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ADOPTING INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) - A FOCUS ON NIGERIA

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ABSTRACT

Nigeria has indicated her intention to adopt International Financial Reporting Standards (IFRS) as from 2012. This is taking place against the backdrop of the argument suggesting that IFRS are irrelevant to developing countries. And that those developing countries adopting it are doing so because IFRS is a product with "network effects." This contradiction and the question of the relevance of IFRS to Nigeria are evaluated and explored in this study, using the perception of users and preparers of accounting information and drawing from the economic theory of network. The results of the descriptive study showed that IFRS adoption in Nigeria will have the potential to be beneficial to a wide range of stakeholders albeit the challenges posed by the ethical environment prevailing in the country. The study recommends, amongst others that Nigeria's adoption of IFRS should be supported as a matter of national urgency to enable full attainment of the country's economic potential, the Nigerian Accounting Standards Board (NASB) should expedite approvals and processes required for formal adoption of IFRS as national accounting standard in Nigeria, the education, sensitization, and communication to stakeholders of issues associated with IFRS should commence in earnest, a rigorous IFRS capacity building program should be embarked upon by all regulatory bodies, firms and training institutions in order to provide the needed manpower for IFRS implementation and finally that this article be updated by further studies to take account of the areas of differences in perception between preparers and users so as to provide further useful information on the subject.

KEYWORDS

Benefits, challenges, International Financial Reporting Standard, network effects, stakeholders.

INTRODUCTION

The quality of financial reporting is essential to the needs of users who require useful accounting information for investment and other decision making purposes. Information emanating from financial reporting is regarded as useful when it faithfully represents the "economic substance" of an organization in terms of relevance, reliability and comparability (Spiceland, Sepe and Tomassini (2001:36). As observed by Chambers and Penman (1984:32) and Ahmed (2003:18), useful accounting information which derives from qualitative financial reports help in efficient allocation of resources by "reducing dissemination of asymmetric information and improving pricing of securities." In an environment of quality financial reporting therefore, there are no deferral of loss recognition, extra reserves are not created and volatility in income is not smoothed away to create an artificial and misleading picture of steady and consistent growth. Therefore, high-quality financial reports should produce financial information that report events timely and faithfully in the period in which they occur. This becomes imperative as every individual as well as every organization is concerned about the future of their investments and of the organizations in which such investments decisions have been made (Okwoli, 2001).

It is in recognition of the need to have quality financial reports that the adoption of International Financial Reporting Standards (IFRS) is becoming the vogue among countries. The process of adoption received a significant boost when in 2002 the European Union (EU) adopted a regulation requiring public companies to convert to IFRSs beginning in 2005. The major objective of the requirement to adopt IFRSs' is the harmonization of accounting standards for listed companies in Europe. Since there are approximately twenty five (25) countries that make up the EU, most of the publicly traded companies reported their financial statements based on standards set in their individual countries which made interpretation of the financial statements difficult beyond their boundaries.

Though a number of banks in Nigeria have started to adopt IFRS, the country has officially expressed her intention to adopt IFRS as from 2012. Though this might be regarded as a welcome development, the questions that beg for answers as to whether the adoption will enhance transparency of financial reporting in Nigeria are a legion. IFRS is more principled-based and does not provide issuers with the same degree of detailed guidance for the preparation of financial statements, as it is for instance, under Nigerian GAAP.

The objective of this article is therefore to address, from the perspective of users and preparers of financial reports, the questions: What are the benefits and costs of the adoption of IFRS and to what degree will the adoption benefit the wide range of interest in financial reporting in Nigeria? Does Nigeria have the required accounting infrastructure to make the transition to a more conceptual approach to financial reporting effective and rewarding?

To answer the above question, section 2 of this article examines recent literature on the requirements, benefits and cost of IFRS adoption. Section 3 explains the research methods used in this study to establish the degree of benefits and cost expected from IFRS adoption to the various interest groups. Section 4 reports the results of the study, while section 5 is conclusions and recommendations.

