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# ADOPTION OF IFRS: A GUIDE TO HANDLE CHALLENGES AND PITFALLS

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**Abstract**

The conversion from local Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS) poses multifaceted challenges for companies. These challenges arise from the disparities between the two accounting frameworks, including differences in the recognition, measurement, and presentation precepts. The complexity of aligning existing accounting policies with IFRS standards necessitates careful evaluation and adjustment of financial reporting practices, resources, and expertise. This transition to IFRS has a significant impact on financial statements. The adoption of new accounting treatments can lead to changes in the recognition, measurement, and presentation of financial elements. These changes can affect key financial metrics, ratios, and indicators, potentially influencing stakeholders' perceptions, credit ratings, and financial analysis techniques. Companies must carefully analyze the impact of the transition on their financial statements to ensure accuracy, comparability, and transparency. This paper examines the challenges and implementation issues encountered by companies during the transition from local GAAP to IFRS and proposes a guide for this adoption by prospecting a case study of International Financial Reporting Standards implementation in Saudi Arabia.

**Keywords:** GAAP, Accounting policies, disclosure requirements, financial statements, Capital Market Authority, Zakat.

## 1. INTRODUCTION

The adoption of IFRS as a global accounting framework has gained significant momentum in recent years. As a result, many companies are faced with the challenge of transitioning from their local GAAP to IFRS. This transition entails a comprehensive evaluation and adjustment of accounting policies, procedures, and reporting practices. The purpose of this paper is to explore the challenges and implementation issues faced by companies during this transition process, with a specific focus on differences in accounting treatments, disclosure requirements, and the ensuing impact on financial statements [1]. The shift from local GAAP to IFRS represents a fundamental change in the way financial information is prepared and presented. While local GAAP frameworks vary across jurisdictions, IFRS provides a globally recognized set of accounting standards that enhances comparability and facilitates global financial analysis. However, the conversion into IFRS is not without its challenges [2].

One of the primary challenges encountered by companies is the need to reconcile the disparities between the local GAAP and the IFRS. These disparities can arise from differences in recognition, measurement, and presentation principles. Companies must carefully assess their existing accounting policies and procedures, identify areas of divergence from IFRS, and make necessary adjustments to ensure compliance with the new standards [2],[3].

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Implementation issues further compound the complexity of the transition process. Companies often face difficulties in interpreting and applying the new accounting rules prescribed by IFRS. Areas such as revenue recognition, fair value measurement, and impairment testing may require a significant shift in accounting practices, necessitating enhanced judgment and estimation techniques. Companies must invest in training programs and provide resources to ensure that their personnel possess the knowledge and skills required to implement the new accounting treatments accurately [4].

Moreover, the transition to IFRS brings about enhanced disclosure requirements. IFRS places a greater emphasis on transparency and comprehensive financial reporting compared to some local GAAP frameworks. Companies must adapt their reporting practices to meet these heightened disclosure requirements, which may involve gathering and organizing new information, presenting it in a standardized format, and implementing robust internal controls to ensure the accuracy and completeness of the disclosed information [5]. The remainder of this paper is constructed as follows:

In section 2, the related work of the topic of this paper is presented. Section 3 outlines a background of GAAP and IFRS. Section 4 describes the challenges and opportunities of the adoption of IFRS. Section 5 discusses a case study, finally, section 6 concludes the paper.

## 2. RELATED WORK

The conversion from local GAAP to IFRS has been a significant topic of interest in the field of and finance and accounting. Several scholars and practitioners have examined the challenges and implementation issues associated with this transition. This section provides an overview of the existing literature, highlighting key findings and insights.

One of the primary challenges encountered when transitioning from local GAAP to IFRS is the differences in accounting principles and practices between the two frameworks. Local GAAP often reflects specific legal, cultural, and economic factors of a country, while IFRS aims for global standardization. These differences can lead to complexities and difficulties during the conversion process. Researchers have identified various challenges, including:

Mohammad Nurunnabi, et al [5] explored that there are Conceptual Differences that Local GAAP and IFRS may have divergent conceptual frameworks, definitions, and recognition criteria for certain financial elements such as revenue recognition, fair value measurement, and lease accounting. These differences require careful analysis and adjustments to ensure compliance with IFRS standards.

In the area of Training and Education: Transitioning to IFRS necessitates significant training and education for accountants, auditors, and other financial professionals. Familiarity with the new standards, their interpretation, and application is crucial to ensure accurate and consistent financial reporting. Studies have highlighted the need for comprehensive training programs to facilitate smooth adoption [3] [6].

