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Perceived costs and benefits of IFRS adoption in Saudi Arabia: An exploratory study

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ABSTRACT

In response to a current lack of research in the Middle East, this study aims to critically evaluate the perceived costs and benefits associated with the adoption of International Financial Reporting Standards (IFRS) in Saudi Arabia, the world's leading oil and natural gas exporter. Using documentary analysis and interviews with stakeholders (account preparers from listed companies in Saudi Arabia, auditors from Big 4 and local accountancy firms, and university academics), the study contributes to the literature by concluding that the benefits of IFRS adoption in Saudi Arabia outweigh the costs. Importantly, a lack of qualified accountants, significant dependence on Big 4 accounting firms, inadequate coverage of IFRS in university education, and a lack of research are identified as major obstacles to the effective implementation of IFRS. The findings offer a possible policy agenda for local and international policy makers.

1. Introduction

> *"…[It is] IFRS [International Financial Reporting Standards] that brings transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability within the global economy."*
>
> Hans Hoogervorst, chairman of the IASB (IFRS Foundation, 2015a)

In a 2015 speech "Financial Reporting Standards for the World Economy" delivered in Toronto, Canada, Hans Hoogervorst, the chairman of the International Accounting Standards Board (IASB), explained that the IASB's new mission was "to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles" (IFRS Foundation, 2015a). He also argued that IFRS continued to be adopted around the world, creating a bridge between countries with very different legal systems.

Since the turn of the millennium, as the pace of globalization and integration of international financial markets has gained momentum, the IASB's efforts to harmonize international accounting standards have also intensified (Al-Akra, Eddie, & Ali, 2010; Alzeban & Gwilliam, 2014; Li & Yang, 2016). The number of countries that have adopted the International Financial Reporting Standards (IFRS) issued by the IASB is growing rapidly (Rodrigues, Schmidt, & Santos, 2012). The standards have gained momentum in Europe since 2005 when adoption of IFRS became mandatory in all European Union (EU) member states. This is now a decade-old news story. According to the IFRS Pocket Guide for 2015, 138 countries have adopted IFRS. Of these, 114 require the use of IFRS by all or most publicly listed companies, and most of these countries have adopted IFRS in full and without modification. The IASB's standards have not only been endorsed by developed economies with advanced capital markets, but have also been adopted more widely, bringing middle income, less developed, and emerging economies into the fold of the world economy (Nurunnabi, 2014). Several researchers, like Fox, Hannah, Helliar, and Veneziani (2013) and Uzma (2016), have called for further research evidence on the benefits and costs of IFRS adoption.

The primary objective of this study is to critically evaluate the adoption of IFRS in Saudi Arabia. There has, though, been limited research on the issue of IFRS adoption in the Middle East, and, in addressing this gap, this study focuses on Saudi Arabia, an oil-rich country that is reliant on the oil and gas industry, but which is looking to diversify its economy. According to the Organization of the Petroleum Exporting Countries (OPEC) (2016), Saudi Arabia has almost a fifth of the world's known oil reserves and is also rich in other natural resources such as natural gas, iron ore, gold, and copper. It is the world's biggest exporter of petroleum, with the oil and gas sector accounting for about 50% of the country's GDP and about 85% of export earnings. This study therefore aims to fill this gap in research literature by investigating the following research questions:

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RQ1: What are the benefits and costs of IFRS adoption in Saudi Arabia?

RQ 2: Do the benefits outweigh the costs or vice versa on the adoption of IFRS in Saudi Arabia?

The study contributes to existing literature in two ways. Firstly, it concludes that the benefits of adopting IFRS outweigh the costs. Secondly, it reports several factors including lack of qualified accountants, significant dependence on Big 4 accounting firms (KPMG, PwC, Ernst & Young, and Deloitte), a lack of coverage of IFRS in university education, and a lack of research to be major challenges in the effective implementation of IFRS. The findings of the study offer an agenda for local and international policy makers.

The remainder of this paper is structured as follows. The next section explains Accounting Regulatory Framework in Saudi Arabia. Section 3 briefly discusses prior literature. Section 4 explains the research methodology adopted. Section 5 presents the findings of the study and includes a discussion of the key benefits and costs of adopting IFRS. Section 6 presents conclusions.

2. Accounting regulatory framework in Saudi Arabia

Regarding accounting regulatory framework, the International Monetary Fund's (IMF) (2012) paper *Saudi Arabia: Reports on the Observance of Standards and Codes* stated that "the regulatory framework for the securities market in Saudi Arabia has significantly developed since the enactment of legislation to regulate the capital markets" (p. 4). The Tadawul (the Saudi stock exchange) was established as a joint stock company in accordance with Article 20 of the Saudi Capital Market Law (CML) (Tadawul, 2016a), and the market performance of the stock exchange indices for the last five years (2014–2018) is shown in Appendix A. The CML defines the duties and powers of the CMA (Capital Market Authority) which was established in 2003 under the CML (Royal Decree Number M/30) and has responsibility for monitoring the capital market (Tadawul, 2016b). The Saudi Arabian Monetary Agency (SAMA), the Saudi central bank, is the government body responsible for regulating and monitoring market activities in Saudi Arabia. Indeed, the successful mandatory adoption of IFRS will also need urgent attention from the CMA (International Monetary Fund, 2013).

