

Taxation Implications of IFRS Conversion for Companies Operating in Nigeria

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Imagine that you have to negotiate a major cross border contract with counterparties who neither understand nor speak your language and vice versa. To make any meaningful progress, you will need a translator and this would definitely cost you time and money in addition to the risk that key messages may be lost in the translation process.

Accounting is the language of business while financial reporting is the medium through which the language is communicated. Accounting and financial reporting are regulated by Generally Accepted Accounting Principles (GAAP) comprising of accounting standards, company law, stock market regulations, and so on. As one would expect, different countries have different GAAPs which makes business communication with other countries difficult. To solve this problem, some decades ago the world started a gradual movement towards adopting a uniform GAAP for accounting and financial reporting which in no small measure is a good thing. But to every good thing in life there is always a side effect and sometimes a good thing can have a negative impact depending on how it is handled.

The global GAAP that is seeking to unify accounting and financial reporting worldwide is the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). Essentially, IFRS comprises of four types of documents (1) International Accounting Standards (IASs); (2) International Financial Reporting Standards (IFRSs); (3) Standing Interpretations Committee (SICs) pronouncements; and (4) International Financial Reporting Interpretations Committee (IFRICs) guidelines.

The major difference between IFRS and the local Statement of Accounting Standards (SAS) is that the former is a more robust and principle based set of accounting standards with detailed disclosure requirements. For instance, the IASB Framework states that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. In order to meet the objective, the Framework requires financial statements to possess certain qualities which are understandability, relevance, reliability, and comparability.

Other key areas of differences include extensive use of fair values for financial instruments, more prescriptive and comprehensive guide for revenue recognition, a more rigorous process for determining goodwill in a business combination, change in format, components and nomenclature of certain items of financial statements. For instance, there are no value added statements or five-year financial summary under IFRS while statement of changes in equity is required.

Increasing demand for public accountability, comparability, improved transparency, ability to analyse impact on tax-related issues, reduced cost of financial reporting, more efficient access to global capital market and easy consolidation of financial statements are some of the key drivers of IFRS conversion the world over.

Notwithstanding the enormous benefits, compliance with IFRS for accounting and financial reporting cannot be enforced in Nigeria without a formal adoption within appropriate regulatory framework. This implies that IFRS financial statements cannot be used for statutory purposes including filing of tax returns, Corporate Affairs Commission annual returns, filing with the Nigerian Stock Exchange / Securities and Exchange Commission, returns to the Central Bank of Nigeria and other regulators.

However, with the recent approval of IFRS conversion for Nigeria by the Federal Executive Council (FEC), Nigeria has joined the over 100 countries that require, permit, or are converging with the goal of adopting IFRS. Following the FEC approval, the IFRS implementation roadmap was unveiled by the Minister for Commerce



and Industry on Thursday 2 September 2010. The roadmap, which is in three phases, mandates publicly listed and significant public interest entities to prepare their financial statements based on IFRS by 1 January 2012 (i.e. full IFRS financial statements are required for accounting period to 31 December 2012) while other public interest entities are required to adopt IFRS for statutory purposes by 1 January 2013. The third phase requires Small and Medium-Sized Entities (SMEs) to adopt IFRS by 1 January 2014.

IFRS has been impacting Nigerian entities for a long time, often through their business dealings with non-Nigerian customers, vendors, investors that use IFRS or through their non-Nigerian subsidiaries in countries requiring IFRS or as Nigerian subsidiaries of overseas' parents. Other Nigerian entities feel the effect of IFRS through application of the local SAS which is largely influenced by IFRS.

While companies who already prepare IFRS financial statements out of necessity may have some sort of advantage, all entities operating in Nigeria still need to brace up for the significant change in the financial reporting landscape that will be brought about by the full adoption of IFRS in Nigeria. As part of the conversion process, organisations need to understand the effect on their financial statements especially income statement, equity and distributable profit. It is advisable to conduct an impact assessment to determine cost, cash flow impact and set out a clear strategy for conversion and allocate responsibilities to individuals with appropriate authorities. There will be far reaching impact on processes, systems and people. The processes that may be impacted include management reporting, budgeting process, accounting manuals, chart of accounts and bases of valuations. In the case of people, communication strategy, training, change management and post implementation support will be necessary. The issues to consider in terms of systems are accounting and consolidation, systems change and new systems requirements or modifications, and data gaps.

Given the interrelationship between accounting measurements and taxation, as part of the conversion process, companies operating in Nigeria need to consider the possible impact of the changes not only on their tax accounting methods but also the possible impacts the changes may have on taxable profits, tax assets and liabilities, and tax distributable reserves.

One major difference between SAS and IFRS is the extensive use of fair value under the latter which may



give rise to differences in recognised income and carrying values of assets and liabilities, and a resulting difference in current and deferred tax liability or asset. Hence, companies assessing the impact of IFRS on their organisations need to keep the tax accounting method implications in mind. A thorough analysis of a company's current tax practices and awareness of the tax variables resulting from the IFRS conversion can help a company identify opportunities to minimize the potential tax issues and manage its tax risks along side.

Changing to IFRS may impact a company's tax positions, complicate or simplify how a company's financial reporting systems and internal control systems are designed, and impact what management communicates with its external stakeholders including the tax authorities. Considering these factors, a successful conversion requires not only the commitment of the finance team, but also demands full involvement of the tax team.

The announcement of IFRS adoption may have been low key but the impact will be far reaching as the stage is now set for a new level in financial reporting in Nigeria. Based on the conversion roadmap, the 2012 reporting date for listed and significant public entities and 2013 for other public interest entities as well as 2014 for SMEs means the time to start preparing for conversion is now. To ensure a successful exercise, tax must be a key item on the conversion agenda.

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