The need for global adoption and adaptation of International Financial Reporting Standards (IFRS): post Enron consequences and the restoration of confidence to capital markets following the 2008 financial and stock market crises

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Abstract

Many questions have been raised as to whether financial accounting has become more conservative. The value relevance and qualitative characteristics of accounting information have become topics of particular relevance given the role they have assumed in influencing the value judgment of investors (local or international) in deciding whether or not to invest in a certain market. Given the quality of accounting information – which has resulted in misleading and inaccurate information (amongst many other low quality attributes), it became evident, particularly following Enron's collapse, to adopt improved, enhanced, better quality standards: namely, International Financial Reporting Standards.

This paper considers the background culminating in the adoption of IFRS – as well as the need for the adoption of IFRS. It also highlights why the value relevance of accounting information is also of vital significance in certain emerging economies and why the successful implementation of IFRS in these jurisdictions may be crucial in restoring investor confidence – particularly in the aftermath of stock market crashes in these economies.

Key words: value relevance, conservatism, capital markets, transparency, disclosure, comparability, consistency, accounting information, IFRS adoption , mark to market accounting, IAS 32, IAS 39, financial instruments, fair value accounting, off balance sheet instruments

The Need for Global Adoption and Adaptation of International Financial Reporting Standards: Post Enron Consequences and the Restoration of Confidence to Capital Markets following the 2008 Financial and Stock Market Crises

Marianne Ojo[1]

A. Introduction

Post Enron consequences such as the introduction of various legislation – most notable of which is the Sarbanes Oxley Act, as well as the need for embracing International Financial Reporting Standards (IFRS), have certainly had immense impact, not only within the United States, but also globally. Whilst nine out of the top ten global industrialized nations have already commenced (with the implementation of IFRS) or are in the process of commencing (the U.S plans to commence by 2014), many other nations, including Nigeria have also instigated „Road Map „ plans and begun with the process of adopting IFRS.

Part of the problems attributed to Enron's collapse is considered to have originated from the use of off balance sheet instruments. One consequence of the global adoption and implementation of IFRS will be the operation of larger balance sheets since a lot of financial instruments which had not previously been accounted for on the face of the balance sheet, will now be brought under the scope of the balance sheet.

IAS 32 and IAS 39 address off-balance sheet instruments. Off balance sheet instruments created problems in the Parmalat and Enron cases as they were not reflected in the balance sheet – even though sizes could have been as large as two to three times global GDP. The standards bring the financial instruments under the balance sheet. One of the biggest challenges facing the IASB will be reconciling IAS 32 and 39 globally – with the US in particular. Other debates relating to IAS 32 and 39 include the distinction between debt and equity as this distinction does not exist in the markets. Bond converts to equity under certain circumstances and vice versa. Under IAS 32 what you could call equity may not be permitted under banking regulation.

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– There are currently four standards in issue by the International Accounting Standards Board (IASB), which relate to financial instruments. These are: IAS 32[2] financial instruments : presentation; IAS 39 financial instruments: recognition and measurement; IFRS 7 financial instruments: disclosures, and IFRS 9 financial instruments.
– As well as being a replacement for IAS 39, IFRS 9 will not be mandatory until 2015 (although early application is permitted).“[3]

– IAS 32 deals with **all types of financial instruments,** both recognised and unrecognised and should be applied to contracts to buy or sell a non financial item that can be settled net •
• in cash
• by another financial instrument, or
• by exchanging financial instruments, as if the contracts were financial instruments (with the exception of contracts for the purpose of the receipt or delivery of a non financial item, in accordance with the entity's expected purchase, sale, or usage requirements).“

– The presentation requirements for IAS 32 apply to the classification of financial instruments into:
• financial assets;
• financial liabilities, or
• equity instruments,
and income should be classified into
• related interest
• dividends, and
• losses and gains „[4]

2 „IAS 32 and IAS 39 were issued as separate standards but are applied in practice as a unit because they deal with the same accounting phenomenon. IAS 39 (Financial Instruments: Recognition and Measurement) also contains some disclosures supplementary to those required by IAS 32. IAS 32 prescribes requirements for the presentation of on-balance sheet financial instruments and identifies information that should be disclosed about both on-balance sheet (recognised) and off balance sheet (unrecognised) financial instruments.“
3 D Raggay, „Accounting for Financial Instruments“ BusinessDay 10 May 2012 at page 23
4 Further, „IAS 32 requires disclosure by means of
• future cash flows relating to financial instruments,
• accounting policies applied to those instruments,
• the entity's use of financial instruments,
• the business purposes they serve,
• the risks associated with them, and
• management's policies for controlling those risks.“