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Ihab Alsaqqa and Nedal Sawan in [7] said that the implementation of IFRS involves complex technical issues, such as data integration, systems compatibility, and information technology infrastructure. Organizations need to invest in updated accounting systems and software to accommodate the requirements of IFRS. Ensuring data accuracy and consistency across systems can be a considerable challenge, particularly for multinational companies with diverse operations.

In addition to the challenges mentioned above, the implementation of IFRS presents several specific issues that require careful attention:

Transitioning to IFRS involves costs related to training, system upgrades, and professional fees. Organizations must assess the potential benefits of adopting IFRS, such as improved comparability, transparency, and access to global capital markets, against these costs. Researchers have examined the cost-benefit trade-offs and found that while the benefits may be significant in the long run, the initial implementation costs can be substantial [7][8].

The transition to IFRS requires alignment with the legal and regulatory framework of a country. Some jurisdictions may need to modify their existing laws and regulations to accommodate IFRS. The interaction between IFRS and local legal requirements can create complexities and regulatory challenges during implementation [9].

## 3. BACKGROUND

### 3.1 The Generally Accepted Accounting Principles (GAAP):

GAAP represents a set of accounting standards and principles that guide the preparation, interpretation, and presentation of financial statements in the USA. GAAP provides a framework for consistent and transparent financial reporting, ensuring that financial information is reliable, relevant, and comparable across different entities and industries [10].

#### 3.1.1 The Evolution and Development of GAAP

The development of GAAP in the United States can be traced back to the early 20th century when the need for standardized accounting practices became apparent. Over time, various organizations, comprising the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA), have played instrumental roles in the establishment and refinement of GAAP. The AICPA, founded in 1887, has been a key contributor to the development of accounting standards in the United States. It has issued numerous pronouncements, including Accounting Research Bulletins (ARBs) and Statements of Position (SOPs), which provided guidance on specific accounting issues. In 1973, the AICPA established the FASB as an independent standard-setting body that is responsible for the development and issuing of accounting standards. The FASB has been instrumental in the ongoing evolution of GAAP. It has issued numerous Statements of Financial Accounting Standards (SFAS) that address various accounting topics and issues. In recent years, the FASB has transitioned from issuing SFAS to issuing Accounting Standards Updates (ASUs) to provide timely updates and improvements to GAAP [11].

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### 3.1.2 The Objectives of GAAP

The objectives can be briefed as follows: [18]

**3.1.2.1 Reliability and Faithful Representation**: GAAP aims to ensure that financial statements are prepared with accuracy, consistency, and reliability. It requires the use of sound accounting principles and the faithful representation of economic transactions, events, and conditions.

**3.1.2.2 Decision Usefulness and Relevance**: GAAP emphasizes the provision of relevant information that is useful for decision-making by various stakeholders, including investors, lenders, regulators, and management. It requires the disclosure of material information that can influence users' assessments and decisions.

**3.1.2.3 Consistency and Comparability**: GAAP promotes the comparability of financial statements by establishing consistent accounting principles and disclosure requirements. This comparability enables users to make meaningful comparisons across different entities and industries.

**3.1.2.4 Transparency and Full Disclosure**: GAAP places a strong emphasis on transparency and full detection of financial information. It requires companies to provide sufficient information to enable users to understand the nature and impact of transactions, events, and conditions reflected in the financial statements.

### 3.2 International Financial Reporting Standards (IFRS):

IFRS has emerged as a global framework for financial reporting, aiming to enhance transparency, comparability, and reliability of financial information across different countries and jurisdictions. Promoted by the International Accounting Standards Board (IASB), the IFRS renders a set of accounting standards that govern the preparation, presentation, and disclosure of financial statements [8].

### 3.2.1 The Adoption and Development of IFRS

The development of IFRS began in the early 2000s with the objective of establishing a single set of high-quality accounting standards which are globally approved. The IASB, the independent standard-setting body responsible for IFRS, collaborates with national standard-setters, regulators, and other stakeholders to develop and refine these standards.

The adoption of IFRS has gained significant momentum worldwide. Many countries and jurisdictions have either fully adopted IFRS or converged their local accounting standards with IFRS. Notably, the European Union, Australia, Canada, and several other countries have mandated the use of IFRS for the preparation of financial statements by publicly traded companies. The increasing global acceptance and adoption of IFRS reflects the recognition of the need for harmonized accounting standards in the era of globalized financial markets [12].

