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Article

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Cogent Economics & Finance

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Suggested Citation: Abebe, Ayalew Ali (2022) : The effect of IFRS on the financial ratios: Evidence from banking sector in the emerging economy, Cogent Economics & Finance, ISSN 2332-2039, Taylor & Francis, Abingdon, Vol. 10, Iss. 1, pp. 1-15,
<https://doi.org/10.1080/23322039.2022.2113495>

This Version is available at:

<https://hdl.handle.net/10419/303762>

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To cite this article: Ayalew Ali Abebe (2022) The effect of IFRS on the financial ratios: Evidence from banking sector in the emerging economy, Cogent Economics & Finance, 10:1, 2113495, DOI: [10.1080/23322039.2022.2113495](https://doi.org/10.1080/23322039.2022.2113495)

To link to this article: <https://doi.org/10.1080/23322039.2022.2113495>



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Received: 08 March 2022
Accepted: 11 August 2022

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Reviewing editor:
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FINANCIAL ECONOMICS | RESEARCH ARTICLE

The effect of IFRS on the financial ratios: Evidence from banking sector in the emerging economy

Ayalew Ali Abebe^{1*}

Abstract: Financial ratios are ratios that are used to measure a company's performance by analyzing its financial records. In light of this claim, this study investigates the effect of IFRS on the financial ratios among seventeen (17) Ethiopian commercial banks. The research hypotheses are addressed by comparing financial ratios computed under Ethiopian GAAP with those computed under the IFRS regime from 2016 to 2020 using Wilcoxon Signed Rank and the Normality Test. The finding revealed that IFRS has a significant effect on the liquidity ratio of commercial banks in Ethiopia, and banks reported higher liquidity under IFRS than under Ethiopian GAAP. The finding also revealed that IFRS has a significant effect on commercial banks' return on equity and that banks recorded a higher return on equity under IFRS than under Ethiopian GAAP. Moreover, the study found IFRS has a significant effect on the leverage ratio of commercial banks in Ethiopia, and banks reported lower leverage under Ethiopian GAAP than under IFRS. However, the finding revealed that IFRS has an insignificant effect on the return on assets of commercial banks in Ethiopia, and banks recorded a lower return on assets under IFRS than under Ethiopian GAAP. The study concluded that the difference in return on equity, liquidity, and leverage of commercial banks following the adoption of IFRS is significant. Therefore, investors and financial analysts should pay close attention to the return on equity (ROE), liquidity ratio (LR), and leverage (LEV) because they are significantly affected by the adoption of IFRS.

ABOUT THE AUTHOR

Ayalew Ali Abebe is a senior lecturer at Mizan Tepi University. He received his BA degree in cooperative accounting and auditing from Mizan Tepi University and his MSc in accounting and finance from Hawassa University. His research interests are in the areas of small and medium-scale enterprise (SME), corporate finance, entrepreneurship, and banking and finance.

PUBLIC INTEREST STATEMENT

This paper aimed to assess the effect of IFRS on the financial ratios of banks in Ethiopia. IFRS is the international accounting framework within which to properly organize and report financial information. IFRS requires businesses to report their financial results and financial position using the same rules. This means that, barring any fraudulent manipulation, there is considerable uniformity in the financial reporting of all businesses using IFRS, which makes it easier to compare and contrast their financial results. The findings of this investigation revealed that IFRS has a significant effect on the liquidity ratio, return on equity, and leverage ratio of banks in Ethiopia. However, the finding revealed that IFRS has an insignificant effect on the return on assets of banks in Ethiopia. Therefore, investors and financial analysts should pay close attention to these significant factors.

Subjects: Economics; Finance; Business, Management and Accounting; Industry & Industrial Studies

Keywords: Banks; GAAP; IFRS; leverage; liquidity; return on assets

1. Introduction

The importance of International Financial Reporting Standards (IFRS) by developed and emerging economies has been highlighted by the interconnectedness of cross-border investment and the development of corporate internationalization (Erin et al., 2017). The implementation of IFRS will improve the quality of financial data and establish a robust communication channel among relevant stakeholders (Smith & Bushman, 2001). The primary goal of the International Financial Reporting Standards (IFRS) is to maintain consistency in the compilation of financial statements and to make them more comparable. Better disclosure of corporate information, enhanced comparability of financial statements across national borders, facilitation and improved international financial markets, and the collapse of capital movement barriers across national borders are some of the identified benefits of adopting International Financial Reporting Standards (Abuda & Rudiawarni, 2015).