B. The Adoption and Adaptation of IFRS in Nigeria

„The International Financial Reporting Standards (IFRS) refers to a series of accounting pronouncements published by the IASB to help preparers of financial statements, throughout the world to produce and present high quality, transparent, and comparable financial information.“[5]

Since globalization is an inevitable process and since high quality standards are crucial to securing and restoring the trust reposed by investors in financial and non financial information (also playing a crucial role in contributing to a country's economic growth and development), as stated in the Report of the Committee on RoadMap to the Adoption of International Financial Reporting Standards in N igeria:

- *It will be in the interest of the Nigerian economy for listed companies to adopt globally accepted, high quality accounting standards, by fully converging Nigerian national accounting standards with International Financial Reporting Standards (IFRS) over the earliest possible transition period, given the increasing globalization of capital markets.*

IFRS 1 deals with the „First Time Adoption“ of IFRS

- *The objective of this International Financial Reporting Standard (IFRS) is to ensure that an entity's first IFRS financial statements and its interim financial reports for part of the period covered by those financial statements contain high-quality information that is :*
- *transparent for users and comparable over all periods presented,*
- *provides a suitable starting point for accounting under IFRS; and*
- *can be generated at a cost that does not exceed the benefits to users*[6]

In a move aimed at „integrating the banking system into the global best practices in financial reporting and disclosure“, Nigeria's central bank (CBN), commenced partial adoption of the International Financial Reporting Standards (IFRS) in the banking system – the move, according to

5 I Alistair, „Understanding IFRS“ PricewaterhouseCoopers Publications

6 „This Standard applies when an entity adopts IFRS for the first time by an explicit and unreserved statement of compliance with IFRS. It aims to ensure that the entity's first IFRS financial statements (including interim financial reports for that specific reporting period) provide a suitable starting point, and are transparent to users and comparable over all periods presented. The IFRS also requires an entity to comply with each individual standard effective at the reporting date for its first IFRS-compliant financial statements.“

the CBN, being aimed at enhancing market discipline and reducing uncertainties which limit the risk of unwarranted contagion. [7]

On the 28th July 2010, an agreement was reached by the Nigerian Federal Executive Council (FEC) which resulted in the approval of January 2012 as ¨the effective date for the convergence of accounting standards (SAS or NGAAP) in Nigeria to International Financial Reporting Standards (IFRS).[8]

The choice of date (that is, the 1st January 2012), according to the government, is attributed to the need ¨to effectively achieve transition to IFRS over a three year period.¨[9] According to the then Minister of Commerce and Industry, Senator Jubril Martin-Kuye, mandatory adoption of IFRS by January 1st 2013, is expected for all other public interest entities – whilst small and medium sized entities (SMEs)[10] are expected to mandatorily adopt the system on the 1st January 2014.

In recognition of the fact that IFRS are ¨less suitable¨ in addressing the needs of users, preparers and owners of SMEs, and as a means of rectifying this gap, the exposure draft of the IFRS for SMEs was issued by the IASB in February 2007.[11] In addressing the needs of smaller enterprises,[12] three sets of guidelines were developed by the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) ¨to meet the needs of those enterprises that do not produce general purpose financial statements.¨

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7 „To achieve full adoption of the IFRS, the Nigerian Accounting Standards Board (NASB), inaugurated a Road map Committee of Stakeholders on its adoption. Members of the committee are the NASB, Federal Ministry of Finance (FMF), NDIC, SEC, NAICOM, PENCOM, Federal Inland Revenue Service (FIRS), and the Institute of Chartered Accountants in Nigeria (ICAN).“ BusinessDay, „Implementing IFRS“ 16-18 March 2012 at page 10

8 ¨The FEC also directed the Nigerian Accounting Standards Board (NASB) to take further necessary actions to give effect to the decision. On the 3rd September 2010, the NASB announced a staged implementation for significant public interest entities by January 2012; other public interest entities by January 2013 and SMEs by January 2014.¨ See PKF, ¨Transition to IFRS: A General Overview and Road Map” <www.pkf-ng.com/IFRS.ppt>

