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Review

A review of the pragmatic utility of the adoption of International Financial Reporting Standards (IFRS)

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The world has become a global village, many nations all over the world engage in various types of international trades which include but not limited to exchange of goods and services, manpower, heavy duty plants and machineries, intellectual materials, foreign exchange transactions, foreign direct investment (FDI), trade finance, loan deals, information communication technology (ICT) and political affiliation. In view of this international network of activities, the International Financial Reporting Standards (IFRS) came on board to make international comparisons as easy as possible. This is however difficult because to a large extent, each country has its own set of rules. For example, US GAAP are different from Canadian GAAP. Synchronizing accounting standards across the globe is an on-going process in the international accounting community (Investopedia, 2013). The aim of this study is therefore to examine the fundamental issues involved in the application of IFRS. Methodology adopted in this study is of theoretical approach of secondary data sourcing which include review of authoritative texts, journals, publications and interviews. The findings of the study show that the issues in IFRS are highly technical and would require great skill and man-power development to understand and implement. The study therefore recommends comprehensive skill acquisition or consulting as an integral step in the process of IFRS implementation. An ideal area for further study is the various stages involved the entire process cycle for full implementation of IFRS.

Keywords: Financial Reporting, International Accounting Standards, Financial Statement, Investors Company.

INTRODUCTION

Background to the Study

International Financial Reporting Standards (IFRS) are accounting standards issued by the International Accounting Standards Board (IASB), an independent organization registered in the United States of America but based in London, United Kingdom. They pronounce financial reporting standards that ideally would apply equally to financial reporting by public interest entities worldwide.

Financial statements apart from stating the financial position of an organization, provides other information such as the value added, changes in equity if any and cash flows of the enterprise within a defined period of time to which it relates (Iyoha and Faboyede, 2011). This information is useful to a wide range of users making informed economic decisions. The quality of financial reporting is indispensable to the need of users who require them for investment and other decision making purposes. Financial reports can only be regarded as

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useful if it represents the "economic substance" of an organization in terms of relevance, reliability, comparability and aids interpretation simplicity (Penman, 1984). Ahmed (2003), stated that useful accounting information derived from qualitative financial reports help in efficient allocation of resources by reducing dissemination of information asymmetry and improving pricing of securities (Spiceland et al., 2001). To prepare and audit financial statements, some accounting convention and principles known as standards have been put in place by appropriate bodies set up for the purpose to encourage uniformity and reliability.

Between 1973 and 2000, international standards were issued by the IASB's predecessor organization, the International Accounting Standards Committee (IASC), a body established in 1973 by the professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, Netherlands, United Kingdom and Ireland, and the United States of America. During that period, the IASC's pronouncements were described as "International Accounting Standards" (IAS). Since April 2001, this rule-making function has been taken over by a newly constituted IASB. The IASB describes its pronouncements under the label "International Financial Reporting Standards" (IFRS), though it continues to recognize (accept as legitimate and adopted by them) the IAS issued by the defunct IASC. The IASB is better-funded, better-staffed and more independent than its predecessor, the IASC.

The objectives of the study include the following:

- To critically examine the differences in basis of preparing financial statements all over the world which led to emergence of the International Financial Reporting Standards (IFRS) as a way of harmonizing the accounting systems
- To evaluate the factors that constitute a challenge to implementation of IFRS

In conclusion, this paper is divided into five parts, the first part being the introduction; the second part deals with the review of relevant literature; the third part looks at the global and local benefits; the forth dealing with the implication of the implementation; while the fifth being the last part deals with policy dimension and recommendations.

Literature review

Recently there has been a push towards the adoption of IFRS developed and issued by the International Accounting Standards Board (IASB). The increasing growth in international trade, cross border financial transactions and investments which unavoidably involve the preparation and presentation of accounting reports that is useful across various national borders, has brought about the adoption of IFRS by both the developed and developing countries (Armstrong et al., 2007). The process of adoption received a significant boost in 2002 when the European Union adopted a regulation 1606/2002 requiring all public companies in the territory to convert to IFRSs beginning in 2005 (Iyoha and Faboyede, 2011). A number of African countries including Nigeria, Ghana, Sierra Leone, South Africa, Kenya, Zimbabwe and Tunisia among others have adopted or declared intentions to adopt the standards. In particular, Nigeria's adoption of IFRS was launched in September, 2010 by the then Honourable Minister, Federal Ministry of Commerce and Industry – Senator Jubril Martins-Kuye (OFR) (Madawaki, 2012). The adoption was planned to commence with Public Listed Companies in 2012 with expectation of full compliance by end of 2014. In the course of this study, the researchers enquiries show that as at today, the Nigerian banking sector has almost fully implemented. This is considered a welcome progress for developing countries especially, some of those that had no resources to establish own standards.

