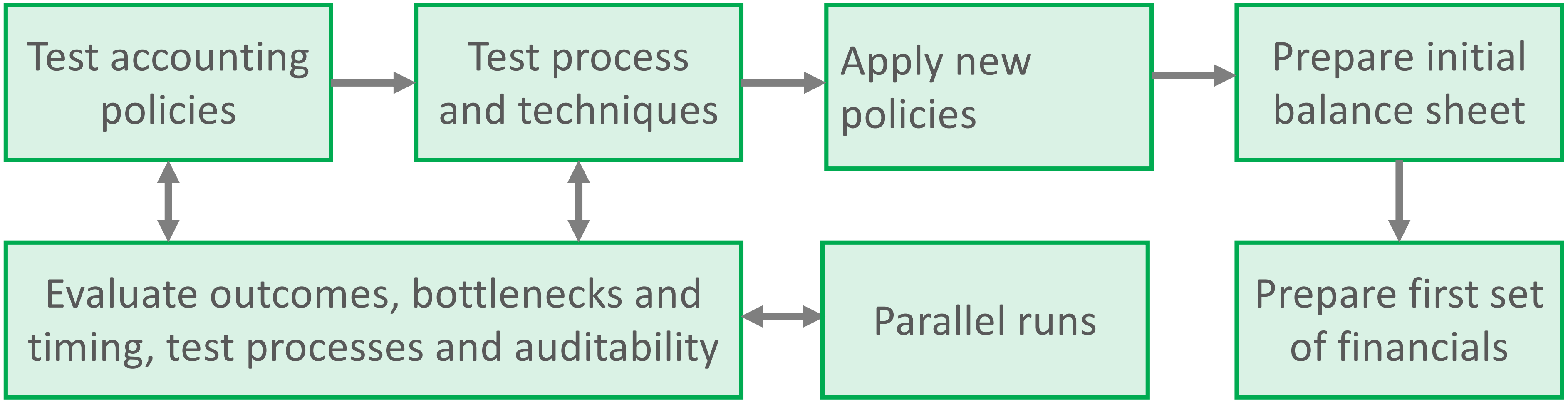
- Requirements and choices under IFRS Accounting Standards, including requirements and reliefs provided in IFRS 1
- Operational, systems, data, process and culture necessary to give effect to those changes

The decision tree on the next slide sets out a possible approach to the streams.

Conversion to IFRS
Decision tree (1 of 2)



Conversion to IFRS
Decision tree (2 of 2)



Continuous feedback of learnings through process, tweak systems, update training of staff and board, interaction with auditors, regulators and tax authorities

Issue 2: Main differences between gaap and IFRS

Ethiopian gaap versus IFRS
What do you think?

IFRS Accounting Standards are a codified, principle-based set of financial accounting standards. Ethiopian gaap is a generally accepted approach to preparing financials and is only partially codified.

What are the main differences between Ethiopian gaap and IFRS?

Ethiopian gaap versus IFRS
Summary of discussion

What are the main differences between Ethiopian gaap and IFRS?

Discussants' consensus view:

» The uncodified nature of Ethiopian gaap makes clear identification of differences difficult, and frequently company specific

» Biggest cause of differences is alignment of accounting practices under gaap with tax requirements

» Research has identified[1] that Ethiopian gaap mirrors IFRS in many respects, but that the lack of codification leads to less rigor in application

» Gap analysis is therefore an essential element of adoption of IFRS, and will likely differ from company to company

1 https://www.researchgate.net/publication/333679683_COMPARISON_OF_IFRS_AND_GAAP_REPORTING_STANDARDS_Case_study_on_Abay_Bank_2

Issue 3: Retention of reserves created at first-time adoption

Reserves created on transition
What do you think?

Transition to IFRS Accounting Standards has the potential to create positive reserves in equity, for example on an upward revaluation of PPE to deemed cost.

We have reserves resulting from first-time adoption of IFRS - how long should this reserve be retained in the accounts?

Reserves created on transition
Summary of discussion

We have reserves resulting from first-time adoption of IFRS - how long should this reserve be retained in the accounts?

Discussants' consensus view:

- IFRS defines equity as the residual after deducting liabilities from assets
- IAS 1 (eg para 109) identifies certain sub-classes of equity. Other standards add to these subclasses (revaluation surpluses in IAS 16 and IAS 38)
- IAS 1.96 allows IAS 16 and IAS 38 revaluation surpluses '*be transferred to retained earnings … as the asset is used or when it is derecognised'*
- IAS 1 permits more sub-classes then the minimum requirements in IFRS so long as total equity is not changed

Reserves created on transition
Summary of discussion continued

We have reserves resulting from first-time adoption of IFRS - how long should this reserve be retained in the accounts?

Discussants' consensus view *continued*:

» Regulatory

  » Regulators in many jurisdictions stipulate further sub-division of equity, as well as the retention period for these sub-classes

  » As long as this does not change the value of total equity, this is not inconsistent with IFRS

» Consequently, in applying sub-catagorising equity into reserves (including reserves created on adoption), entities typically apply the regulatory requirement

Issue 4: Distribution of non-cash ‘reserves’

Distribution of non-cash reserves
What do you think?

