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Corporate Financial Reporting Legal and Regulatory Frameworks in Ethiopia

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This paper analyzes the corporate financial reporting legal and regulatory environment in Ethiopia. The aim of the paper is reviewing and examining the legal and regulatory requirements for corporate financial reporting, and analyzing the extent of the implementation of policy recommendations made by ROSC Ethiopia team in 2007. Qualitative research was employed through analysis of legal and non-legal documents (such as Commercial codes, various proclamations, regulations and directives, manuals academic literatures, newspapers, etc.). The empirical results of the study revealed that there were inadequate laws that stipulate the detail minimum requirements and formats for presentation and disclosures of both financial and non-financial information in financial statements of Corporate Companies in Ethiopia. Regarding the extent of the implementation of the recommendations made by Reports on Observance of Standards and Codes (ROSC) Ethiopia (2007), the examination of legal and regulations revealed that the Federal Democratic Republic of Ethiopia has enacted financial reporting law, established the regulatory body, adopted IFRS instead of setting its own accounting standards and mandated International Standards on Auditing (ISA) for auditors.

Key words: Ethiopia, accounting standards, financial reporting, legal and regulatory environment.

INTRODUCTION

Previous literatures have discussed, among others, regarding the objectives of financial reporting, qualitative characteristics of financial reporting, typed of financial statements and elements to be included in the financial statements (e. g. conceptual framework of IASB, 2010). Other literatures also explained the efforts being made toward improving the financial reporting practices and the benefits of having high quality financial reporting. For instance, UNCTAD ISAR (2012) explained that:

"In the wake of the financial crisis, continued efforts are being made to improve the quality of corporate reporting as an essential component of measures aimed at strengthening the international financial architecture. High-quality corporate reporting is a key in improving transparency, facilitating the mobilization of domestic and international investment, creating a sound investment environment, fostering investor confidence and promoting financial stability. A strong and internationally comparable

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reporting system facilitates the international flows of financial resources, while at the same time helping to reduce corruption and mismanagement of resources, while at the same time helping to reduce corruption and mismanagement of resources. It also strengthens the international competitiveness of enterprises by attracting external financing and benefiting from international market opportunities."

Lal (2009: 7-9) has identified and explained the following two primary objectives of corporate financial reporting, viz., Investment Decision – Making and Management Accountability:

"The first basic objective of corporate financial reporting is to provide information useful to investors, creditors, and other users of accounting information in making sound investment decisions. These decisions concern with the efficient allocation investment funds and the selection among investment opportunities. For the preparer of the corporate financial reporting it is essential to have an understanding of the investment decision process applied by external users in order to provide useful information to them. The second objective of corporate financial reporting is to provide information on management accountability to judge management's effectiveness in utilizing the resources and running the enterprise. Management of an enterprise is periodically accountable to the owners not only for the custody and safe keeping of enterprise resources, but also for their efficient and profitable use and for protecting them to the extent possible from unfavorable economic impact of factors in the economy such as technological changes, price level changes (inflation or deflation)."

Regarding the benefits of the high quality financial reporting and its eminence in Ethiopia, Addis Fortune (2009) explained that:

"Good financial reporting is also a base for effective monitoring of companies, including better tax revenue collections. High-quality financial reporting infrastructure is also the prime ingredient for effective functioning of a stock exchange market. That seems why international financial institutions, such as the World Bank, assist developing countries to improve their financial reporting structure. Such institutions have recognized the contributions of high-quality financial reporting to a nations' economic development."

These benefits, however, can be utilized if there is properly designed and implemented legal and regulatory framework. According to UNCTAD ISAR (2012), "the legal and regulatory framework covers laws, regulations, standards, codes, requirements and guidelines that incorporate the body of requirements to be followed by all participants in the corporate reporting chain to produce high-quality reports, including financial and non-financial information." Gebeyaw (2012) argued that in the contemporary world, the existences of appropriate and effective legal, regulatory and institutional underpinnings are backbones for fostering market integrity, improves economic efficiency and growth as well as building investors' confidence.