REVIEW OF RELATED LITERATURE

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. It however remains an empirical question whether this is the case. For example, proponents argue that substantial benefits can be reaped from greater cross-country comparability of firms' financial reports. On the other hand, opponents argue that one single set of accounting standards cannot reflect the differences in national business practices arising from differences in institutions and cultures (Armstrong, Barth, Jagolinzer, and Riedl, 2007; Access Bank Plc, 2010).

None-the-less, the decision to adopt IFRS by countries can be conceptualized and analyzed with the aid of the Economic Theory of Networks. Network effects refers to a situation in which the utility that a user derives from the consumption of a product or service increases with the number of other agents consuming the same product or service. In other words, a network effect exists where users find a product or service more valuable as additional users use the same product or service. The decision to adopt IFRS can be seen as a decision to adopt a product with network effects because a standard like IFRS is likely to be more appealing to a country if other countries chose to adopt it also.

Following Katz and Shapiro (1985); Lemley and McGowan, 1998), network markets are viewed in this study as falling on a continuum that can be divided into – *actual network*, *virtual network and simple positive-feedback phenomena.* Actual networks are essentially limited to communication markets—the main characteristics separating it from other networks being the absence of inherent value and the necessity for common standards among users in the network. IFRS is becoming a fundamental and global medium of communication of financial accounting information and thus could be said to have both negligible inherent value to the organization generating financial information/reports and increasing value over the range of additional users of the information. Therefore, IFRS as a specialized language conveying common meaning to the proficient could be seen to share some characteristics with actual networks because at least, it ensures common definitions (protocols) to facilitate communication among a set of users. Given the above analysis, a country will adopt IFRS if autarky and synchronization values of IFRS are greater than local GAAP.

The autarky value of IFRS will derive from economic and political factors. The economic factors are intended to capture direct pecuniary benefits as they are usually conceived in economic models of networks, while the political factors are included to assess whether adopters consider the benefits arising from the potentially political nature of international accounting standard setting. Based on the above analysis, arguments and inferences can be drawn on the benefits and costs of IFRS adoption by countries.

There are proponents as well as opponent who have arguments for and against the global adoption of IFRS. For instance, Barth, (2007; 2008,), argues that by adopting a common body of international standards, countries can expect to lower the cost of information processing and auditing to capital market participants as users, and auditors of financial reports can be expected to become familiar with one common set of international accounting standards than with various local accounting standards.

If adopting IFRS is expected to lower such costs, then Nigeria which depend to some degree on foreign capital would be interested. The argument here is that countries choose to adopt IFRS when they expect to increase the share of foreign capital and trade in their economy. In this sense, even countries with low *levels* of foreign capital and trade can choose to adopt IFRS if they are expecting *growth* in those factors.

In countries where the quality of governance institutions is relatively high, IFRS adoption is likely to be less attractive as high quality institutions represent high opportunity and switching costs to adopting international accounting standards. The opportunity costs arise because in adopting IFRS, countries forgo the benefits of any past and potential future innovations in local reporting standards specific to their economies. However, in many developing countries, the quality of local governance institutions are low and thus are important determinants of the decision to adopt IFRS (Ball *et al.*, 2000; Leuz *et al.*, 2003; and Ball, 2006). Such countries are likely to suffer from corrupt, slow-moving, or ineffectual governments that are resistant to or incapable of change (La Porta *et al.*, 1999). In these countries, the opportunity and switching costs are lower and thus, the chance to adopt an externally developed body of accounting standards presents an advantage. Thus, among countries with less developed institutions like Nigeria, the decision to adopt IFRS is likely to be driven by lower opportunity and switching costs.

RESEARCH METHODS

This is a descriptive study in which questionnaire was used to collect data in order to determine the perception of two main groups, one representing the preparers of annual reports (represented by finance managers of quoted firms in Nigeria) and the other representing users of annual reports (that is investors represented by financial analysts).

Finance managers were selected as respondents because they are deemed to be knowledgeable about IFRS and could provide a preparer's perspective on its adoption. Similarly, the Investment analysts were chosen over other users for three reasons, thus: First, Investment analysts are identified in the literature as the principal users of financial reports (Schipper, 1991; Bercel, 1994; Capstaff, Paudyal and Rees, 2000; Healy and Palepu, 2001; Clement and Tse, 2003; Mangena, 2004). Secondly, the work of investment analysts requires that they have the accounting knowledge to enable them to analyze the reports and make decisions (Baker, 1998). Thirdly, provision of information that meets the needs of the analysts is considered as also meeting most of the needs of other users (Gebhardt, Reighardt, and Wittenbrinck, 2004). Based on the above, it could be implied that the intensity of using a company's financial report is higher for analysts than for other users.