The International Financial Reporting Standards (IFRS) are widely regarded as an internationally acknowledged, high-quality reporting standard that is expected to transform most organizations' basic financial and management reporting. The International Financial Reporting Standards (IFRS) aid in the compilation of external financial reporting as well as internal management reporting (Emeni et al., 2016). The rapid growth of Ethiopia's economy in the global market, like that of other areas of the world, necessitated the adoption of a globally recognized accounting system. This measure required policymakers in Ethiopia's financial sector regulatory agencies to ensure migration to the IFRS reporting system. As a result, Ethiopia's official adoption of International Financial Reporting Standards (IFRS) began in 2014.

It is thought that business owners and managers all over the world are very interested in finding the best way to run their businesses and satisfy their financial commitments, consequently increasing their profit margins. Therefore, to survive and promote progressive growth, organizations must govern their strategies and apply proper financial rules (Ksenija, 2013; S.A. Owolabi & Obida, 2012). As a result, profit as the primary goal of the company is viewed as a relative measure in comparison to other factors such as good reporting standards such as the International Financial Reporting Standards (IFRS), which can have a positive impact on the profitability of the organization.

Identifying which accounting standard, IFRS or GAAP, produces a higher financial ratio in Ethiopian banks is the basic motivation of this study. The banking sector was chosen because sufficient data is available, banks formally started preparing their financial statements using IFRS during the study period, and banks are predominant and play a great role in the Ethiopian economy. The major problem that the study faced is that commercial banks in Ethiopia failed to make retrospective adjustments to their financial statements, which limited the range of the data only to 2016 to 2020.

The current study contributes to the financial literature because it is the first of its kind to look at the effect of IFRS on the financial ratios of the banking sector in Ethiopia and is useful for individuals who are interested in investing in the banking sector in Ethiopia. Moreover, the finding enables investors and other market participants to make informed economic decisions and provide information that is needed to hold management to account.

Several studies on International Financial Reporting Standards (IFRS) and financial ratios in developed economies have been conducted by (Blanchette et al., 2011), (Nengzih, 2015), (Lantto

& Sahlstrom, 2009), (Hung & Subramanyam, 2004), and (Terzi et al., 2013). Furthermore, the studies in Ethiopia are focused on the challenges and opportunities of adopting the International Financial Reporting Standard (Alemi & Pasricha, 2016; Zewdu, 2019), which means any study has not yet been explored on the effect of IFRS on the financial ratios of commercial banks in Ethiopia. Therefore, this study investigates the effect of IFRS on the financial ratios of banks in Ethiopia with the specific aims of:

- Examine the effect of IFRS on the return on assets of banks in Ethiopia
- Determine the effect of IFRS on the return on equity of banks in Ethiopia
- Investigate the effect of IFRS on the liquidity ratio of banks in Ethiopia
- Assess the effect of IFRS on the leverage of commercial banks in Ethiopia

2. Literature review

2.1. Concepts and definitions of IFRS and GAAP

International Financial Reporting Standards (IFRS) set common rules so that financial statements can be consistent, transparent, and comparable around the world. International Financial Reporting Standards (IFRS) are issued by the International Accounting Standards Board (IASB), formerly known as the International Accounting Standards Committee (IASC). The International Financial Reporting Standards (IFRS) specify how companies must maintain and report their accounts, defining types of transactions and other events with financial impact. The International Financial Reporting Standards (IFRS) were established to create a common accounting language so that businesses and their financial statements could be consistent and reliable from company to company and country to country. IFRS is sometimes confused with International Accounting Standards (IAS), which are the older standards that IFRS replaced (Barclay Palmer, 2021). Obviously, there are major differences in the financial reporting of companies in different countries. These differences result in complications in preparing, consolidating, auditing, and interpreting published financial statements. There has been a greater need to bridge the gap between the differences in financial reporting standards among countries. To make this real, several organizations have been involved in trying to harmonize the financial reporting standards worldwide.

More than 144 countries around the world have adopted the International Financial Reporting Standard (IFRS), which aims to establish a common global language for company accounting affairs. But all countries are not adopting the International Financial Reporting Standards (IFRS) and still use the old General Accepted Accounting Principles (GAAP). The major difference between Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) is that Generally Accepted Accounting Principles (GAAP) are rule-based, whereas International Financial Reporting Standards (IFRS) are principle-based. Basically, International Financial Reporting Standard (IFRS) guidelines provide much less overall detail than Generally Accepted Accounting Principles (GAAP). Consequently, the theoretical framework and principles of the International Financial Reporting Standards (IFRS) leave more room for interpretation and may often require lengthy disclosures on financial statements. On the other hand, the consistent and intuitive principles of the International Financial Reporting Standards (IFRS) are more logically sound and possibly represent the economics of business transactions.

2.2. Theories on the relationship between IFRS and financial ratios

The most important theories on the relationship between IFRS and financial ratios of this study are as follows.