9 A Garuba, ¨The Challenges of Adopting International Financial Reporting System in Nigeria¨ JORIND (9) June 2011 ISSN 1596-8303 <www.transcampus.org/journals>

10 ¨The definition of 'small and medium-sized entities' in the context of the IFRS for SMEs is based on the nature of an entity rather than on its size. The definition of 'SMEs' is entities that do not have public accountability but that publish general purpose financial statements ('public accountability' covers entities with or seeking to have securities traded in a public market or that hold assets in a fiduciary capacity as their main business activity). It is a matter for authorities in each territory to decide which entities are permitted or even required to apply IFRS for SMEs.¨ See PwC, ¨IFRS for SMEs¨ http://www.pwc.com/gx/en/ifrs-reporting/ifrs-pocket-guide/ifrs-for-smes.jhtml

11 ¨The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) also recognised the likelihood that the IFRS for SMEs may not be suitable for smaller enterprises – since such enterprises may not generate general purpose financial statements.¨ See United Nations Conference on Trade and Development (UNCTAD), ¨International Accounting and Reporting Issues 2008 Review¨ at page 78

12 ¨Sometimes referred to as micro enterprises¨

Some identified major international accounting and financial reporting issues include :[13]

• High quality accounting standards

• High quality auditing standards

• Quality assurance

• Corporate governance

• Regulatory oversight

Nigerian GAAP (NGAAP) comprises of the following components:[14]

• The Companies and Allied Matters Act (CAMA) LFN 2004

• Statements of Accounting Standards (SAS) as issued by the Nigerian Accounting Standards Board (NASB)

• Other local legislation and industry specific guidelines such as BOFIA, Prudential Guidelines, Insurance Act and SEC Rules

• International best practice – this being optional

At present, the Companies and Allied Matters Act 2004 (CAMA) LFN is considered to be the major legal framework in relation to matters involving business law as well as corporate accounting. The evolution and development of the Act can be traced as follows:[15]

• From the Bubble Act of 1720 to the Joint Stock Companies Act of 1844, it developed to the Companies Ordinance of 1922 and later to the Companies Act of 1958;

• It then developed to the Business Act of 1968 before the emergence of the ¨formal¨ Companies Act of 1968 which was to dominate the Nigerian business and corporate law environment for the subsequent 20 years;

13 O Adoga, ¨New Frontiers for Corporate Regulations in Nigeria¨ <http://www.hg.org/article.asp?id=62287>

14 T Oyedele, Chartered Institute of Taxation of Nigeria (CITN): □ An Overview of IFRS and Challenges Posed to Professionals □ Seminar on IFRS Adoption in Nigeria April 2011 <www.citn.org/others/IFRS2.pdf>

15 O Adoga, “New Frontiers for Corporate Regulations in Nigeria” April 2009 <http://www.hg.org/article.asp?id=6228>

• The Companies Act of 1968 was ultimately replaced by the CAMA of 1990 till it evolved
to its present state.

Some of the updates which will have to be incorporated into the CAMA in order to facilitate the adoption of IFRS in Nigeria include the following:[16]

• The incorporation of new business laws
• The incorporation of corporate regulatory practices
• The incorporation of corporate ethics
• The recognition of special purpose vehicles
• The codification of corporate governance laws and rules
• The enactment of a new corporate governance law by the National Assembly as a means
of establishing a uniform code of governance and ethics for all corporate bodies in
Nigeria
• Paid up capital as at incorporation.¨

C. Challenges Faced in the Adoption and Adaptation of International Financial Reporting Standards (IFRS) in Nigeria

As well as the need for updates to the present legal framework embodied by the CAMA 2004, another major challenge which relates to the successful implementation and enforcement of standards and codes in Nigeria, is corruption, ethics and values. The issue relating to compliance with standards and codes in Nigeria also constitutes further challenge. Whilst it is argued by some that the adoption of the new IFRS is likely to have little impact on levels of corruption, the adoption of IFRS should to an extent, serve as a deterrent in reducing levels of fraud and corruption.