Therefore, developing and implementing a national financial reporting framework is crucial because without this framework at a national level, it is common to see companies employ different accounting rules or principles or methods which in turn lead to production of different sets of financial statements which lack the quality of comparability (Addis Fortune, 2009). Wulandari and Rahman (2004: 4) cited that Kothari (2000), Ball (2001), and Benston (2003) have argued that accounting standards on their own are ineffective without certain mechanism of regulation illustrating that infrastructural arrangements for implementing and enforcing standards are also important in giving accounting standards the capability to make accounting information relevant for capital markets and high quality financial reporting regulatory infrastructure make investors perceive financial reports as truthfully reflecting the firm's fundamentals. UNCTAD ISAR (2012: 4) also pointed out that a strong and internationally comparable reporting system facilitates the international flows of financial resources, while at the same time helping to reduce corruption and mismanagement of resources and it also strengthens the international competitiveness of enterprises by attracting external financing and benefiting from international market opportunities.

"Strengthening the country's financial architecture will make available quality financial information to facilitate investment decisions and to help reduce the risk of financial crises and corporate failures together with their associated negative economic impacts that have been witnessed in many industrialized and developing countries." (ROSC Ethiopia, 2007). The corporate financial reporting in annual reports helps the end users to know the results of the business activities of a corporate enterprise and its credibility, accountability and reliability of working. It is a process through which an entity communicates with the outside world. Financial reporting is gaining significance now a days due to the expansion and growth of company form of organization, increased competition and increase in the information needs of the users.

The financial reports can achieve these objectives if and only if there are well-designed, defined and implemented financial reporting legal and regulatory frameworks. Without the existence of such legal frameworks, it is impossible to take action on non-compliant companies as there is no frame of reference with which comparison is made. Besides, monitoring and enforcing companies toward providing sufficient and high quality information to the users of their financial statements is absurd. In addition to the legal and regulatory frameworks that prescribe the measurement, recognition, presentation and disclosure of information in the annual reports; the books to be kept, and the types financial statements to be prepared; it is a necessary condition to have a regulatory body that enforces the compliance with the legal requirements and a qualified, competent and independent (both in fact and in appearance) professionals who give an assurance on the quality of the information disclosed on the annual reports of reporting entities.

Objectives of the study

ROSC Ethiopia (2007) conducted a study in Ethiopia focusing on a review of corporate sector accounting, auditing, and financial reporting practices and supporting infrastructure in Ethiopia and provided policy recommendations, inter alia, regarding: revising the Commercial Code 1960 and the other relevant laws and regulations, enacting a financial reporting law, establishing a National Accountants and Auditors Board, setting accounting standards, mandating International Standards on Auditing (ISA) for all auditors, establishing a strong accountancy professional body, with IFAC membership, and establishing a local professional and technician accountancy qualification. However, to the knowledge of the researcher, after such recommendations were made there is no research conducted to examine the extent of implementation of these policy recommendations. Therefore, the main objective of this study is to examine the progress made toward implementation of the recommendations made by ROSC Ethiopia (2007) and assess other financial reporting legal and regulatory environment that were not covered by the ROSC Teams.

LITERATURE REVIEW

Corporations are purported to report their financial and operational performance to the stakeholders through what is known as corporate financial reporting in accounting literatures. Lal (2009) has defined corporate financial reporting as a communication of published financial statements and related information from a business enterprise to third parties (external users) including shareholders, creditors, customers, governmental authorities and the public.

The “term financial reporting” encompasses general purpose financial statements[1] plus other financial reporting. Other financial reporting comprises information provided outside financial statements that assists in the preparation of complete set of financial statements or improves users’ ability to make efficient economic decisions (IASB, 2009: 6). Encyclopedia also stated that Financial Reporting includes financial statements and other means of communicating financial information about an enterprise to its external users.

Developing and implementing a national financial reporting framework is crucial because without this framework at a national level, it is common to see companies employ different accounting rules or principles or methods which in turn lead to production of different sets of financial statements which lack the quality of comparability (Addis Fortune, 2009). Moreover, regulation of the financial reporting is needed for the following reasons: the first reason is market imperfection (the free-rider problem) and another potential reason is that the business and accounting practices become increasingly complicated, so setting the accounting treatment standards is an efficient way to increase the transparency and comparability of financial reporting.