The questionnaire was administered to a total of 183 preparers who met the conditions specified below- The firm in which they are employed is listed and active on the Nigerian Stock Exchange in the last ten years i.e (between 1990 and December, 2009) and the industry that the firms belong has at-least three firms. Also, the questionnaire was administered to each of the two hundred and twenty five (225) investment analyst firms identified from the list of Capital Market Operators compiled by the Nigerian Stock Exchange. They were all included in the sample because, as observed by Mangena (2004:34), the response rate among investment analysts is usually low.

The questions required the respondents to answer on a five-point Likert scale anchored by (5) indicating very strong and (1) very weak. On this scale, a score of 5 or 4 indicates that the item is perceived to be essential while a score of 3 or 2 indicates that the item is perceived to be fairly important, but not essential, while a score of 1 indicates that the item could be disregarded for being unimportant. Similar scales have been used by Firer and Meth (1986), Courtis (1992) and Myburgh (2001) and were found suitable. The questionnaire attempted to probe the preparers' and users' perceptions on the usefulness of the adoption of IFRS in different areas of operations of organizations. To obtain a score for these questions, the mean score was calculated. A total number of 75 questionnaires were returned by the preparers out of which 69, representing 38% were useable. For the users, 60 questionnaires were returned out of which 43, representing 19% were found useable. While a 38% response rate is generally considered satisfactory in studies of this nature (Stainbank and Peebles, 2006), a response rate of 19% for the user group means that not much significant statistical inference can be made with regard to the user group.

SURVEY RESULTS

The first question probed the advantages which preparers and users consider companies will derive from the adoption of IFRS. The results for this question are shown in Table 1.

Table 1 BENEFITS OF ADOPTION OF IFRS TO COMPANIES

		Preparers n= 69		Users n=43	
		Mean	Rank	Mean	Rank
1	Improved management information for decision making.	3.69	3	3.60	4
2	Better access to capital, including from foreign sources	3.20	5	3.58	5
3	Reduced cost of capital	3.47	4	3.86	2
4	Facilitated mergers and acquisitions	3.87	2	3.76	3
5	Enhanced competitiveness	3.10	7	2.68	8
6	Ease of using one consistent reporting standard in subsidiaries from different countries	4.35	1	4.45	1
7	Greater effectiveness of the internal audit	2.86	8	2.56	9
8	Lower cost of audit fees	3.15	6	3.45	6
9	Better risk management	2.40	9	3.26	7

Field survey, (2010)

The preparers and the users both agree that ease of using one consistent reporting in subsidiaries from different countries is the most useful benefit of IFRS. They also agree on the benefits of better access to capital and lower cost of audit fees which ranked fifth and sixth among the nine variables respectively. They however differ in their ranking of the other factors. The preparers and users consider better risk management and effectiveness of internal audit as the least benefit to be derived from adoption of IFRS.

The second question probed the benefits to investors of the adoption of IFRS in Nigeria from the perception of both preparers and users of financial reports. These results are shown in Table 2 below.

Table 2 BENEFITS FOR INVESTORS

		Preparers n= 69		Users n=43	
		Mean	Rank	Mean	Rank
1	Better information for decision making	3.53	5	3.65	4
2	More confidence in the information presented	4.36	1	4.55	2
3	Better understanding of risk and return	3.69	3	3.86	5
4	Companies can be compared to a peer group of companies	4.08	2	4.59	1
5	More timely financial reports	3.45	6	3.50	6
6	Easier access to financial reporting	3.54	4	4.10	3

Field survey, (2010)

From Table 2, it is observed that preparers chose confidence in the information presented in the financial reports as the most important benefit, followed by comparability of companies by peer group of companies, which users also ranked as the most beneficial. This is followed by confidence in the information presented. The preparers and users ranked timely financial reports as the least benefit to be derived from the adoption of IFRS. The overall results show that the preparers and users are quite positive that IFRS adoption will be beneficial to the investors.