2.2.1. Agency theory

The theory of agency is a supposition that explains the relationship between principals and agents in business. Agency theory is primarily concerned with resolving problems that exist in

agency relationships; that is, between principals (such as shareholders) and agents of the principals (for example, company executives). Agency theory addresses two concerns: the problems that arise when the desires or goals of the principal and agent are in conflict and the principal is unable to verify the agent's actions; and the variance in risk tolerance that may lead the principal and agent to take different actions Blake and Clizza (2012). The theory of agency is plagued by the problem of information asymmetry, a situation in which one party in a transaction has more or superior information than another. This causes potentially harmful situations because one party can possibly take advantage of the other party's lack of knowledge (Easley & Kleinberg, 2010). Management and investors are constantly in need of vast amounts of high-quality data, thus enabling them to make well-informed decisions that minimize risk and maximize return. Time and cost constraints often make perfect information impossible or the pursuit of it unrealistic.

The adoption of International Financial Reporting Standards (IFRS) has led to a significant correlation between external and internal financial reports, while the need to prepare information in accordance with International Financial Reporting Standards (IFRS) requires additional corporate costs. However, IFRSs are useful not only to external users but also to internal users and provides an appropriate basis for internal reporting, control and decision-making (Prochazka, 2010). IFRSs are thought to provide reliable accounting standards for developing and emerging countries that lack the resources to develop their own standards or who want to benefit from the adoption of universally accepted accounting standards (Samaha et al., 2016). According to Soderstrom and Sun (2007), the adoption of IFRS in the EU reduces the cost of cross-border comparison of companies. It also reduces the cost of the investor to assess the quality of the financial reports between the two companies, again reducing agency costs.

2.2.2. New institutional theory

New institutional theory (also known as new institutionalism or neo-institutionalism) appears to be gaining popularity. This is intended to be a widely accepted framework for actor-centered studies of organizations. In this state of affairs, new institutionalism cannot be seen as a full-fledged theory. New institutional theory has become a major approach to the social sciences generally. Institutionalism believes that institutions matter and policies are embedded in institutions. Individual political behavior is always present in institutions. In other words, institutions provide guidance for individual actions and could possibly provide sanctions when they do not adapt to the institutions' expectations. The study of institutions, therefore, involves the interaction of structure and agency in producing outcomes. Florou and Pope (2010) study changes in institutional investors' investment allocations surrounding IFRS adoption. Overall, they find that the institutional ownership in IFRS adopter companies increases after adoption. More importantly, the study documents that these effects are most pronounced for companies that reside in countries where institutions and enforcement are strong.

2.3. Empirical literature review and hypothesis development

Several studies have been carried out to investigate the implications of International Financial Reporting Standard (IFRS) adoption on financial ratios. Blanchette et al. (2011) looked at how Canadian Generally Accepted Accounting Principle (GAAP) and International Financial Reporting Standard (IFRS) adoption differed. The research used 26 financial ratios for nine (9) publicly traded companies and the study; found that International Financial Reporting Standard (IFRS) yielded a better result than financial ratios calculated under Canadian Generally Accepted Accounting Principles (GAAP). Similarly, Nengzih (2015) used a paired sample t-test to investigate the impact of International Financial Reporting Standards (IFRS) on the profitability ratios of sampled Indonesian listed firms and revealed the adoption of the International Financial Reporting Standards (IFRS) improved the average ratio of enterprises' profitability. On the other hand, Lantto and Sahlstrom (2009) looked into the impact of International Financial Reporting Standard (IFRS) adoption on financial ratios in Finland. The study assessed financial ratios for 91 Helsinki Stock Exchange listed businesses and found that profitability ratios rose, liquidity ratios decreased, and other market-

based financial measures decreased due to the adoption of the International Financial Reporting Standard (IFRS).

Goodwin et al. (2008) looked at the impact of accounts and accounting quality adjustments on financial ratios under DAS and International Financial Reporting Standards (IFRS) of 1,065 publicly traded companies in Australia and found liabilities, leverage, and profitability grow under the International Financial Reporting Standard (IFRS). However, equity declines under the International Financial Reporting Standard (IFRS).

Using a case study approach, Abdul-Baki et al. (2014) investigated the impact of the International Financial Reporting Standards (IFRS) on the financial ratio of listed enterprises in Nigeria using One-Sample Kolmogorov-Smirnov Test to determine normality and the Mann-Whitney U Test to determine significance. The study discovered that only investment and profitability ratios performed better under the International Financial Reporting Standards (IFRS).

Onipe et al. (2015) used a regression model projected using pooled data and fitted with dependent variables to investigate the effects of the implementation of the International Financial Reporting Standards on bank financial statements and found that International Financial Reporting Standard (IFRS) adoption has had a favorable impact on some financial statement. Moreover, the study found the shift to International Financial Reporting Standards (IFRS), given the fair value perspective of the International Financial Reporting Standards (IFRS), causes inconsistency in income statement.