Naranjo et al. (2013) examined the influence of major reforms in financial regulation on financial decisions in the world using the adoption of IFRS as a mandatory change in financial reporting and found that changes in financial reporting regulation, over all, increased firms’ financing capacity as reduced adverse selection costs and allowed firms to tap into external capital markets, and allowed certain firms to rebalance their capital structure arguing that there are (at least) two reasons why financial reporting regulation can affect financing decisions: improving transparency and reduce information asymmetry among capital market participants (Leuz and Wysocki, 2008) and establishing a convergence in financial reporting practices with the intent of reducing information processing costs and enhances comparability among various financial reports.

Various countries across the globe have already set their own legal frameworks for financial reporting of the companies operating business in their jurisdiction to facilitate for enforcement through monitoring compliance. For instance, inter alia, pertaining to statutory framework governing financial reporting in Kenya, according to UNCTAD ISAR (2008: 81), Companies Act (CAP 486) was the main legislation governing companies, including financial reporting even though there were other laws that have an incidence on financial reporting of some specialized sectors such as the insurance sector, banks and listed companies. The Companies Act requires (1) all limited liability companies to prepare and keep proper books of accounts as are necessary to give a true and fair view of the state of the companies’ affairs and to explain its transactions, and (2) companies to present a profit and loss account and a balance sheet each year during its annual general meeting and prescribes in detail what should be included in the profit and loss account and the balance sheet. The Kenyan Companies Act has prescribed in detail what should be included in financial

[1]The general purpose financial statements are those directed to general financial information needs of a wide range of users who are not in a position to demand reports tailored to meet their particular information needs. General purpose financial statements include those that are presented separately or within another public document such as an annual report or a prospectus. They are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. The objective of financial statements is to provide information about the financial position, performance and cash flows of an entity that is useful to those users in making economic decisions.

reports (UNCTAD Secretariat, 2008: 81).

Similarly, in India, the Companies Act (1956) provided the basic requirements for financial reporting of all companies in India. The Act requires the preparation, presentation, publication, and disclosure of financial statements, as well as an audit of all companies by a member-in-practice certified by the Institute of Chartered Accountants of India (ICAI). Under the Act, the Central Government has the power, by notification in the Official Gazette, to constitute the National Advisory Committee on Accounting Standards to advise the Central Government on the formulation and laying down of accounting standards for adoption by companies or class of companies (UNCTAD Secretariat, 2008: 47). The newly enacted The Company Act (2013) also, under its Chapter IX Section 128 and 129 prescribes books of accounts to be kept, and the financial statements to be prepared by companies, respectively. According to UNCTAD ISAR (2008), legal recognition was given to accounting standards issued by ICAI by the following regulators such as Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), and the Insurance Regulatory and Development Authority (IRDA). "ICAI requires its members to ensure compliance with all the accounting standards that it issues while discharging their attesting function." (USAD ISAR, 2008).As far as literatures that focus on the financial reporting legal framework of Ethiopia are concerned, the study conducted by ROSC Ethiopia (2007) was the first study in its nature and type and there are no other studies. It was conducted based on a review of corporate sector accounting, auditing, and financial reporting practices and supporting infrastructure in Ethiopia and the results of the review revealed areas requiring improvement. The study found that the Commercial Code has made directors of companies responsible for preparation of financial statements, including consolidated financial statements for group companies, and for ensuring that an audit of the financial statements is conducted but the provisions for both preparation and audit of financial statements require improvement.

Besides, according to the study, in provisions for preparing financial statements, there is no requirement to comply with accounting standards, and the financial statements required to be produced are only balance sheet and profit and loss account and in provisions for audit, there is no requirement to comply with auditing standards, no specified qualification of auditors. Based on the findings of the study the ROSC Ethiopia (2007) provided the following policy recommendations to bring an improvement in this regard: the revision of the Commercial Code 1960 and the other relevant laws and regulations, Enacting a financial reporting law, Establishing a National Accountants and Auditors Board, Setting accounting standards, Mandating International Standards on Auditing (ISA) for all auditors, Establishing a strong accountancy professional body, with IFAC membership and Establish a local professional and technician accountancy qualification.