The third question sought to ascertain the benefits of IFRS adoption to policy makers from the stand point of the preparers and users of financial reports. The results are shown in Table 3.

Table 3. BENEFITS FOR POLICY MAKERS (MANAGEMENT)

		Preparers n= 69		Users n=43	
		Mean	Rank	Mean	Rank
1	Strengthened and more effective Nigerian capital market.	3.21	3	3.50	3
2	Better access to the global capital markets	4.56	1	4.32	2
3	Promotion of cross-border investment	3.58	2	4.38	1
4	Better information for control and decision making purposes	2.60	4	3.34	4
5	More realistic planning experiences	2.57	5	2.80	5

Field survey, (2010)

The preparers ranked better access to global capital market as the greatest benefits policy makers will derive from the adoption of IFRS while for the users it is ranked second. Similarly, the preparers ranked promotion of cross-border investment as the second most important benefit while the users ranked the same factor as the most important. For the other benefits, both the preparers and users are unanimous in their rankings. However, the users are slightly more positive in their perception of IFRS being beneficial in terms of better decision making purposes and realistic planning experiences.

The fourth question probed the perception of preparers and users concerning the benefits of IFRS adoption to national regulatory bodies. The results are shown below.

Table 4 BENEFITS FOR NATIONAL REGULATORY BODIES

		Preparers n= 69		Users n=43	
		Mean	Rank	Mean	Rank
1	Improved regulatory oversight and enforcement	2.53	3	3.05	4
2	A higher standard of financial disclosure	3.67	1	3.50	3
3	Better information for market participants	3.43	4	4.56	1
4	Better ability to attract and monitor listings by foreign companies	3.58	2	3.66	2

Field survey, (2010)

Though the preparers and users are unanimous in their ranking that the adoption of IFRS will lead to better ability of regulatory bodies to attract and monitor listings of foreign companies, they however differ in respect of other benefits. Whereas the preparers ranked higher standard of disclosure as the greatest benefit, for the users, better information for market participants ranked first. These rankings are not unexpected because accounting regulation in Nigeria has traditionally been very prescriptive and thus invites a *form* over *substance* approach. With IFRS, this trend has the potential to reverse.

The curious and interesting issue about the results presented in the above table is that while the preparers ranked better information for market participants as the least beneficial, the users ranked it the most beneficial. Also, the mean scores of the preparers for three of the factors are lower than those of the users. These issues create the impression that the preparers are more knowledgeable about what goes in to financial statements than the users. This could be perceived as 'insider' knowledge which only the preparers are exposed to.

The fifth question probed the perception of the preparers and users with regard to the importance of the adoption of IFRS to other stakeholders. The results are presented below.

Table 5 BENEFITS FOR OTHER STAKEHOLDERS

		Preparers n= 69		Users n=43	
		Mean	Rank	Mean	Rank
1	Greater credibility and improved economic prospects for the accounting profession.	4.35	2	4.00	2
2	Better reporting and information on new and different aspects of the business	3.59	1	4.34	1
3	Enhanced transparency of companies through better reporting	3.34	3	3.58	3

Field survey, (2010)

Though the mean scores for each of the benefits are different for both the preparers and users, they are however unanimous in their rankings. In two out of the three benefits, the users are slightly more positive. That both preparers and users are unanimous in their rankings could be merely coincidental.

The sixth question sought to ascertain the perception of the preparers and users with respect to the factors that could make the adoption of IFRS successful. Eight factors which could potentially lead to successful adoption of IFRS were considered and the results are shown below.