There are proponents as well as opponents who have arguments for and against the global adoption of IFRS. According to Barth (2007), the adoption of a common body of international standards is expected to have the following benefits: lower the cost of financial information processing and auditing to capital market participants as users, familiarity with one common set of international accounting standards instead of various local accounting standards by Accountants and Auditors of financial reports, comparability and uniformity of financial statements among companies and countries making the work of investment analysts easy, and attraction of foreign investors in addition to general capital market liberalization. Ball (2006) stated that many developing countries where the quality of local governance institutions is low, the decision to adopt IFRS will be beneficial. Lipsey and Chrystal (2003) noted that FDI often generates somewhat higher-paying jobs than might otherwise be available to local citizens, it generates investment that may not be possible with the local resources only, it links the recipient economy into the world economy in manners that would be hard to achieve by new firms of a purely local origin. According to Lipsey and Chrystal (2003) the FDI alters country's comparative advantages and improves its competitiveness through technology transfer and effects myriad externalities, domestic investment which can alter a country's volume and pattern of trade in many income enhancing directions. Countries that suffer from corruption, slow-moving, or ineffectual government are likely to resist the change (La Porta et al., 1999) but in such countries, the opportunity and switching costs are lower which makes the possibility of adopting IFRS advantageous. Kumar (2007) stated that the foreign capital has the potential to deliver enormous benefits to developing nations in addition to helping bridge the gap between savings and investment in capital-scarce economies,

capital often brings with it modern technology and encourages development of more mature financial sectors. Capital flows have proven effective in promoting growth and productivity in countries that have enough skilled workers and infrastructure. Some economists believe capital flows also help discipline governments' macroeconomic policies.

GAB (2012) stated that one of the demerits that will be experienced by countries adoption of IFRS includes: forgoing the benefits of any past and potential future innovations in local reporting standards specific to their economies. Single set of accounting standards cannot reflect the differences in national business practices arising from differences in institutions and cultures (Armstrong et al., 2007). The Nigerian accounting regulatory instruments include: the Companies and Allied Matters Act 1990 which stipulates the format, content and scope of the financial statements, disclosure requirements and auditing. It also requires that financial statements of companies comply with statements of accounting standards (SAS) issued from time to time by NASB and audit carried out in accordance with generally accepted auditing standards. Secondly, Nigerian Accounting Standards Board (NASB) Act No.22 of 2003 as the only independent body responsible for developing and issuing SAS for preparers and auditors of financial statements of business concern and government agencies (Madawaki, 2012).

Although many countries have faced challenges in their decisions to adopt IFRS, its wide spread adoption has been promoted by the argument that the benefits outweigh the costs (Iyoha and Faboyede, 2011). The existing theoretical models imply that FDI is beneficial for host country's economic growth. According to traditional economic theory (law of diminishing returns), FDI will tend to concentrate in less developed countries, where there exist greater opportunities to achieve higher returns. In order for FDI to become productive in developing countries, the following conditions should exist: (i) the existence of a minimum threshold level of human capital (Borensztein et al, 1998), improved domestic infrastructures (de Mello, 1999), and a developed local financial systems (Alfaro et al, 2006). Out of all, the last prerequisite seems to have more weight in order for FDI to flow into any developing country and have a measurable impact on economic growth. Lack of these requirements has resulted in imbalance in the FDI distribution across many developing countries. Some of the countries are facing difficulties in attracting foreign investors. FDI is considered as an important channel for direct technology distribution and may be the major vital conduit for technology transfer because of the scarcity of financial resources and the urgent need for reconstruction in many developing countries (Hossein and Yazdan, 2012). Within this framework it is expected that FDI will contribute to economic growth, indirectly by accelerating the diffusion of general purpose technologies (Hossein and Yazdan, 2012). Adoption of IFRS will be a major driver of FDIs as it will aid easy comparability and analysis of financial statements as well as risk rating for the purpose FDI.