Terzi et al. (2013) studied on the impact of International Financial Reporting Standards (IFRS) on the financial ratios in Turkey's listed manufacturing sector and found that the adoption of International Financial Reporting Standards (IFRS) in Turkey boosted the value of current ratios, liquidity ratios, and profitability ratios. In addition, Callao et al. (2007) investigated on the impact of IFRS adoption on associated financial parameters of 35 enterprises in Spain and found total liabilities, long-term obligations, cash equivalents, and shareholders' equity for financial ratios generated using the International Financial Reporting Standards (IFRS) were statistically significant when compared to financial measures prepared under local Generally Accepted Accounting Principles (GAAP).

Cengiz (2014) investigated the disparities between DAS and International Financial Reporting Standard (IFRS) financial ratios of firms on the Istanbul Stock Exchange and found that under DAS and International Financial Reporting Standards (IFRS), a statistical link was discovered for return on equity, return on assets, ratios of assets to equity, ratios of liabilities to equity, and ratios of liabilities to assets.

Agca and Aktas (2007) looked at financial accounts from various businesses to see how much variety there was in five (5) Turkish listed companies and found that there was a statistically significant difference between financial ratios prepared under International Financial Reporting Standards (IFRS) and those prepared under local standards moreover, Iatridis (2010) studied on the relationship between international financial reporting standards and financial ratios and found International Financial Reporting Standards (IFRS) adoption has a positive substantial influence on company performance (profitability and development potential) similarly, Ibiameke and Ateboh (2014) studied on the relationship between international financial reporting standards and financial ratios and revealed profitability ratios declined after International Financial Reporting Standard (IFRS) implementation in Nigeria.

Nwaogwugwu (2020) examined the impact of International Financial Reporting Standard (IFRS) adoption on the financial performance of companies in Nigeria as measured by ROA, ROE, and EPS and the study concluded that the adoption of International Financial Reporting Standards (IFRS) did not lead to higher performance. In addition, Turki et al. (2020) tested the impact of

International Financial Reporting Standards (IFRS) on the performance of companies in France based on three financial ratios, namely, retention ratio, Tobin Q, and price earnings ratio, and the study found that there was no direct impact of the application of International Financial Reporting Standards (IFRS) on the performance of companies and that the impact of the application was indirect through the cost of capital. On the same trend, Hussein and Nounou (2021) suggested that there are no significant differences between International Financial Reporting Standard (IFRS) companies and non-International Financial Reporting Standard (IFRS) companies for both stock price and stock return ratios in Egypt. Conversely, there is a significant difference between International Financial Reporting Standard (IFRS) companies and non-International Financial Reporting Standard (IFRS) companies in the company value ratio.

Ebaid (2022) studied on the relationship between adoption of the International Financial Reporting Standard (IFRS) and accounting-based performance measures from an emerging capital market. The study sampled 67 listed companies in the Saudi stock market from 2014 to 2019 and found there were no significant differences between profitability, liquidity, and leverage in the post-mandatory adoption period compared to the values of profitability, liquidity, and leverage in the pre-mandatory adoption period.

Akgün (2022), Investigate the relationship between bank performance and accounting standards evidence from M&As in European banking. The study aims to identify whether international financial reporting standards (IFRS) or local generally accepted accounting principles (GAAP) reporting provides investors and senior management of acquirer banks with superior information on target banks' post-merger bank performance and the study found that Generally Accepted Accounting Principle (GAAP) reporting allows a more transparent assessment of financial performance using traditional indicators, making it a superior tool for assessing potential acquisition targets.

Iyoha and Owolabi's (2012) studied on the adoption of IFRS in Africa and found investors believe that IFRS develops confidence in financial statements and those auditors or preparers hold the perception that IFRS will ensure consistent reporting in subsidiaries. However, local auditors fear that, at the initial stages of IFRS adoption, they may lose clients who may decide to opt for global audit firms (Tawiah & Musvosvi, 2017; Wieczynska, 2016). Okpala (2012) also revealed that Nigerian authorities perceive that IFRS brings more FDI into the country. Moreover, Nnadi and Soobaroyen (2015) found a negative relationship between IFRS and FDI. These contradictory findings imply that either the consequences of IFRS adoption have not been analyzed within their specific segment, particularly in the case of Africa, or the evidence to date is not useful (Ball, 2016). IFRS is an accounting and finance phenomenon; hence, its impact must be looked at from the angle of how it is affecting the accounting profession and practice in Africa.

As a result of the review of previous studies, the following are the hypotheses for this study:

H1: There is no statistically significant difference in the return on assets reported under IFRS compared to Ethiopian GAAP.