Table 6. KEY SUCCESS FACTORS FOR IFRS ADOPTION

		Preparers n= 69		Users n=43	
		Mean	Rank	Mean	Rank
1	Having technology in place to support the conversion	4.66	2	4.51	5
2	Having trained people in place	4.50	5	4.55	3
3	Sufficient funding	3.80	8	4.05	7
4	Executive and board support	4.56	4	4.32	6
5	Professional support with IFRS experience	4.78	1	4.64	2
6	Sound system of corporate governance	4.58	3	4.53	4
7	Self enforcement by companies	4.00	6	4.78	1
8	Accurate analysis provided by the public and the press	3.84	7	3.76	8

Field survey, (2010)

From the results presented in the Table, it is evident that preparers and users are not unanimous in their rankings. The preparers ranked professional support with IFRS experience as the most important factor while the users ranked it as the second. This is closely followed by the need to have technology in place to support the conversion process as the second for the preparers, whereas the users consider self enforcement by companies of the provisions of IFRS as the most important. The preparers ranked sufficient funding as the least important factor while the users ranked the ability of the public and the press to provide accurate analysis as the least factor. Overall, the mean scores for each of the factors and for both the preparers and users are quite above the average, suggesting that they are positive that the factors listed have potential to lead to successful adoption of IFRS.

The seventh question probed the perception of preparers and users in terms of the challenges of the adoption of IFRS. The results are as presented in table 7.

Table 7. CHALLENGES OF IFRS ADOPTION

		Preparers n= 69	Users n=43

		Mean	Rank	Mean	Rank
1	Training	3.59	6	3.45	6
2	Funding	4.00	5	3.65	5
3	Compliance and enforcement	4.56	3	4.34	2
4	Complexity of conversion	4.12	4	3.89	4
5	Retention of key employees	4.65	2	4.23	3
6	Ethical environment	4.76	1	4.65	1

Field survey, (2010)

The results presented in Table 7 show that the preparers and users only differ in their ranking of the challenges of the adoption of IFRS in two out of six issues raised. They are unanimous that the ethical environment is the most important challenge for the successful adoption of IFRS. This should not be surprising because corporate transparency is a particularly important component of good governance as it ensures the protection of parties (both individual and institutional) who have operational interest in financial reporting in terms of accurate and reliable information which are needed in order to take well-considered economic decisions.

Interestingly, preparers and users are both unanimous that training will be the least challenge. This is curious especially that the country (Nigeria) does not have enough trained and professional accountants. One would have expected training to create the greatest obstacle especially in the issue of first time adoption of IFRS. The result also show that retention of qualified employees will be a challenge as it is ranked second and third respectively by the preparers and users. In this early stage of IFRS, poaching of staff, especially accounting personnel might be pronounced due to the dearth of such personnel.

CONCLUSION

By presenting the results of a questionnaire survey addressed to preparers and users of financial reports (represented by Financial officers and Financial analysts respectively), this study has provided evidence of the potential benefits and challenges of the adoption of IFRS in Nigeria which has officially been scheduled to commence in 2012. The results show that the introduction of IFRS in Nigeria will result in a number of important benefits for a wide range of stakeholders. The benefits of ease of using one consistent reporting standard in subsidiaries from different countries will accrue to companies while investors will benefit, amongst others, more confidence in the information presented in financial statements which they can understand and use. For policy makers (management), the adoption of IFRS will create better access to the global capital markets and a higher standard of financial disclosure for national regulatory bodies. Similarly, other stakeholders would benefit from overall better reporting and information on new and different aspects of the business.

The benefits will be largely driven by a number of potential success factors which include among others professional support with IFRS experience and self enforcement by companies. The benefits and potential success factors notwithstanding, there are a number of challenges to be faced in the process of adoption of the new standard. These among others include ethical environment and the ability to protect qualified and competent employees from being poached by other companies.

Against the backdrop of the objectives of this paper, the following recommendations are hereby suggested: (a) As the time table for the adoption of IFRS in Nigeria has been determined, updating this research to take account of the areas of differences in perception between preparers and users may provide further useful information (b) Nigeria's adoption of IFRS should be supported as a matter of national urgency to enable full attainment of the country's economic potential (c) The Nigerian Accounting Standards Board (NASB) should expedite approvals and processes required for formal adoption of IFRS as national accounting standard in Nigeria (d) The education, sensitization, and communication to stakeholders of issues associated with IFRS should commence in earnest. (e) A rigorous IFRS capacity building program should be embarked upon by all regulatory bodies, firms and training institutions in order to provide the needed manpower for IFRS implementation.

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