METHODOLOGY

To achieve the objective of the study, data were collected from secondary sources using content analysis research approach and evidences were gathered through review of documents (such as Commercial code, proclamations, regulations, literatures, laws and manuals) which were collected from public and academic libraries, purchased sources from publisher, online sources, and custody of organizations and regulatory bodies. The researcher read and surveyed for the reporting requirements for the presentation and disclosures of financial and non-financial information on the annual reports of reporting entities in Ethiopia on laws, Commercial Code and other regulations manually.

EMPIRICAL RESULTS AND DISCUSSION

As indicated the in the methodology, the analysis of the legal documents pertaining to financial reporting in Ethiopia revealed that corporate financial reporting legal and regulatory frameworks are framed in Commercial Code of 1960, and disseminated between various proclamations, regulations, directives, accounting procedures and manuals, codes of corporate governance and has been regulated by different regulatory bodies as there has not been any single organized financial reporting regulatory body in Ethiopia until the establishment of the Accounting and Auditing Board of Ethiopia in December 2014 by regulation 332/2014 in accordance with Proclamation No. 847/2014. Financial statements are not filed and reviewed to check whether they have been prepared in compliance with existing rules and regulation or not and the work of auditor has not been reviewed. Of course, as also indicated by ROSC Ethiopia (2007), the Office of the Federal Auditor General (OFAG) was regulating the accountancy profession through the committee established under its ambit but OFAG has had other broader responsibilities. The major legal and regulatory frameworks that govern the corporate financial reporting in Ethiopia are next discussed.

Commercial code of 1960

Under its chapter 6 of book 2, the commercial Code of 1960 contains provisions that deal with the accounts and annual reports of the corporate companies. The Commercial code requires the preparation of the following financial statements only: Balance Sheet, Profit and loss account and Annexures to them and Statement of Cash Flows and statements of Owners Equity are excluded. For instance, Article 446 of the commercial code of Ethiopia requires corporate entities' directors to prepare a detailed inventory and valuation of assets and liabilities at the end of each financial year and to draw up a balance sheet and a profit and loss account and to prepare a report on the state of the company's activities and affairs during the last financial year.

According to this provision, the report should give detailed information on the profit and loss account, an exact statement of the total amount of remuneration of the directors and auditors, and proposals for the distribution of dividends, if any. Regarding the formats of the Balance sheet, according to Article 74(1) of the code, the balance sheet shall show all the debit balances as assets, and all the credit balances as liabilities and also lay down the order in which each assets and liabilities items appear in the balance sheet as follows:

"The assets shall appear in the following order (Art.74/2): (i) Establishment expenses; (ii) Fixed assets; (iii) Stocks; (iv) Short term or liquid assets; (v) the results (Debit balance of the Profit and Loss Account). And the liabilities shall appear in the following order (Art.75): (i) the proper capital account and reserves; (ii) profits brought forward and renewal funds; (iii) Provisions and long term debts; personnel pension funds, if any; (iv) short-term debts; and (v) the results (Credit balance of the Profit and Loss Account)."

According to Commercial code, amortizations and provisions for depreciation shall appear under the respective headings of the assets in the balance sheet (Art.76/1/) and the adjustment accounts shall appear in the assets or liabilities side of the balance sheet following the accounts to which they relate (Art.76/2/) but the code was salient on the depreciation rate and methods to be used. The commercial code requires the balance sheet and profit and loss account to be prepared each year in the same form as in preceding years and the methods of valuation shall remain the same, unless the general meeting adopts variations in the mode of presentation of the accounts or the methods of valuation on the reasoned advice of the auditors(Art.448/1) and the profit and loss account shall show under separate heads losses or profits arising out of the company's various activities (Art.448/2/). However, as notes to the financial statements, the commercial code requires only the reporting of a return of liabilities which do not appear in the balance sheet, such as guarantees to the balance sheet, and other information such as the accounting policy adopted and implemented in relation to measurement and recognitions were not required.

Memorandum and articles of associations

The memorandum of association of Ethiopian share companies requires the board of directors to prepare only Balance sheet and Profit and loss account for the fiscal year what is already indicated in the commercial Code of Ethiopia and does not require any other additional disclosure. The article of association does not have any provision that describe the types of financial statements that should be prepared and the disclosure thereof.