The acquisition of IFRS reinforces the comparability and transparency of the financial statements by promoting consistency in accounting principles and disclosure practices. Consequently, this can lead to improved accuracy in financial reporting [13].

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### 3.2.2 Objectives of the IFRS

IFRS is designed to achieve several objectives: [19]

**3.2.2.1 The Enhanced Comparability**: IFRS aims to improve the comparability of financial statements across different entities and jurisdictions. By providing a common set of accounting principles, IFRS facilitates the consistent measurement, recognition, and disclosure of financial information, enabling users of financial statements to make meaningful comparisons.

**3.2.2.2 The Relevance and Transparency**: IFRS promotes transparency in financial reporting by requiring comprehensive and relevant information to be disclosed in the financial statements. The focus is on providing information that is useful for decision-making by investors, creditors, regulators, and other stakeholders.

**3.2.2.3 The High-Quality Financial Reporting**: The IFRS sets standards that promote the elaboration of the high-quality financial statements. These standards require companies to apply sound accounting policies, exercise professional judgment, and ensure the faithful representation of economic events in their financial reports.

**3.2.2.4 The Global Consistency**: The IFRS aims to establish a globally consistent framework for financial reporting. By aligning accounting practices across borders, IFRS eases international investment, acquisitions and mergers, and cross-border comparisons, fostering confidence in financial markets.

## 4. THE CHALLENGES OF THE IFRS ADOPTION

The acquisition of IFRS can present several challenges for countries, organizations, and stakeholders. The key challenges corresponding with the IFRS adoption can be concluded in those points:

**4.1 Legal and Regulatory Frameworks**: One of the primary challenges in adopting IFRS is the need to align the legal and regulatory frameworks of a country or jurisdiction with the principles and requirements of IFRS. This involves making amendments to existing laws, regulations, and reporting requirements to ensure compatibility with IFRS. The process of harmonizing legal and regulatory frameworks can be time-consuming and complex, requiring coordination between standard-setting bodies, government authorities, and legislative bodies.

**4.2 Training and Education**: IFRS adoption necessitates a significant investment in education and training to ensure that accountants, auditors, regulators, and other professionals are equipped with the necessary knowledge and skills to apply IFRS effectively. Training programs need to be developed and delivered to enhance understanding of the concepts, principles, and application of IFRS. This challenge is particularly relevant in countries where the accounting profession may have limited exposure to IFRS or where educational institutions need to update their curriculum to incorporate IFRS.

**4.3 Interpretation and Application**: IFRS contains principles-based standards that require professional judgment and interpretation. The application of IFRS can be challenging due to the inherent subjectivity involved in applying principles-based standards. Different

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interpretations of IFRS can lead to inconsistencies in financial reporting, which may hinder comparability across entities. Standard-setting bodies and regulators play a crucial role in providing guidance on the interpretation and application of IFRS to address these challenges.

**4.4 Systems and Processes**: Adopting IFRS may require organizations to update their financial reporting systems and processes to ensure compliance with the new standards. This includes modifying accounting software, data collection and analysis systems, and internal controls. Organizations may also need to invest in new technologies and infrastructure to support the adoption and application of IFRS.

**4.5 Data Availability and Quality**: IFRS places significant emphasis on the availability and quality of financial and non-financial data. Adopting IFRS may require organizations to enhance their data management practices, including data collection, storage, validation, and reporting. This can be challenging, particularly for organizations operating in countries with limited infrastructure for data collection and reporting.

**4.6 Impact on Financial Statements**: The adoption of IFRS can result in significant changes to financial statements, including the recognition, measurement, and disclosure of assets, liabilities, revenue, and expenses. These changes can impact key financial metrics, such as profit, equity, and ratios, which may have implications for financial analysis, performance evaluation, and regulatory compliance. Organizations need to carefully assess the impact of IFRS adoption on their financial statements and communicate these changes effectively to stakeholders.

**4.7 Transition and Comparative Reporting**: Transitioning from existing accounting standards to IFRS requires careful planning and execution. Organizations may need to prepare opening balance sheets, restatements of prior financial statements, and reconciliations to facilitate the transition. Comparative reporting, which involves presenting prior-year financial information in accordance with IFRS, can be challenging due to differences in recognition, measurement, and disclosure requirements.