H2: There is no statistically significant difference in the return on equity reported under IFRS compared to Ethiopian GAAP.

H3: There is no statistically significant difference in the liquidity reported under IFRS compared to Ethiopian GAAP.

H4: There is no statistically significant difference in the leverage reported under IFRS compared to Ethiopian GAAP.

3. Methodology

3.1. Research design

The study used an ex-post facto, or causal comparative research design, to achieve its goal. Ex-post facto (causal comparative) is the most appropriate research design to apply when controlling and influencing all or any of the independent variables is not always possible, or when laboratory control would be impractical, expensive, or morally questionable (Brigham & Houston, 2011).

3.2. Population, sampling technique, data sources and variables description

The population under investigation is made up of 22 Ethiopian-listed banks. The sample size consists of 17 commercial banks using the census sampling technique because all banks prepare their financial statements using the International Financial Reporting Standard (IFRS), with the exception of Ethiopia's development bank, which is not for profit (non-commercial). Similarly, Zamzam bank, Hijra bank, Sinqee bank, and Shabelle bank are excluded from the analysis because they began operations in 2021 and have no five-year data. The data sample includes selected commercial banks listed in Ethiopia (Nib international bank, Abay bank, Addis international bank, Awash international bank, bank of Abyssinia, Berhan bank, Bunna bank, Commercial bank of Ethiopia, Cooperative bank of Oromia, Dashen bank, Debub global bank, Enat bank, Lion international bank, Ormia international bank, Hibret bank, Wogagen bank, and Zemen bank).

Unlike prior studies like Ibiameke and Atebo (2014) and Callao et al. (2007), which used two sets of financial statements from two distinct accounting years, this analysis used all of the financial statements from the same accounting year from 2016 to 2020. This guarantees that the numbers are comparable and that the true impact is demonstrated. Ethiopian Accounting Standard (AS) financial statements are utilized as a proxy for Ethiopian Accounting Standard (IFRS) based on the following assumptions:

- From the second year of Ethiopian AS adoption onwards, the majority of the IFRS 1 and Ethiopian AS differences are likely to be erased.
- The textual difference isn't taken into account.
- The entity selects the IFRS-compliant alternative, which is determined by Ethiopian AS.

3.2.1. Variables description

Financial ratios are created with the use of numerical values taken from financial statements to gain meaningful information about a company. The numbers found on a company's balance sheet, income statement, and cash flow statements are used to perform quantitative analysis. The financial ratios used in this study are discussed below.

3.2.1.1. Return on assets (ROA). It is a financial ratio that measures a bank's profitability in relation to its total assets. ROA is a metric that can be used by corporate management, analysts, and investors to measure how well banks use their assets to generate profit. Using a bank's net income and average assets, the metric is often stated as a percentage. A higher return on assets (ROA) implies that banks are more effective and productive in managing their balance sheets to create profits, whilst a lower ROA suggests that there is still space for improvement.

3.2.1.2. Return on equity (ROE). The ability of banks to earn a return on their equity investments is measured by this key ratio for shareholders. Without additional equity investments, ROE (net income divided by shareholders' equity) may rise. The ratio may rise as a result of higher net income generated by a larger asset base that is financed with debt.

3.2.1.3. Liquidity ratio. A liquidity ratio is a financial measure that is used to assess a bank's capacity to meet its short-term loan obligations. The metric is used to determine whether the

bank's current assets, or liquid assets, can cover its current liabilities. Moreover, Liquidity ratios are a type of financial indicator that is used to assess a debtor's capacity to repay current debt obligations without having to raise additional funds. Liquidity ratios calculate indicators including the current ratio, quick ratio, and operating cash flow ratio to determine the bank's capacity to meet debt obligations and its margin of safety.

3.2.1.4. Leverage ratio. Liquidity ratio shows how much of the banks' capital comes from debt, which is a useful indicator of whether the banks can meet its financial obligations. A higher financial leverage ratio implies that banks are relying on debt to fund its assets and activities, which is frequently a warning indicator that banks are in a dangerous investment. It could suggest that earnings would be erratic; that shareholders will have to wait a long time to get a meaningful return on their investment, or that the company will go bankrupt shortly. If a bank's financial leverage ratio is too high, it suggests spending too much of its cash flow on debt repayment and is more likely to fail on loans; however, lower financial leverage ratio usually indicates financially sound banks with a consistent revenue stream. An exceptional financial leverage ratio advises potential shareholders and credit agencies that a business poses minimal risk and is likely worth an investment, even if the corporation behind it is in heavy debt. Leverage ensures maximum utilization of capital and fixed assets in order to increase the profitability of a firm, it helps to know the reasons not having more profit by a company. Leverage is also an important technique in investing as it helps companies set a threshold for the expansion of business operations. The study variables are summarized in [Table 1](#).