Some retained income and/or reserves are created through the revaluation (eg PPE) or remeasurement (eg shares) of assets and liabilities. This increase in equity does not directly result in cash flows to the entity.

As discussed in the previous question, retention of a revaluation reserve is a jurisdictional matter. However, from technical perspective, how is it possible to distribute such a reserve which did not result from cash inflow?

Distribution of non-cash reserves
Summary of discussion

Retention of a revaluation reserve is a jurisdictional matter. However, from technical perspective, how is it possible to distribute such a reserve which did not result from cash inflow?

Discussants' consensus view:

» IFRS, like much other gaap, is an accrual-based accounting methodology

» This means that there is frequently misalignment between IFRS income and net cash inflows (for example sales on credit or revaluation of PPE)

» Retained earnings are an accumulation of earnings from various sources - cash is equally a combination of net cash inflows from different sources

» IFRS has no restriction on when cash or other assets may be distributed, however jurisdictional regulators frequently restrict what can be distributed

Issue 5: Backlogged Ethiopian gaap financial statements

Backlogged financial statements
What do you think?

Financial statements can become backlogged, occasionally by multiple years. In such circumstances, catching up financials in an arduous but necessary step to ensure integrity of financial numbers.

If a Company's financial statements are significantly back-logged, is it possible to convert from gaap to IFRS without challenges? If it is possible how can this be done?

Backlogged financial statements
Summary of discussion

If a Company's financial statements are significantly back-logged, is it possible to convert from gaap to IFRS without challenges? If it is possible how can this be done?

Discussants' consensus view:

» IFRS and gaap record the results of past transactions, events and circumstances, some of which may date back many years

» Consequently, financial statements represent a progression of information over time

» Financial statements provide information to hold senior management accountable, as a basis for determining tax, and as a recordal of economic indicators (among others purposes)

» **<u>It is therefore generally essential for an entity to 'catch up' back-logs</u>**

Backlogged financial statements
Summary of discussion *continued*

If a Company's financial statements are significantly back-logged, is it possible to convert from gaap to IFRS without challenges? If it is possible how can this be done?

Discussants' consensus view *continued*:

» IFRS 1 does provide reliefs on first-time adoption of IFRS

» These reliefs provide the adopter with the opportunity to clean up past data, for example by applying a deemed cost approach to certain assets

» However, this does remedy:

  » Lack of accountability

  » Tax and other obligations

Issue 6: Deemed cost

Deemed cost
What do you think?

Under IFRS, the default approach is full retrospective – IFRS is applied to the original acquisition of an asset, and to each subsequent period to determine opening IFRS balance. IFRS 1 allows a first-time adopter the choice of instead applying deemed cost to certain assets (including PPE) at the date of transition.

During first-time adoption to IFRS, deemed cost has been interpreted differently in Ethiopia with respect to IAS 16. IFRS allows deemed cost for first-time adoption of PPE, but what does it mean?

Deemed cost
Summary of discussion

During first-time adoption to IFRS, deemed cost has been interpreted differently in Ethiopia with respect to IAS 16. IFRS allows deemed cost for first-time adoption of PPE, but what does it mean?

Discussants' consensus view:

IFRS 1, D5 to D8 defines deemed cost for PPE as one of

» fair value at the date of transition; or

» revaluation under Ethiopian gaap before date of transition (only if, at date of revaluation, revalued amount is broadly comparable to fair value or cost/depreciated cost indexed for inflation; or

» event-driven fair value under Ethiopian gaap at a date before the end of the period covered by the first IFRS financial statements

Issue 7: Combined operations

Combined operations
What do you think?

IFRS 3 *Business Combinations* is applicable[1]. For SOEs, business combinations are usually with other SOEs and consequently occur between entities under common control.

Two organizations are combined under restructuring - the first implemented IFRS before the combination and the other did not. How can the IFRS reporting be approached for the combined (restructured) entity.

[1] IFRS 3 is also discussed separately elsewhere in these Q&As

Combined operations
Summary of discussion

Two organizations are combined under restructuring - the first implemented IFRS before the combination and the other did not. How can the IFRS reporting be approached for the combined (restructured) entity.

Discussants' consensus view

» Business combinations under common control are scoped out of IFRS 3

» However, common control entities can chose to apply it

» A key element of IFRS 3 business combinations accounting is decided which entity is the acquiror and which is the acquiree

» Following that key decision, the accounting differs (see next slide)

Combined operations
Summary of discussion

» Assuming the combined entities are required or elect to apply IFRS 3

Acquiror previously adopted IFRS	Acquiree previously adopted IFRS
• Acquiror accounting and accounting values remain unchanged • Acquiree assets and liabilities are typically recognised by the acquirer at their combination-date fair value • From the date of combination, acquiree applies IFRS to restated balance sheet • IFRS 1 is not reapplied by acquirer	• Acquiror accounting and accounting values remain unchanged • Ethiopian GAAP would be applied to the combination • At some future date, the combined entity transitions to IFRS • IFRS 1 is applied