**4.8 Industry-specific Challenges**: Certain industries, such as financial services, extractive industries, and insurance, may face industry-specific challenges in adopting IFRS. These challenges can arise from complexities in accounting for financial instruments, revenue recognition, fair value measurement, or specialized industry practices. Standard-setting bodies and regulators often issue industry-specific guidance to address these challenges.

Despite the challenges, IFRS adoption offers several benefits, including improved comparability, transparency, and global market integration. Over time, many countries and jurisdictions have successfully overcome these challenges and transitioned to IFRS, reaping the benefits of a globally recognized accounting framework [21].

As mentioned above there is a difference in the requirements for financial statement structure between IFRS and country GAAP but some countries can adopt IFRS without facing this issue for example US GAAP and IFRS requirements for financial statement structure are relatively identical, according to the EY annual book. Under both of the sets of standards, a complete set

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of financial statements consists of a statement of financial position, an analysis of profit and loss (income statement), an analysis of comprehensive income (either in a single continuous statement or two successive statements), an analysis of cash flows, and accompanying notes to the financial statements. The depiction of changes in shareholders' equity is required by IFRS and US GAAP, respectively. However, IFRS requires the display of changes in shareholders' equity as a separate statement, but US GAAP permits the inclusion of changes in shareholders' equity in the notes to the financial reports. Additionally, unless there are extraordinary conditions, both require the financial statements to be prepared on an accrual method of accounting. The ideas of materiality and consistency that companies must examine in producing their financial statements are approximate in US GAAP and IFRS. The degree of detailed instruction offered tends to be where the two sets of criteria differ [14][17]. The main significant differences between US GAAP and IFRS are shown in the following table.

**Table 1: Differences between the financial statement presentation of the US GAAP and the IFRS**

| | **US GAAP** | **IFRS** |
|---|---|---|
| Financial periods required | A single year can be presented in certain circumstances, while comparative statement is presented. On the other hand, public companies must follow SEC rules, which typically require two most recent years. | Comparative information must be presented to previous period, for all amounts reported in current period's financial statement. |
| Layout of the balance sheet and the income statement | Public companies must follow the detailed regulations, there is no general requirements within the US GAAP to prepare income statement or balance sheet | IFRS doesn't require a specific layout but includes minimum line items, and these are less than the required by the US GAAP for public companies |
| Presentation of debt of the Balance sheet as current versus noncurrent | Debts in which there has been a covenant violation may be resented as non-current if there is agreement by the lender to waive the right to claim payment more than one year before the financial statements are issued or made available for issuance | Debt related to breach of the covenant violation must be provided as current unless the lender agreement is reached before the date of the balance sheet. |
| Classification of deferred tax assets and liabilities of the Balance sheet | All deferred tax assets and liabilities are recorded as current or noncurrent on the balance sheet | All amounts classified as noncurrent on the balance sheet. |

## 5. CASE STUDY

### 5.1 IFRS implementation in Saudi Arabia:

The Saudi Ministry of Commerce and Investment (previously known as the Ministry of Commerce and Industry) oversees the **S**audi **O**rganization for **C**hartered and **P**rofessional **A**ccountants SOCPA, whose responsibilities include examining, establishing, and certifying accounting and auditing standards. Until 2015, the SOCPA released 22 accounting standards, 15 auditing standards, as well as various accounting and auditing interpretations and professional views (SOCPA 2015). The SOCPA follows international best practices in

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analyzing, creating, and approving accounting standards as outlined in US, UK, and international standards. The SOCPA steering committee [which includes officials from the Ministry of Finance, the Saudi Arabian Monetary Authority (SAMA), and Tadawul] makes recommendations to the board for approval on the convergence of Saudi standards with international standards. The SOCPA has mandated that all endorsed IFRS standards be applied by Saudi publicly traded enterprises commencing January 1, 2017. The convergence timeframe for IFRS adoption in Saudi Arabia is indicated in Figure 1. Listed companies must begin generating IFRS interim financial statements for the first quarter of 2016 to have comparative statistics for 2017 interim financial statements. Companies will, however, continue to issue SOCPA financial statements for Q1-Q3 in 2016. Companies must also produce annual reports in accordance with IFRS beginning December 31, 2016, to provide comparative figures for December 31, 2017. Dual reporting and reconciliation will be required between January 1, 2016, and December 31, 2016, as shown in Fig. 1[15].