3.3. Method of data analysis

Accounting figures were first retrieved from the financial statements of the sampled banks in order to calculate financial ratios, and then a normality test was performed to see if the data was normally distributed then financial ratios calculated using Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) were analyzed using descriptive statistics and the Wilcoxon Signed Ranks test. The Wilcoxon signed-rank test is a non-parametric statistical hypothesis test used either to test the location of a set of samples or to compare the locations of two populations using a set of matched samples; moreover, the Wilcoxon signed-rank test does not assume the differences between paired samples are normally distributed.

4. Empirical results and discussions

4.1. Descriptive statistics

As shown in [Table 2](#), the average value of ROA of commercial banks in Ethiopia was 0.0509869 under GAAP and 0.0397009 under IFRS, with a minimum of 0.01100 and 0.00195 under GAAP and IFRS, respectively. The maximum value of ROA was 0.29000 under GAAP and 0.31400 under IFRS. The ROA of commercial banks deviates from its mean by 0.06811272 under GAAP and 0.05627828 under IFRS. The mean value of ROE of commercial banks in Ethiopia was 0.1500867 under GAAP and 0.1795506 under IFRS, with a standard deviation of 0.07630785 and 0.06667738, respectively.

Table 1. Variables and their measurement

Variables	Symbol	Measurement
Return on assets of Ethiopian banks	ROA	Net income after tax to total asset of banks (Rao & Tekeste, 2012).
Return on equity of Ethiopian banks	ROE	Net income after tax to total equity of banks (F. Brigham & Houston, 2004).
Liquidity ratio /current ratio/ of Ethiopian banks	LR	Current asset to current liability of banks (Tariq et al., 2014).
Leverage of Ethiopian banks	LEV	Total debt to total equity of banks Mehari & Aemiro, 2013).

Table 2. Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
GAAP ROA	85	.01100	.29000	.0509869	.06811272
IFRS ROA	85	.00195	.31400	.0397009	.05627828
GAAP ROE	85	.00011	.35000	.1500867	.07630785
IFRS ROE	85	.02100	.45620	.1795506	.06667738
GAAP LR	85	.14800	1.52000	.5411906	.29953713
IFRS LR	85	.56000	1.30700	.8556741	.14392458
GAAP LEV	85	.12900	1.89000	.8400435	.16129998
IFRS LEV	85	.26800	.98500	.8612191	.09,298,626

Table 3. Tests of normality

	Kolmogorov-Smirnov^a			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	df	Sig.
GAAP ROA	.406	68	.000	.584	68	.000
IFRS ROA	.358	68	.000	.446	68	.000
GAAP ROE	.097	68	.000	.957	68	.020
IFRS ROE	.170	68	.000	.805	68	.000
GAAP LR	.086	68	.000	.948	68	.007
IFRS LR	.116	68	.024	.947	68	.006
GAAP LEV	.274	68	.000	.545	68	.000
IFRS LEV	.232	68	.000	.600	68	.000

* This is a lower bound of the true significance.

^aLilliefors Significance Correction

The minimum value of ROE was 0.00011 and 0.02100 under GAAP and IFRS, respectively. The maximum value of ROE of commercial banks in Ethiopia was 0.3500 and 0.45620 under GAAP and IFRS, respectively. The average value of liquidity of commercial banks in Ethiopia was 0.5411906 and 0.8556741 under GAAP and IFRS, respectively. The liquidity of commercial banks in Ethiopia deviates from its mean by 0.29953713 under GAAP and by 0.14392458 under IFRS. The minimum value of liquidity was 0.14800 under GAAP and 0.5600 under IFRS. The maximum value of liquidity was 1.5200 during GAAP and 1.30700 during IFRS. The average value of leverage was 0.8400435 under GAAP and 0.8612191 under IFRS. The leverage value of commercial banks deviates from its mean by 0.16129998 under GAAP and 0.9298626 under IFRS. The minimum value of commercial banks' leverage was 0.12900 under GAAP and 0.26800 under IFRS. The maximum value of leverage was 1.89 million under GAAP and 0.98 million under IFRS.

4.2. Normality test

The data points stray from the diagonal line because the significance under the Shapiro-Wilk test is all less than 0.05, whereas the test for normality assumes that the significance must be more than 0.05 for any data to be normally distributed (the diagonal line shows a clear nonlinear figure with the data points straying from the diagonal line). As a result, the Wilcoxon Signed Rank Test should be used to do the analysis because it is the optimum method of analysis for non-normally distributed data. The p-value for Kolmogorov-Smirnov is 0.000 indicates that there is significant evidence to reject the null hypothesis that the variable follows a normal distribution.