Other gaps identified in the CAMA are as follows:[17]

• The lack of effective mechanisms to monitor and enforce requirements for accounting and financial reporting as provided for in the Companies and Allied Matters Act.
• Although requirements are imposed by the CAMA on companies – that such companies comply with standards issued by NASB, the NASB "was only statutorily empowered under the 2003 NASB

16 ibid
17 United Nations Conference on Trade and Development (UNCTAD), ¨International Accounting and Reporting Issues 2008 Review¨ at pages 8 and 10

Act to monitor and enforce compliance with accounting standards. The NASB also prescribes sanctions for non compliance. However, the NASB lacks financial and human resources and still has to develop the infrastructure for monitoring and enforcing compliance with accounting standards."

• There is a lack of "effective and efficient institutional arrangements – in respect of facilities which exist to ensure compliance with auditing standards and the professional code of ethics."

• The time consuming nature of the legal process discourages regulators "from taking legal recourse in enforcing compliance with accounting, auditing and financial reporting requirements."

• The extent of numerous areas of accounting issues – which are covered by IAS/IFRS (accounting issues such as comparative information : IFRS 1.7 and IAS 1.36), but yet to be considered by the NASB.

"The Nigerian Statements of Accounting Standards (SAS) appear incomplete as an authoritative guide to the preparation of financial statements." Furthermore, even though the NASB has been mandated to monitor and enforce compliance with accounting standards, it lacks the capacity to do so."

Further challenges presented to the adoption of IFRS in Nigeria – although not with respect to the legal framework of CAMA 2004, include the level of awareness by users of financial reports (statements etc), accounting education and training, resources – hence the need to involve educators and professional accounting bodies responsible for training students to become certified accountants.

As highlighted by Popoola (2012), ¨Though the Nigerian Accounting Standards Board (NASB) sanctions companies and auditing firms for non compliance with accounting standards, the ultimate objective in adopting IFRS is to ensure compliance by the preparers of financial reports in the country in order to restore investors' confidence in the economy 16(for which a stable political climate is also of vital importance). In this respect, measures required to ensure that users' compliance is also fostered, may also be addressed. Further, necessary safeguards must be in operation to ensure that the independence of those verifying financial statements, that is external auditors, is not compromised.

Hence it can be seen that even though the present major legal framework in Nigeria presents challenges in the adoption and adaptation of IFRS, benefits which will arise from the adoption of IFRS include the compelling of preparers of financial reports to observe compliance with standards – as a means of restoring investors' confidence in the economy and attracting more investors to the economy (another benefit of adopting IFRS).

Other benefits emanating from the adoption of IFRS will be discussed in the subsequent section.

D. Benefits and Disadvantages Emanating from the Adoption of IFRS

These include:[18]

• Cost/benefit issues relating to easier accounting rules, simplified format, low ongoing costs;
• The harmonisation of rules with overseas entities applying IFRS (particularly if foreign owned)
• The facilitation provided t o investors as well as lenders, to make better comparisons of financial performance of private entities
• The potential to suit better and meet users´ needs
• The adoption of IFRS is considered to provide a "one stop shop" of accounting requirements which is only updated every 2-3 years.

According to Fowokan,[19] the net economic value of IFRS to a country, arises as a result of two factors, namely:
• The value from having a shared body of accounting standards; and
• The relative quality of local governance institutions.

Disdavantages associated with the adoption of IFRS include:[20]

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18 T Oyedele, Chartered Institute of Taxation of Nigeria (CITN): An Overview of IFRS and Challenges Posed to Professionals Seminar on IFRS Adoption in Nigeria April 2011 <www.citn.org/others/IFRS2.pdf>

19 T Fowokan, "IFRS Adoption in Nigeria – Tax Implications" Paper presented for CITN Seminar on IFRS Adoption in Nigeria (not dated).

20 T Oyedele, Chartered Institute of Taxation of Nigeria (CITN): An Overview of IFRS and Challenges Posed to Professionals Seminar on IFRS Adoption in Nigeria April 2011 <www.citn.org/others/IFRS2.pdf>

• Initial conversion costs

• The fact that greater information (than that provided by private entities currently under local GAAP) may be given – for example, comparatives;

• Acceptability by users: the question relating to whether adoption will be accepted by the user

• Understandability/Comprehensibility by local users

• Legal, tax and financial implications of differences between previous and new standards

• The need for training and/or technical support on IFRS (especially in the short term);

• The fact that a “simplification” of the standards does not necessarily mean that better results will be achieved.