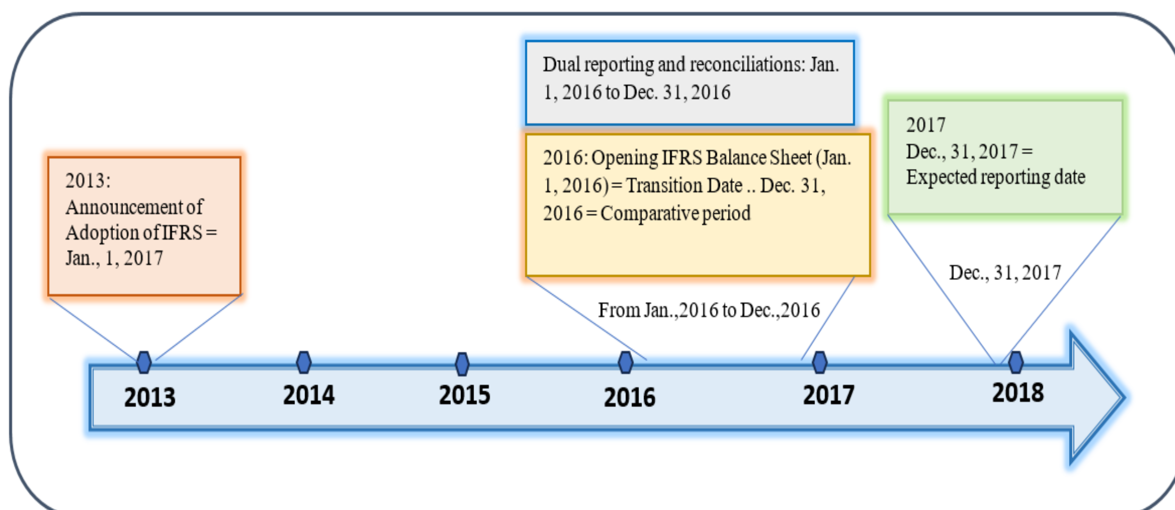


**Figure 1: IFRS adoption dates in Saudi Arabia: convergence timeline**

Recently, the Capital Market Authority (CMA) made a resolution that obligates listed companies in Saudi Arabia to adopt the IFRS as endorsed by the SOCPA.

Currently, SAMA -the Saudi Arabian central bank- demands banks and insurance companies in Saudi Arabia (both listed and unlisted) to report using IFRS standards. The CMA issued a resolution that exempts listed and unlisted banks and insurance companies from preparing their interim and annual accounts in accordance with SOCPA standards, as mandated under the listing rules, and allows them to use IFRS standards instead, so IFRS for the Small and Medium Sized Entities (SMEs) will be the financial reporting framework for unlisted companies starting in 2018 (IFRS Foundation 2017). The decision to move toward convergence with IFRS standards in Saudi Arabia was agreed upon by the SOCPA Board in February 2012. Its transition plan aims to achieve convergence with IFRS by 2017. The SOCPA's stated goal for the project is to make a transition towards the IFRS standards after emphasizing their

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convenience to the Saudi environment through SOCPA's independent standard-setting process (SOCPA 2015) [15]

To overcome the challenges mentioned in the paper, Saudi Arabia adopted a phased approach to IFRS implementation:

**5.1.1 Assessment and Awareness:** SOCPA conducted awareness campaigns, seminars, and workshops to educate stakeholders about the benefits and implications of IFRS. Organizations assessed the impact of IFRS on their financial statements and identified areas requiring changes.

**5.1.2 Capacity Building and Training:** Extensive training programs were conducted by SOCPA to enhance the knowledge and skills of accounting professionals. Training modules covered various aspects of IFRS, including recognition, measurement, and disclosure requirements.

**5.1.3 Interpretations and Guidance:** SOCPA issued localized guidance and interpretations to address specific industry practices and facilitate consistent application of IFRS across the organizations in Saudi Arabia. This provided clarity and guidance to practitioners.

**5.1.4 Monitoring and Support:** SOCPA established monitoring mechanisms to guarantee the compliance with IFRS. The organization provided ongoing support, guidance, and clarification to organizations during the transition period. Regular assessments and inspections were conducted to evaluate compliance levels.

### 5.2 The Outcomes:

The implementation of IFRS in Saudi Arabia yielded several positive outcomes:

**5.2.1 The Improved Financial Reporting:** The adoption of IFRS improved the quality and comparability of financial statements across organizations. It made Saudi Arabia aligned with the international accounting standards and eased financial analysis and cross-border investment.