Specialty laws

The study found that the corporate financial reporting legal framework of Ethiopia is almost inadequate and they existing once are found in a dispersed manner between various proclamations issued for regulation purposes by various regulatory bodies in Ethiopia such as Public Enterprises Privatization and Supervisory Agency (PEPSA), Ethiopian Commodity Exchange Authority (ECXA), National Bank of Ethiopia (NBE), Ethiopian Revenue and Custom Authority (ERCA), and so forth Some of the specialty laws that are related to the corporate financial reporting are summarized and presented in Table 1.

Even though these proclamations states "in accordance with GAAP or Accepted Accounting Standards", it is not clear to which accounting standards they are referring as there is no such type of standards which are either officially adopted from outside or developed internally and the definitions of these standards are not indicated in the definition sections of these proclamations. The regulatory bodies for financial institutions, state-owned enterprises, and NGOs do not have expertise to effectively deal with technical accounting and auditing matters in their regulation. Most regulators do not have professional accountants to analyze accounts prepared in accordance with IFRS and audited in accordance with ISA for public interest entities falling under their regulation. The only capacity the regulators have is to deal with the specific sector requirements (ROSC, 2007: 38). This fact was manifested in the following articles of the National Bank of Ethiopia issued for Banking and insurance Business: Article 23 and 26 of the Proclamation No. 592/2008 and 746/2012 are entitled "Financial Record" but their sub-article 1 states about accounting standards which indicate the existence of technical expertise in identifying financial records from standards which in turn shows lack of technical skills in accounting from those who drafted and enacted these proclamations. The study found that Article 23 of Proclamation No. 286/2002 describes the depreciation rate to be applied in determining taxable income as under:

"The acquisition or construction cost, and the cost of improvement, renewal and reconstruction, of buildings and constructions shall be depreciated individually on a straight-line basis at five per cent (5%), (ii) the acquisition or construction cost, and the cost of improvement, renewal and reconstruction, of intangible assets shall be depreciated individually on a straight-line basis at ten percent (10%), (ii) the following two categories of business assets shall be depreciated according to a pooling system at the following rates: (a) Computers, information systems, software products and data storage equipment: twenty five (25%), (b) all other business assets: twenty percent. The depreciation base shall be the book value of the category as recorded in the opening balance sheet of the tax period: (a) increased by the cost

Table 1. List of specialty laws related to financial reporting in Ethiopia.

Name of the proclamation	Proclamation No.	Article No	Provisions related to	
			Accounting standards	Reporting (Disclosure)
Public enterprise	25/1992	27	Yes (GAAP)	No
Income tax	286/2002	18 22(2) 58(1)	Yes (GAAP)	No
Excise tax	307/2002	8(a)	Yes (Proper accounting Principles)	No
Ethiopian commodity exchange authority	551/2007	17 and 18	No	No
Banking business	592/2008	23(1)	No	No
Microfinance business	626/2011	15(1)	Accepted accounting standards	No
National payment system	718/2011	27(1)	No	No
Insurance business	746/2012	26(1)	No	No

Source: Self compilation from legal documents.

of assets acquired or created and the cost of improvement, renewal and reconstruction of assets in the category during the -tax period, and (b) decreased by the sales price of assets disposed of and the compensation received for the loss of assets due to natural calamities or other involuntary conversion during the tax period. Article 23 sub-article 3-5, Proclamation No. 286/2002".

From the observation of annual reports of few companies, it was observed that these provisions play a vital role in standardizing the depreciation rates among companies as companies usually use these rates in determining their depreciation expenses (as using different rates requires preparing financial statements with different depreciation rates which in turn increases compliance costs). The next examination was wade regarding bad debts allowance for financial institutions and it was found that national bank of Ethiopia has a guide line that provide for the criteria and rate to be used in determining bad debt expenses in financial institutions[2]. The National Bank of Ethiopia through its directive No. SBB – 52 -2012 (sub-article 8.3) requires development financial institutions to maintain the following minimum provision percentages against the outstanding principal amount of each loan or advance classified under criteria set outs under article 7 of the same directive. However, there is no other legal or regulatory framework that provides for the procedures, criteria or valuation methods for bad debt expenses for entities that are non-financial institutions.