Table 4. Wilcoxon signed rank test

	IFRS ROA—GAAP ROA	IFRS ROE—GAAP ROE	IFRS LR—GAAP LR	IFRS LEV—GAAP LEV
Z	−1.096 ^b	−2.910 ^c	−7.177 ^c	−2.773 ^c
Asymp. Sig. (2-tailed)	.273	.004	.000	.006

^aWilcoxon Signed Ranks Test

^bBased on positive ranks.

^cBased on negative ranks.

4.3. Wilcoxon signed rank test

As shown in [Tables 3 and 4](#), respectively, return on assets (ROA) is insignificant; however, return on equity (ROE), liquidity ratio (LR), and leverage (LEV) are all significant at the one-percent significance level, with p-values of 0.004, 0.000, and 0.006 respectively. Furthermore, the results demonstrate that the difference in return on equity, liquidity, and leverage of Ethiopian banks following the implementation of the International Financial Reporting Standard (IFRS) is significant. Conversely, the difference in return on assets of Ethiopian banks following the implementation of the International Financial Reporting Standard (IFRS) is not significant.

4.4. Hypothesis testing and discussions of result

In the first hypothesis, it was believed that there is no statistically significant difference in the return on assets reported under IFRS compared to Ethiopian GAAP. The Wilcoxon Signed Rank Test analysis shows that the P-value of 0.273 indicates that ROA is not significant at this level. As a result, the null hypothesis has been accepted and the alternative hypothesis has been rejected.

The result of this study showed banks reported less return on assets (ROA) during IFRS than Ethiopian GAAP, with a negative and insignificant result. This is because banks incurred more costs for the implementation of IFRS in Ethiopia and the negative relationship is the result of banks funding it to be expensive to implement efficient new standards. The findings of this study is consistent with Tanko (2012), Abdul-Baki et al. (2014), Lantto and Sahlstrom (2009), Terzi et al. (2013), Kabir et al. (2010), and Nengzih (2015). Furthermore, the findings of this study is supported by the findings of Uzoma et al. (2016), who reported that banks in Nigeria performed better before IFRS adoption than after adoption. Similarly, Ibiame and Ateboh (2014) documented a negative relationship between IFRS adoption and return on assets. However, Blanchette et al. (2011), Agca and Aktas (2007), and Iatridis (2010) found a statistically significant effect and difference in profitability ratios measured under POSTIFRS as compared to the PREIFRS period and discovered that the implementation of IFRS has a significant positive effect on profitability ratio and financial performance measured by ROA.

In addition, the second hypothesis assumes that there is no statistically significant difference in the return on equity reported under IFRS compared to Ethiopian GAAP through this, the null hypothesis is accepted because the P-value of 0.004 in the Wilcoxon Signed Rank Test analysis is less than 0.05. Moreover, the findings revealed under IFRS, banks record a higher return on equity than Ethiopian GAAP. Therefore, the study confidently states that the implementation of IFRS had a significant role in the improvement of the financial statements of the banks' return on equity and resulted in a significant and higher return on equity. The result of this study is supported by Blanchette et al. (2011), Agca and Aktas (2007), and Iatridis (2010), who reported a statistically significant difference in return on equity measured under IFRS as compared to the GAAP period. Furthermore, the study's findings are supported by new institutional and agency theory, which state that IFRS can be viewed as a factor influencing the very existence of a business organization and the importance of examining and questioning organizational profits. However, the finding of the study is contrary to Tanko (2012), Abdul-Baki et al. (2014), Lantto and Sahlstrom (2009), Terzi

et al. (2013), Kabir et al. (2010), and Nengzih (2015), who came up with different results and found that the implementation of IFRS has no significant effects on return on equity.

The third hypothesis is that there is no statistically significant difference in the liquidity reported under IFRS compared to Ethiopian GAAP and the null hypothesis has been accepted because the P-value of 0.000 in the Wilcoxon Signed Rank Test analysis is less than 1%, implying that the liquidity ratio (LR) is significant at this level. Liquidity is heightened if there are fewer costs to convert a company's assets into cash quickly. Better corporate performance is achieved under IFRS adoption since the adoption limits managerial accounting manipulations but has the ability to maintain cash flow for satisfying short-term commitments. The increase in accounting quality results in greater liquidity with a lower spread between the buying and selling and a reduction of analysts' forecast errors. In line with accounting information quality improvement, the impact of international financial reporting standard adoption is also related to capital cost reduction. Therefore, the study deduces that banks are able to pay short-term liabilities under IFRS rather than GAAP in Ethiopia. The findings of this study agree with Terzi et al. (2013) but disagree with Lantto and Sahlstrom (2009).