Global benefits of IFRS

The implementation of IFRS, as observed by world accounting standards setters, would reduce information asymmetry and subsequently smooth the communication between managers, shareholders, lenders and other interested parties, resulting in lower agency costs. Lower information asymmetry would also lead to lower costs of equity and debt financing. The benefits of implementing IFRS include higher comparability, lower transaction costs and greater international investment.

The implementation of IFRS would reduce information irregularity and strengthen the communication link between all stakeholders (Bushman and Smith, 2001). It would also reduce the cost of preparing different versions of financial statements where an organization is a multinational (Healy and Palepu, 2001). Accounting standards ensure that important matters regarding preparation and presentation of financial statements as well as auditing same are not left to the whims of the preparers and auditors. Before IFRS adoption era, most countries had their own standards with local bodies responsible for developing and issuance. The Nigerian Accounting Standards Board (NASB) was responsible for developing and issuing standards known as Statements of Accounting Standards (SAS) and in the new dispensation, the body was renamed Financial Reporting Council (FRC) of Nigeria as the regulatory body overseeing the adoption and implementation of IFRS.

IFRS also assists investors in making informed financial decisions and predictions of an entity's future financial performance and give a signal of higher quality accounting and transparency. Therefore, IFRS would tend to reduce earnings manipulation, enhance stock market efficiency and positively impact on entities' stock returns and stock related financial performance measures.

Nigeria started considering adopting IFRS in 2007. In fact, the CBN actually disclosed that Banks should adopt IFRS from 2008 while the SEC advertised 2009. There were several reasons for this deep thought. The bank were however unable to comply due to various technical challenges encountered. The Apex bank therefore had to shift the compliance date to December, 2012.

In view of the on-going economic globalization, emergence of global financial markets and growing business relationships among various companies and different countries all over the world, the need to achieve comparability in financial statements has become highly imperative. In the words of Nobes and Parker (2008),

differences in financial reporting are the norm. If a number of accountants from different countries or even one country are given a set of transactions from which to prepare financial statements, they will not produce identical statements. Awareness of these differences has led in recent decades to impressive attempts to reduce them, in particular, by the International Accounting Standards Board (IASB) which issues International Financial Reporting Standard (IFRS).

As part of strategies aimed at finding a resolution to the divergence in accounting systems, IFRS began as an attempt to harmonize accounting across the European Union, but the value of harmonization quickly made the concept attractive around the world. However, different countries of the world and as a matter of fact different organizations within a country are at different stages in the implementation of IFRS and the process of implementation itself brings a lot of challenges in its wake.

Benefits of adopting IFRS for Nigeria

The benefits of IFRS adoption are numerous. In general, it offers organizations opportunity for a fresh look at their processes and policies. It also gives room for one basis of accounting (simplify local statutory reporting, cross-border transactions, strengthening of controls and efficiencies in future reporting). Furthermore, it may lead to standardization of practices across countries (that is, consistency of global accounting policies and procedures, shared service centre deployment and streamlined merger and acquisition activities). Finally, it can lead to improved comparability across borders and within global industries, with worldwide peers and competitors. A more specific consideration may reveal individual benefits as hereunder:

International investors

Ability to make useful and meaningful comparisons of investments portfolios in different countries.

Multi-national companies

Easy consolidation of financial statements; better management control; as harmonization would aid internal communication of financial information; and easier to comply with the reporting requirements of overseas stock exchanges

Regional economic groups (e.g. ECOWAS, etc.)

Promotion of trade within the region through common accounting practices; and ability to compile meaningful data on the performance of various enterprises within the region.

Governments and national standard setting bodies

Assist governments in attracting international investors as adoption of IFRS enables international investors easy monitoring of overseas investments.

Local and domestic companies

Easier access to external capital; global comparability of financial statements; transparency enhanced disclosures and seal of quality.

Implications of IFRS implementation

The IFRS is a global standard, setting principle–based and globally accepted standards published by the IASB to support those who have adopted in the preparation and presentation of high quality, transparent and comparable financial statements that will aid easy interpretation. Okoye and Akenbor (2012) opined that the perceived challenges involved in IFRS adoption and implementation includes: the intrinsic problems of aligning with IFRS pointing out that international accounting clearly has a language problem (Ukpai, 2002), Adams (2004) claimed that where an accounting standard conflicts with government policy, the standard is revised such as the last in, first out (LIFO) method of stock valuation not allowable for tax purpose in Nigeria. Another problem inherent with the adoption of IFRS is the universal tendency to resist change (NASB 2010). Gambari (2010) noted that the successful adoption of IFRS entails assessing technical accounting, tax implications, internal processes, and statutory reporting, technology infrastructure, and organizational issues. Major implications can be classified as follows:

Increased interest of foreign direct investors

FDI has been defined in several ways. According to Kumar (2007), FDI which involves building long-term relationships with enterprises in foreign countries can be made in several ways. First, and most likely, it may involve parent enterprises injecting equity capital by purchasing shares in foreign affiliates. Second, it may take the form of reinvesting the affiliate's earnings. Third, it may entail short or long-term lending between parents and affiliates. To be categorized as a multinational enterprise for inclusion in FDI data, the parent must hold a minimum equity stake of 10 percent in the affiliate (Kumar, 2007). Garkovic and

Lavin (2002), noted that economic rationale for offering special incentive to attract FDI frequently derives from the belief that foreign investment produces externalities in the form of technology transfer and spillovers. DeGregorio (2003), while contributing to the importance of FDI noted that it allows a country to bring in technologies and knowledge that are not readily available to domestic investors and increases productivity throughout the economy (Oyetoye et al., 2011).

Jeffrey and Spaulding (2005) also stated that FDI advantage includes; circumventing trade barriers, hidden and otherwise making the move from domestic export sales to a locally-based national sales office and capability to increase total production capacity, opportunities for co-production, joint ventures with local partners, joint marketing arrangements. In recent times, it was revealed that FDI in Nigeria have been declining (NASB, 2010). According to NEF (2011) the trend shows that the value declined from $6.9 billion in 2007 to about $4.602 billion in 2008 and $3.94 billion in 2009 and $6.1b in 2010. The decline in 2010 was due to ongoing uncertainty related to the proposed Petroleum Industry Bill (PIB) as well as political unrest in some sections of the country. The new FDI was estimated at $6.8bin 2011. Nigeria is the third largest recipient of FDI in Africa after Angola and Egypt.

The implications of IFRS implementation on the Nigerian Capital market will present themselves in several forms. Assurances shall be evidence in areas such as costs of capital and market integrity, implied cost of equity capital, the price impact of trades and the frequency of zero-return days.

In the European Union, entities that adopted IFRS in 2005, found some evidences that the cost of capital was lower for all firms reporting under IFRS. Their liquidity proxies provided strange results that were robust across different benchmarks, the findings for the price impact of trades and for the frequency of zero-return days suggested improvements in market liquidity after IFRS reporting became mandatory. They also observed that the results for their bid-ask spread improved marginally. I am convinced that the Nigerian experience will show better results because of learning curve advantage (Obazee, 2012).

Foreign Investors might react positively to movement towards IFRS adoption in Nigeria as they expect application of IFRS to have positive cash flow effects. These effects could include reduced contracting costs or reduced scope for managerial rent extraction associated with greater financial reporting transparency capable of providing convergence benefits. Foreign investors only react negatively to movement towards IFRS if, for example, they believe that IFRS would decrease financial reporting quality; largely due to weak governance (enforcement). This could occur if investors believe that IFRS would fail to either adequately reflect regional differences in economies or accommodate countries' differing political and economic features that hitherto led to existing differences in domestic accounting standards.

Alternative enforcement environment as a result of legislative changes

The enactment of the Financial Reporting Council of Nigeria Act No. 6, 2011 gave legal provisions that support implementation of IFRS in Nigeria and promote institutional reforms that are also affecting the Nigerian Capital Market positively. Investors believe that variation in the implementation and enforcement of IFRS could lead to increase in opportunistic managerial discretion when applying IFRS. With the working of the FRC Act, this looseness is protected.

Late supporters may throw up wrong positions and give numbers instead of economic information

Entities are expected to learn certain lessons that can lead to a successful IFRS conversion process. The following issues, if not properly addressed during the conversion process and design of IFRS implementation strategies by adopters who are players in the Nigerian capital market, may lead them to produce numbers instead of economic information. These are:

Management buy-in, Tone at the top/Board sponsorship, knowing that it is not just a corporate level exercise and not under estimating the amount of work involved, establishment of a strong project management office and not underestimating the scale and complexity of conversion and time frame needed. Those expected to adopt IFRS by 2013 are to note, besides the issues mentioned above, that they are expected to come up with a methodical approach to reviewing accounting differences by assessing the financial implications of converting to IFRS. They are to take care to limit the number of accounting platforms to be utilized and align internal and external reporting. Developing IFRS technical knowledge early will help them reduce the likelihood of last minute fire drills and minimize the risk of miss-reporting. Finally, they are expected to invest the time necessary to roll out business process changes such as accounting practices, control mechanism and changes in reporting requirements (to the wider organization).