Accounting manuals

The ministry of Industry during the Provisional Military Government of Socialist Ethiopia introduced a General Accounting Manual in 1982 for the first time in Ethiopia in order to establish sound internal procedures, uniform accounting terminology and standard accounting systems at all corporations and plants. The Manual was prepared by the United Nations Technical Assistance Project, Financial Management in the Ministry of Industry, in the light of the practical experience gained from the accounting systems reviews carried out at all corporations and twenty five plants in different industrial activity sectors (Ministry of Industry, 1987: 7).

The systems and procedures recommended in the manual was implemented by most enterprises but experience had shown that the variations in size and types of activity at different enterprises under the Ministry was such that the imposition of standard accounting system did not work effectively in practice with the result that accounts recording at most plants is not as efficient or as up to date as it should be. Also the General Accounting Manual did not include accounting systems for purchases and stock with the result that the control and recording of these fundamental transactions were found to be unsatisfactory at almost all plants (Ministry of Industry, 1987: 7).

The General Accounting Manual described in detail the internal control and recording procedures for all basic accounting transactions and explains how such procedures should be adapted to the requirements of enterprises of different types and sizes by modifying the chart of accounts and register formats. In order to ensure flexibility within the prescribed accounting framework, alternative recording procedures are described were appropriate. The Manual codified the findings and accounting records and preparation of financial statements and other management information reports. As a result, it was replaced by the Accounting Procedures Manual which was issued by Ministry of Industry in June, 1987. The Manual also covered detailed information on the following areas of accounting and Financial statements: the accounting system; chart of accounts; cash received; sales; sales tax; bank reconciliation; petty

[2] Ethiopian Financial institutions include Banks, Insurances and Micro-finance institutions.

cash; purchases; direct and indirect material stocks; finished goods and work in process; payroll; assets, liabilities, expenses and trial balances; annual financial statements, budgetary control and management information systems; and various annexes of formats of accounting documents and financial statements.

The Accounting Procedures Manual repealed the General Accounting Manual of 1982 and all other manuals and directives issued Ministry of Trade that conflict with it. The manual described the basic systems and procedures for most enterprises which were under the total control of government as private ownership was not totally allowed during that regime. The Accounting Procedures manual of 1987 is the only document in Ethiopia that succinctly described, inter alia, the particular matters to be considered in the preparation of the annual financial statements, the format in which such statements should be presented and the information to be disclosed. After comparing the 10 years' financial statements of 40 corporate entities with the formats prescribed in the manual, the researcher believes that it was the foundation of the present corporate financial reporting practices in Ethiopia. According to the Manual, Enterprises were requested to prepare financial statements – prepared for external audit, which comprised: (i) Balance Sheet (Annex – 1), (ii) Profit and Loss Account (Annex – 2), (iii) Statements of source and application of funds (Annex – 3), and (iv) Notes to the accounts.

In the Accounting Procedures Manual of 1987, the purpose of describing the presentations of the Financial Statements were described as follows:

"In order to enable the Ministry to monitor and control the activities of its enterprises and to make valid comparisons of their financial situations and operating results, it is necessary that financial statements be presented in a standard format by all enterprises (MOI, 1987: 96)".

The manual also presented detail matters related to information included in the financial statements along with the formats in which they should be presented (for detail see the manual). For instance, inter alia, the Balance Sheet, Profit and Loss and The Notes to the financial Statements described by this manual.

Business income tax declaration

Following Article 72 of the Income Tax Proclamation (Proclamation No. 286/2002) that requires every tax payers to submit assessment notification every year which contain the following elements:

1) Gross income and deductions applicable under this Proclamation; 2) taxable income and 3) rates applicable or percentage, Ethiopia Revenue and Customs Authority has issued Business Income Tax Declaration that prescribes the heading under which transactions are expected to be summarized and presented. ERCA has also issued Regulation No. 78/2002 which specifies items to be included and excluded from expenses and depreciation rate to be used in calculating depreciation expenses on fixed assets.