A fourth hypothesis is that there is no statistically significant difference in the leverage reported under IFRS compared to Ethiopian GAAP and the null hypothesis is rejected because the P-value of 0.006 in the Wilcoxon Signed Rank Test analysis is less than 1%, implying that leverage (LEV) is significant at this level. Moreover, the study found that banks reported lower leverage under GAAP than under IFRS. As a result, the finding of this study is consistent with Naranjo et al. (2014), who found that IFRS adoption with high debt capacity was chosen as their primary source of external financing, as firms with better reporting quality likely have better access to public, rather than private, debt, opposing the pecking order theory proposed by Myers and Majluf (1984). However, the finding of this study is contradicted by Olayinka and Oduwole (2018), Olayinka Adedayo Foluke Oduwole (2019), and Marques et al. (2017). Access to capital would become less costly because higher quality information in company reports would lead to a reduction of informational asymmetry, affecting both equity capitals through stock issuance, as external agents would purchase assets at better prices, and third party capital because companies would contract less costly debt. This adjustment is important as investors and creditors have different demands regarding the quality of disclosed information.

5. Conclusion

International Financial Reporting Standards (IFRS) is an internationally approved high-quality reporting standard that is thought to redefine most organizations' basic financial and management reporting and aid in the preparation of external and internal financial reporting. Ethiopia has decided to join the IFRS network with a big bang strategy to adopt IFRS by enactment of a proclamation in 2014, following the benefits of IFRS on a national level. The desire of professionals, scholars, and preparers to work with international trends and pressure from global audit companies forces the adoption of IFRS in Ethiopia. All of Ethiopia's research has focused on the advantages and challenges of implementing IFRS. Therefore, this study is aimed at investigating the effect of IFRS on the financial ratios of commercial banks in Ethiopia through comparing the financial ratios of Ethiopian GAAP and IFRS from 2016 to 2020 using the Wilcoxon Signed Rank Test.

The finding revealed that IFRS has an insignificant effect on the return on assets of commercial banks in Ethiopia, and commercial banks reported less return on assets under IFRS than Ethiopian GAAP that is supported by Tanko (2012), Abdul-Baki et al. (2014), Lantto and Sahlstrom (2009), Terzi et al. (2013), Kabir et al. (2010), and Nengzih (2015). However, Blanchette et al. (2011), Agca and Aktas (2007), and Iatridis (2010), found a statistically significant difference in return on assets measured under IFRS versus GAAP period. Moreover, the study found that IFRS has a significant effect on the return on equity of commercial banks in Ethiopia and banks record higher return on equity under IFRS than Ethiopian GAAP that is supported by the findings of Blanchette et al. (2011),

Agca and Aktas (2007), and Iatridis (2010) and in contrast with Tanko (2012), Abdul-Baki et al. (2014), Lantto and Sahlstrom (2009), Terzi et al. (2013), Kabir et al. (2010), and Nengzih (2015). Similarly, the study found that IFRS has a significant effect on the liquidity ratio of commercial banks in Ethiopia, and banks reported a higher liquidity ratio (LR) under IFRS than under Ethiopian GAAP that is supported by Terzi et al. (2013) but disagree with Lantto and Sahlstrom (2009). Finally, the study discovered that IFRS and leverage of commercial banks in Ethiopia have a significant relationship that is supported by Naranjo et al. (2014) and contradicted by the findings of Olayinka and Oduwole (2018) and Olayinka Adedayo Foluke Oduwole (2019). Therefore, the study concludes that returns on equity, liquidity, and leverage showed a significant change after the adoption of IFRS, but the adoption did not bring a significant change in return on assets.

The current study contributes to the financial literature because it is the first of its kind to look at the effect of IFRS on the financial ratios of the banking sector in Ethiopia and is useful for individuals who are interested in investing in the banking sector in Ethiopia. Moreover, the finding enables investors and other market participants to make informed economic decisions and provide information that is needed to hold management to account. The study has limitations. First, the study focuses on return on assets (ROA), return on equity (ROE), liquidity ratio (LR) and leverage (LEV) means that other financial ratios are not considered. Therefore, further research will be carried out, including other financial ratios. Second, the study finding focused on commercial banks other than other institutions. Therefore, investigations will be conducted into other financial institutions like insurance companies.

5.1. Recommendations

Investors and financial analysts should pay special attention to return on equity, liquidity, and leverage as these are the significant financial ratios that are affected by the implementation of the International Financial Reporting Standards (IFRS). In addition, investors should consider the long-term survival and performance of banks rather than short-term financial ratios when making investment decisions and banks should determine whether IFRS changed their reported financial ratios and use this information in their planning processes.

Funding

The author received no direct funding for this research.

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Disclosure statement

No potential conflict of interest was reported by the author(s).

Citation information

Cite this article as: The effect of IFRS on the financial ratios: Evidence from banking sector in the emerging economy, Ayalew Ali Abebe, *Cogent Economics & Finance* (2022), 10: 2113495.

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