Currently, banks and insurance companies in Saudi Arabia are required to report under IFRS in line with SAMA regulations. All other listed and unlisted companies are required to follow the Saudi Organization for Certified Public Accountants (SOCPA) accounting standards until 2016. The responsibilities of the SOCPA include development and approval of accounting and auditing standards. In July 2013 the SOCPA board approved an IFRS convergence plan and stated that all listed companies other than banks and insurance companies were required to follow IFRS from 1 January 2017. All other entities are required to report under IFRS from 1 January 2018. In the case of banks and insurance companies, auditors currently require compliance with IFRS and accounting standards issued by the SAMA, the relevant Saudi Banking Control Law, the bank's bylaws, and the entity's articles of association (for insurance companies) (IFRS Foundation, 2015b). The transition towards IFRS and the process for evaluating the suitability of individual standards to the Saudi financial and business environment was set out in the "SOCPA Project for Transition to International Accounting Auditing Standards". The standards were split into 14 groups. Based on the initial assessment, it was reported that 18 effective IFRSs directly correspond to Saudi accounting standards. Six IFRSs are partially covered by Saudi accounting standards; nine IFRSs have no corresponding Saudi accounting standards; and two Saudi accounting standards have no corresponding IFRS. As of March 2017, the SOCPA had reached the third stage in the transition plan – it had reviewed 37 standards and 14 standards had been endorsed for issuing locally with modifications (see Appendix B). In this study, the terms "costs" and "challenges" are used interchangeably.

3. Prior literature

Prior research has identified a number of socio-environmental factors that influence the financial reporting practices of a given country (Adhikari & Tondkar, 1992; Belkaoui, 1996; Islam & Hossain, 2017; Nurunnabi, 2014, 2017; Pajunen, 2013; Phan & Mascitelli, 2014; Rodrigues et al., 2012). As already stated a large number of countries around the world are adopting IFRS (Al-Akra et al., 2010; Alzeban & Gwilliam, 2014; Chand, Patel, & Patel, 2010; Dalton, Buchheit, Oler, & Zhou, 2013; Huerta, Petrides, & Braun, 2013; Muniandy & Ali, 2012; Uyar & Güngörmüş, 2013). Chand et al. (2010, p. 280) call for further research since "much attention has been given in the extant accounting literature to accounting standards, as to how they vary across countries, and the political and economic pressures to reduce variation". Muniandy and Ali (2012) argue that quality in financial reporting practices is necessary to build the confidence of stakeholders and potential investors.

According to Fox et al. (2013, p. 88), the costs and benefits of IFRS adoption may vary from firm to firm and even across countries. IFRS implementation has benefits as well as costs. For example, Ramanna and Sletten (2009) used a sample of 102 non-EU countries, and investigated the variations in the decision to adopt IFRS. They found that:

(a) More powerful countries are less likely to adopt IFRS as such countries are less inclined to surrender standard-setting authority to an international body.
(b) IFRS adoption at first increases and then decreases the quality of countries' domestic governance institutions.
(c) In terms of network effects in IFRS adoption, a country is more likely to adopt IFRS if its trade partners or countries within in its geographical region are IFRS adopters.
(d) There is no evidence that IFRS adoption affects the expected changes in foreign trade and investment flows.

Using a sample of 150 randomly selected listed companies in three countries (UK, Hong Kong and Singapore) in their first year of first-time adoption of IFRS, Taylor (2009) compared the costs of the transition to IFRS and found the cost of adjustment to first-time adoption of IFRS for UK companies to be greater than for companies in Hong Kong and Singapore. Fox et al. (2013) investigated the costs and benefits of IFRS adoption in the UK, Republic of Ireland and Italy and reported the costs exceeded the benefits of reporting under IFRS.

In the case of Brazilian experience, Rodrigues et al. (2012) also earlier highlighted that the decision to converge to IFRS was determined by government and Brazilian accounting associations on this issue did not even explain clearly the government considered IFRS adoption. In the case of Finland, Pajunen (2013) argues that a positive attitude towards IFRS is needed for effective implementation of IFRS. Using the perceptions of the preparers of 305 Australian company financial reports, Morris, Gray, Pickering, and Aisbitt (2014) evaluated the costs and benefits of implementing IFRS. They found "...a very negative tone among respondents reflecting concerns about the problems of IFRS implementation and the low level of expected benefits", and identified three main aspects to the concerns about IFRS. These were difficulties associated with specific accounting issues; the ongoing monetary costs involved; and the perceived limited impact the changes would have on capital markets.