The declaration describes the elements of Business Income, Cost of Goods Sold, Selling and distribution Expenses and other deductions. The declaration also requests the tax payers to attach Balance Sheet, Profit and Loss accounts and Statement of Source and Application of Funds, Fixed Asset and depreciation Schedule, General and Administrative Expenses, Selling and Distribution Expenses, Provisions and Reserves. Gross Profit and the manner it is computed, Statement of Manufacturing and/or Cost of Goods Sold with the declaration to be submitted. Since tax payers know that the income tax law allows ERCA to inspect all the documents submitted to it through its own inspectors and failing to comply with the tax laws requirement have financial and rigorous imprisonment, most share companies classify their transactions in accordance with ERCA's requirement to minimize tax law compliance costs. As companies don't want to incur additional costs to reconcile from the other accounts classification to the ERCA's requirement, therefore, the tax laws and this declaration have their own impact in shaping the contents and formats of financial statement particularly that of Income statement in Ethiopia.

Enactment of financial reporting proclamation and establishment of the board

The existence of institutional foundation which is responsible with the enforcement of and duly compliance with legal and regulatory requirements is basic condition in a given financial reporting environment (UNCTAD ISAR, 2012). Accordingly, ROSC team who reviewed the accounting and auditing environment in Ethiopia made a basic policy recommendation and among the recommendations made by ROSC Ethiopia (2008), the examination of legal and regulations revealed that the Federal Democratic Republic of Ethiopia has (1) enacted financial reporting law entitled "A Proclamation to Provide for Financial Reporting (Proclamation No. 847/2014)" in December, 2014, (2) established the regulatory body called Accounting and Auditing Board of Ethiopia by issuing a proclamation No. 332/2014, (3) adopted IFRS instead of setting its own accounting standards (Article 5 of the proclamation), and (4) mandated International Standards on Auditing (ISA) for auditors (Article 12(1) of the proclamation). Other policy recommendations such as revising the Commercial Code 1960, and establishing a strong accountancy professional body, with IFAC membership, and establishing a local professional and technician accountancy qualification are not realized but the researcher has learned that works are going on to realize them.

To study the corporate financial reporting legal framework of Ethiopia, the researchers employed content analysis approach to explore the provisions related to corporate financial reporting in the country. Even though international practices showed that corporate financial reporting is being regulated either by enacted Company Acts or by issuance of accounting and auditing standards, Ethiopia has had inadequate legal framework that regulate the financial reporting and did not issued or adopted accounting and auditing standards till the country officially adopted International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) in December 2014 through enactment of Proclamation No. 847/2014.

Conclusions

Corporate financial reporting is a system of communicating the outcome of operational and financial activities of a corporate entity to its stakeholders in general and shareholders in particular (Hasan et al., 2014). However, the information provided through financial reporting needs to be true and fair and denotes the actual financial and operational performance of the reporting entity. In order to meet these objectives, there should be a legal frame work that provide for the measurement, recognition, presentations of economic activities; the books to be kept, the type of financial statements to be prepared and the formats in which they should appear, the period of time within which they should be available to users, the qualification requirements for individuals engaging in preparing and auditing of the financial statements, the enforcement mechanisms and the legal actions to be taken on the non-complaints. In some countries accounting standards are used as a legal framework for preparations of financial statements (e. g. USA and UK) and in others Companies Acts (e.g. Kenya and India) and accountancy professions, auditors and regulatory bodies play the enforcement roles.

The examination and comparison of the current financial statements presentations with the General Accounting Manual issued in 1987 revealed that the current financial statements presentations in Ethiopia have been shaped by these accounting manuals. Except this accounting manual, there were insufficient laws that stipulate the detail minimum requirements and formats for presentation and disclosures of non-financial and financial information in financial statements of Corporate Companies in Ethiopia. However, following the recommendations made by ROSC Ethiopia (2007), it was observed that the Federal Democratic Republic of Ethiopia has introduced the following legal framework in the financial reporting environment of the country: enacted financial reporting law, established the regulatory body, adopted IFRS instead of setting its own accounting standards and mandated International Standards on Auditing (ISA) for auditors.

Other policy recommendations such as revising the Commercial Code 1960, and establishing a strong accountancy professional body, with IFAC membership, and establishing a local professional and technician accountancy qualification are not realized. This paper suggests for the building of the capacity (both in qualified and competent human resources and necessary logistics) of the newly established Accounting and Auditing Board of Ethiopia (the Board), and the Board shall be stringent in enforcing IFRSs requirements in order to enhance compliance practices of reporting entities. The Board should also play its roles and work hard on establishing accountancy professional institutions that will assist it in that regard.