**5.2.2 Investor Confidence and Transparency:** IFRS implementation promoted transparency and increased investor confidence in the Saudi Arabian market. Investors gained access to standardized financial information, enabling better-informed investment decisions.

**5.2.3 The International Integration:** The adoption of IFRS facilitated the integration of Saudi Arabian companies into global capital markets. It enhanced their ability to attract international investors and strengthened their competitiveness on the global stage.

**5.2.4 Professional Development:** The implementation of IFRS provided accounting professionals in Saudi Arabia with exposure to international accounting practices, enhancing their professional development and career opportunities.

**5.2.5 Harmonization with GCC Countries:** The successful implementation of IFRS in Saudi Arabia served as a model for other Gulf Cooperation Council (GCC) countries, leading to increased harmonization within the region.

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Saudi Arabia faces Special challenges like how to consider Zakat in the financial statements and tax planning In Saudi Arabia, Zakat is a religious obligation and a form of Islamic wealth tax. It is independent from the implementation and the financial reporting of IFRS. Here are some ways organizations address the inclusion of Zakat in their financial reporting:

- **Understanding Zakat Requirements:** Organizations need to have a clear understanding of the Zakat requirements and principles outlined in Islamic law. This involves studying relevant Islamic texts, consulting with religious scholars, and engaging with professional advisors who specialize in Islamic finance and Zakat matters.
- **Identifying Zakat Assets:** Organizations must identify and classify their Zakat assets, which include cash, inventory, investments, accounts receivable, and certain types of properties. They need to assess the valuation and eligibility of these assets for Zakat purposes.
- **Calculating Zakat Liability:** Organizations calculate their Zakat liability based on the applicable Zakat rates and the value of their Zakat assets. This calculation is typically a percentage (such as 2.5%) of the net value of the Zakat assets after deducting certain liabilities and exemptions as per Islamic principles.
- **Maintaining Zakat Records:** Organizations must maintain proper records of their Zakat assets, calculations, and payments. This includes documenting the valuation methodologies, supporting documents, and any exemptions or adjustments made by Zakat rules.
- **Integration with Financial Reporting:** Organizations integrate their Zakat calculations and liabilities into their financial statements to provide a comprehensive view of their financial position. They disclose the Zakat amount separately or within the tax provision section, ensuring transparency and compliance with reporting standards.
- **Aligning Tax Planning with Zakat:** Organizations consider both Zakat and income tax implications in their tax planning strategies. They seek to optimize their tax liabilities by structuring their operations, investments, and financial arrangements in a manner that aligns with both Zakat requirements and tax regulations.

It's important to note that the specific implementation of Zakat and its integration with financial reporting may vary based on the organization's size, sector, and the guidance provided by regulatory bodies such as the Saudi Arabian Monetary Authority (SAMA) and the General Authority of Zakat and Tax (GAZT). Organizations should consult with professionals and advisors who specialize in Islamic finance and Zakat to ensure compliance with the applicable regulations and principles.

## 6. CONCLUSION

In conclusion, the acquisition of IFRS demonstrates both challenges and opportunities for organizations worldwide. The challenges surrounding the acquisition of IFRS stem from different factors. Firstly, transitioning from the existing accounting framework to IFRS requires

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significant effort and resources. This paper concludes that organizations need to invest in comprehensive training programs to ensure that their finance and accounting staff are equipped with the necessary knowledge and skills to apply IFRS correctly, adapting financial systems, processes, and controls to accommodate the new standards can be complex and time-consuming. The paper showed that the implementation of IFRS may highlight the need for significant changes in financial reporting practices. Organizations must carefully assess the impact of IFRS on their financial statements, key performance indicators, and internal reporting systems. This requires a thorough understanding of the new measurement requirements, recognition criteria, and disclosure obligations introduced by IFRS. It showed that despite these challenges, the adoption of IFRS also presents numerous opportunities for organizations like IFRS which facilitates global comparability and transparency in financial reporting. By adopting a globally recognized accounting framework, organizations can enhance the consistency and comparability of their financial statements, making it easier for investors, analysts, and other stakeholders to assess their performance and make informed decisions. A guide to handling challenges and pitfalls during IFRS adoption has been proposed taking the Saudi IFRS adoption case study into consideration.

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