Certain benefits of IFRS are linked to key drivers of IFRS:[21]

• Improved comparability of reported financial information by entities – owing to improved transparency for investors and rating agencies

• Optimisation of tax planning – the ability to analyse impact on tax-related issues

• Easier access to foreign capital funding and cross border stock exchange listings – the need to attract international investors and to enable easy monitoring of overseas investments

• Ability to understand interaction with strategic initiatives to generate value from synergies – this also facilitates more effective management of enterprises and efficient processes since IFRS reporting is peformance based.”

The increasing demand for public accountability and transparency will also be addressed through the adoption of IFRS since greater transparency to all stakeholders will be facilitated.

Certain Provisions as Embodied within the CAMA

Provisions relating to the appointment of auditors, remuneration, rights, functions, powers, and termination as well as the establishment of an audit committee[22] are some of those functions

21 See PKF, ¨Transition to IFRS: A General Overview and Road Map” <www. www.pkf www.pkf-ng.com/www.pkf-ng.com/IFRS www.pkf-ng.com/IFRS.ppt www.pkf-ng.com/IFRS.ppt > and T Oyedele, Chartered Institute of Taxation of Nigeria (CITN): ¨An Overview of IFRS and Challenges Posed to Professionals¨ Seminar on IFRS Adoption in Nigeria April 2011 <www.citn.org/others/IFRS2.pdf>

22 See particularly Part XI Chapter 2, sections 357-358 of the Act “Each company is required by the CAMA to establish an audit committee. Further, the CAMA defines audit committee's composition, functions and powers. The

provided for by the CAMA.

Despite the fact that the CAMA "provides for the right of the company or shareholder to sue auditors for negligence in the case of loss or damage," very few reported cases of litigation against auditors and audit firms exist[23]– inferring that shareholders' or company's rights are yet to be exercised.

Auditors should be held liable for negligent consequences of their actions – however not to the extent that it results in "defensive auditing." Generally, producers of consumables owe a "duty of care" to third parties. However, it was held in Caparo Industries plc v Dickman and Others [(1990) 1 All ER HL 568] that generally, auditors only owe a duty of care to the company as a legal person, and that "they do not owe a duty of care to any shareholder, creditor, pension scheme members or any other stake holder."

Threat of litigation to auditors could lead to further concentration in the audit industry and also increase incidences of "defensive auditing" - whereby audit partners tend to interprete rules prescriptively rather than exercising subjective judgment.

F. Conclusion

Expected Impact of IFRS Adoption on the Nigerian Stock Exchange

Improved transparency and comparability of accounting and financial information, as well as other benefits of high quality standards which should be derived from the adoption of IFRS: benefits such as improved attributes of information (such as relevance, reliability, understandability), will certainly ensure that users of financial information benefit from better decision making as well as restoring the confidence of investors in the aftermath of economic, capital market and financial crises, which have damaged the credibility of audits, and financial reporting.

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audit committee reviews audited financial statements and reports to shareholders. Half of its composition comprises members from among shareholders, and internal members should be non executive. The auditor has a statutory duty to report to the audit committee as well as to report to on compliance with disclosure requirements relating to the remuneration of directors and certain highly paid staff." See United Nations Conference on Trade and Development (UNCTAD), ¨International Accounting and Reporting Issues 2008 Review¨ at pages 3-10

23 Ibid at page 6

Without a doubt,

- *Whilst banks and firms had been able to evade full disclosures in their balance sheet in the past, depending on the performance of some of the securities (like bonds), the new IFRS requires banks to be transparent in their reporting format, irrespective of the performance of the securities – in order to bring out the real performances of the companies.*[24]

Whilst price manipulation and abnormal price appreciation certainly had their roles in partly contributing to the Nigerian Stock Market Crash of 2008, the role of low level quality information and misleading accounting information, coupled with a culture where there is a high level of collusion between auditors and management (be it strategic or operational management within a company), also had their roles in contributing to the Stock Market Crash. Furthermore, greater efforts and a greater commitment to professional ethics will be required if the level of confidence in accounting information and audits is to be restored to prior, or better still, reasonable levels.

24 BusinessDay, „Implementing IFRS“ 16-18 March 2012 at page 10

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Source: Report of the Committee on Road Map to the Adoption of IFRS in Nigeria (NASB, 2010, January 2010 at page 23)