CONFLICT OF INTERESTS

The authors have not declared any conflict of interests.

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http://www.fasri.net/index.php/2009/06/why-there-is-a-need-for-regulation-of-financial-reporting/

Annex 1.

ETHIOPIAN XXX CORPATION
XYZ MANUFACTURING FACTORY
BALANCE SHEET AT 30 JUNE 1978

	Notes	Birr	Birr	1977 Birr
ASSETS EMPLOYED				
Fixed assets	1a, 2			
Assets Transferred to Government	3			
Deferred Expenditure	4			
Current Assets				
Stock	1b, 5			
Debtor	6			
Associated Enterprise	7			
Cash and Bank Balances				
CURRENT LIABLITIES				
Creditors	8			
Associated Enterprises	9			
Bank Overdrafts	10			
Short –term loans	11			
Provision for taxation	12			
Capital Charge payable				
Residual Surplus Payable	13			
NET CURRENT ASSETS				
DEFERRED LIABLITIES	14			
			=========	=======
FINANCED BY				
STATE CAPITAL				
GENERAL RESERVE	15			
LOAN REDEMPTION RESERVE				
FORMER SHAREHOLDERS				
MEDIUM TERM LOANS	16			
LONG TERM LOANS	17			
			=========	=========

Source: Accounting Procedures Manual (1987). Provisional Military Government of Socialist Ethiopia, Ministry of Industry, Addis Ababa, P 106.

Annex 2.

ETHIOPIAN XXX CORPORATION

XYZ MANUFACTURING FACTORY

PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 30 JUNE1978

	Notes	Birr	Birr	1977 Birr
SALES	18			
COST OF GOODS SOLD	19			
GROSS OPERATING SURPLUS				
OTHER INCOME	20			
EXPENSES				
Distribution	21			
Administration	22			
Corporation Levy				
Interest	23			
Capital Charge				
Audit Fees				
Amort. of deferred expenditure	4			
Provision for stock obsolescence				
Provision for doubtful debts				
NET SYRPLUS BEFORE TAXATION				
PROVISION FOR TAXATION				
NET SURPLUS AFTER TAXATION				
TRANSFER TO GENERAL RESRVE	15			
RESIDUAL SURPLUS				
TRANSFER TO RESIDUAL SURPLUS PAYABLE	13			
			NIL	NIL

Source: Accounting Procedures Manual (1987). Provisional Military Government of Socialist Ethiopia, Ministry of Industry, Addis Ababa, P 107, Annex 15/B.

Annex 3

ETHIOPIAN XXX CORPORATION

XYZ MANUFACTURING FACTORY STATEMENT OF FUNDS

FOR THE YEAR ENDED 30 JUNE 1978

			1977
	Birr	Birr	Birr
SOURCE OF FUNDS			
From Operations			
Net surplus before taxation			
Less: Appropriations from surplus:			
Provisions for taxation	( )		( )
Residual surplus Payable	( )		( )
		( )	( )
Add: Adjustment for items not involving the movements of funds			
Depreciation			
Amortization of deferred expenditure			
Profit on sale of fixed asset	( )		( )
From Other Sources			
Proceeds of sales of fixed assets			
Long term loan			
Application of Funds			
Purchase of fixed assets	( )		( )
Deferred expenditures	( )		
Ling and medium term loans,			
Current maturities	( )		( )
Prior year taxation	( )		( )
		( )	( )
		==========	=======

ETHIOPIAN XXX CORPORATION

XYZ MANUFACTURING FACTORY STATEMENT OF FUNDS

FOR THE YEAR ENDED 30 JUNE 1978

			1977
	Birr	**Birr**	**Birr**
INCREASE (DECREASE) IN WORKING CAPITAL			
Stock			
Debtors and related enterprises			
Creditors and related enterprises			
Provisions for taxation		( )	( )
Capital change and residual surplus payable		( )	( )
Movement in net liquid funds:			
Increase (decrease) in cash and bank balances	( )		
Decrease (Increase) in bank overdrafts and			
Short term loans	( )		
		( )	
		( )	( )

Source: Accounting Procedures Manual (1987). Provisional Military Government of Socialist Ethiopia, Ministry of Industry, Addis Ababa, pp. 107 - 108, Annex 15/C/1