Restatement may lead to punishment from investors leading to lower share prices

It is important to push down IFRS conversion to the tran-

saction level to eliminate lopsided, manual solutions. Not involving tax and IT personnel early in the process may lead to unexpected results. IFRS changes the way performance is measured and the basis of incentive schemes. The timing and nature of communication must be properly timed as it might send wrong signals to local investors if the Financial Reporting Council orders a restatement of the financial statements of the affected entity.

More significant public interest entities will enlist in the capital market because of enhanced disclosures

The principles-based nature of IFRS triggers the need for enhanced explanations that can provide readers with sufficient information to effectively understand the company's financial statements. In addition to this, there are numerous detailed rules pertaining to specific disclosure requirements in all the existing standards. These are likely to increase as new standards are issued, old ones reviewed and convergence with US GAAP progresses. This will be particularly sharp in the year of transition from Nigerian GAAP to IFRS (depending on the phase under consideration) as the disclosures will need to discuss the various transition adjustments between the two different accounting standards particularly for the opening statement of financial position. Also, related party disclosures now have to be made in strict compliance with IFRS requirements. These disclosures may have legal implications which were hitherto not a consideration for the entity.

Aside the legal implications, the strategic implication has to be considered as well if the entity is to survive in the ensuing aggressive global competitive climate. IFRS on operating segment makes it mandatory for reporting entities to disclose those competition sensitive information that were hitherto the exclusive preserve of management. Information on revenue cost and profit margins, use of assets for business and product lines would now be available for all users of the financial statements.

The government shall be in a better position to understand the activities of some foreign entities, operating in Nigeria, especially their level of profitability; cash management and may thus direct primary regulators to covenant with such entities by requesting them to enlist in the Nigerian capital market if they are to continue to operate in Nigeria.

Capital is essential for the conduct of business, absorption of risks and financing of investment in systems and training. Nigerian businesses, with few exceptions, tend to have comparatively low statutory paid up capital and solvency requirements compared with their peers internationally. The possible consequences of accumulating liabilities without adequate capital are better imagined (Obazee, 2012).

Nigerian societies tend to be close-knit, with businesses structured on family ties. This is natural in an environment where law does not yet fully replace personal trust, greater value is placed on family trust. The various businesses in conglomerates do business with each other that are not at arm's length. The disadvantage here is that the business of conglomerates is geared to serving the conglomerate not its customers. The challenge here is how to understand the nature of the relationships and cross exposures of conglomerates and their family ties.

Obazee (2012) in his report noted that large long-established domestic companies offering traditional products dominate the Nigerian business environment. What is a concern is that these companies may have become set in their ways, with inefficient management and distribution structures and unwillingness to innovate some of these dinosaur companies.

Policy dimension and recommendation

At the end of this research work and based on our findings, we have arrived at the conclusion that time is ripe for all companies all over the world to adopt the International Financial Reporting System (IFRS) and even-though the process of its adoption may be costly and cumbersome, the ultimate benefits will outweigh the cost . Any company that fails to adopt the IFRS will be left in isolation and will find its financial statements difficult to compare with those of its business associates and counterparties; consequently it will find itself denied of the benefits of economic globalization.

RECOMMENDATIONS

- Companies that are yet to commence implementation of IFRS should take necessary steps and deploy resources to initiate the process in order to ensure that their financial statements meet world standard and are comparable with the rest of the world.
- Those that have commenced the process should not be deterred or discouraged by the complexities, rather they should endeavor see it to a logical end.
- It is important to push down IFRS conversion to the transaction level to eliminate lopsided, manual solutions. Not involving tax and IT personnel early in the process may lead to undesired results.
- Those expected to adopt IFRS by 2013 are to note, besides the issues mentioned above, that they are expected to come up with a methodical approach to reviewing accounting differences by assessing the financial implications of converting to IFRS. They are to take care to limit the number of accounting platforms to be utilized and align internal and external reporting. Developing IFRS technical knowledge

early will help them reduce the likelihood of last minute fire drills and minimize the risk of miss-reporting.

- Finally, they are expected to optimize investment of time, finance and other resources required to roll out business process changes such as accounting practices, control mechanism and changes in report-ting requirements.

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