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THE ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS AND THE EARNINGS QUALITY OF FIRST BANK NIGERIA PLC

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Abstract

The adoption of IFRS became mandatory in Nigeria in 2012. This study evaluated the impact of the adoption on the earnings quality of First Bank Nigeria Plc, one of the leading banks in the country against the background that the adoption of IFRS is expected to lead to the disclosure of more and better information which will improve the earning quality of firms. The study period of six years was divided equally into three year(2009-2011) pre-IFRS and three year (2012-2014) post-IFRS periods. Earning yield and Changes in earning yield were used as proxies for earning quality in line with reviewed literature. The data on these variables, sourced from the published financial statements of the bank and Nigerian Stock Exchange, were winsorized with STATA to remove outliers and made normal. Robust command was used to take care of serial correlation. The results of fractional regression analysis conducted with STATA revealed that earning yield increased significantly by48.9% (p =0.0000) while changes in earning yield also increased significantly by 57.7% (p=0.000) indicating an improvement in the earning quality of the bank after the adoption of IFRS though other factors (economic, political and global)can also affect earning quality.

Keywords: IFRS, Earning quality, Earning yield, Changes in earning yield, First Bank Nigeria Plc, Adoption

INTRODUCTION

Globalization is the current trend in the world as countries as well as people harmonize best practices and standards. Accounting and financial reporting are no exception. Consequently, the financial statements prepared according to a nation's local accounting standards may hardly meet the needs of investors, business partners, financiers and decision makers who are conversant with international standards. The International Financial Reporting Standard (IFRS) is an intervention to harmonize accounting practices globally, so that various users can properly understand and analyze financial reports and meaningfully interpret them for optimal decision making (Sanni, 2016).

The question of whether IFRS should be applied in developing countries has been controversial as these countries are mostly characterized by weak institutional and volatile economic and political environments that are not conductive for the adoption of IFRS. Also controversial is the relevance of IFRS on the improvement on earnings quality of firms that adopt them. Supporters of International Financial Reporting Standards suppose a positive effect of the use of IFRS on the accounting information quality. IFRS improve the value relevance of firms and therefore their usefulness for investors (Daske, Hail, Leuz& Verdi, 2008; Florou & Pope 2012). Others argue that using a single set of accounting standards does not necessarily lead to a high quality of accounting information for all economic environments (Soderstrom& Sun 2007; Tsalavoutas, Andre & Evans*,* 2012).

The adoption of IFRS by 'public listed entities and significant interest entities' became mandatory in Nigeria in 2012 and not much has been done on its influence on the earnings quality of firms that adopted them, hence the need for this study. First Bank Nigeria Plc is not only the oldest bank in the country but also one of the leading banks in Nigeria. Anything that affects the bank is likely to have ripple effects, not only in the banking industry alone but also on the Nigerian economy.

LITERATURE REVIEW

Conceptual Review

Cohen (2003) defined earnings quality as the extent to which accounting figures accurately portray the underlying financial health of a firm and the degree to which they result in future operating cash flows. Schipper and Vincent (2003) considered earnings quality as the degree to which reported earnings represent Hicksian income. Chan (2004) viewed earnings quality as the extent to which operating fundamentals are captured by reported earnings. Yee (2006) considered that earnings quality has two components—(1) as a fundamental attribute of the firm and (2) as a financial reporting attribute. Firms report a potentially noisy signal, their earnings.

This is the financial reporting attribute. The proximity of reported to fundamental, or true earnings, is the quality of earnings. Others ascribed conservatism to earnings quality (Penman & Zhang, 2002; White, Sondhi& Fried, 2003).

Theoretical Review

The decision to adopt IFRS can be analyzed as a decision to adopt a product with network effects. A standard like IFRS is likely to be more appealing to a country if other countries choose to adopt it as well. Network theory suggests that there are generally two factors to consider in adopting net-work dependent products: the intrinsic value of the product and the value of the product's network (the value of other people using it) (Katz & Shapiro, 1985; Sanni, 2005). The direct value is sometimes referred to as the autarky value of the product while the network related value is called the synchronization value (Liebowitz& Margolis, 1996). The existence of the synchronization value of a product suggests that the product can be adopted even if its autarky value is inferior to that of a substitute product. Given the network framework, a country's decision to adopt IFRS can be expressed as follows:

Adopt IFRS if and only if:

Autarky value of IFRS + Synchronization value of IFRS > Value of the local GAAP

This should surely lead to an improvement of the earnings quality of firms that adopt the superior standard.

Empirical Review

Many studies have focused on the effect of IFRS adoption on earnings information content. They have mixed results. Some studies have found an improvement of the informational content of accounting numbers after adoption of IFRS.

The adoption of IFRS has resulted in a reduction of the information asymmetry between informed investors and those uninformed (Leuz&Verrecchia, 2000; Bushman & Smith, 2001). IFRS limits the accounting alternatives and enhances the firm's ability to report accounting numbers that better reflect its financial performance and economic position (Barth, Landsman, & Lang, 2008). Several empirical studies (Jaggi and Li, 2004; Bartov, Goldberg and Kim, 2005; Barth, Landsman and Lang, 2008; Lenormand and Touchais, 2009) examining earnings value relevance by analysing the association degree between returns and earnings, have confirmed the information content of IFRS adoption. Several studies that analyse the effect of mandatory IFRS on earnings quality resulted in the same conclusions. For example, Lenormand and Touchais (2009) found that IFRS adoption by French firms produces information with more quality. Iatridis (2010) study, which focused on the adoption of the IFRS in the UK, also found that the introduction of IFRS reduced the level of earnings management and improves value relevant accounting figures.

Other studies have confirmed that the adoption of IASB standards did not result in a strong association between the book value and the market value of the company. In a Chinese context, Eccher and Healy (2000) and Lin and Chen (2005) indicated that accounting numbers prepared according to IFRS were less relevant than those developed by Chinese standards. Several studies (Jeanjean and Stoloww, 2006; Kaserer and Klingler, 2008;Christensen, Lee and Walker,2009) found similar results and did not find that the IFRS result in an informational surplus against local standards. Ames (2013) found that the earnings quality of South African firms did not significantly improve post adoption.

Research works on the earnings quality of Nigerian firms after the adoption of IFRS are not many. Ibiamke and Abanyam (2014) as cited by Sanni (2015) found that the adoption of IFRS resulted to a significant increase in financial statement value relevance of quoted Nigerian firms. Results of the research by Asian and Dike (2015) indicated a decline in accounting quality using earnings management, value relevance, and timely loss recognition as independent variables. Earnings and book value of equity were less value relevant and timely loss recognition was less in post-IFRS compared to pre-IFRS period. Onalo, Lizamand Kaseri (2014) established from an investigation into IFRS and the quality of financial information by Nigerian banks that IFRS adoption engendered higher quality of banks financial statement information compared to local GAAP (Generally Accepted Accounting Principles).

It should be noted however that IFRS application alone is not sufficient to reduce the opportunistic behavior of managers. Hence, effective enforcement of IFRS standards by strong institutional framework and monitoring and supervisory systems is necessary to reduce opportunistic behavior of managers. Therefore, a combination of high quality standards like IFRS and effective corporate governance systems is necessary to enhance the quality of accounting information (Akileng, 2014).

RESEARCH METHOD

In order to empirically test the adoption of IFRS on the earnings quality of financial reports, an association studies had been constructed and improved after the seminal work of Ball and Brown (1968). These studies measured the strength of the association between accounting information (earnings) and the firm valuation (market returns). The model used in this study draws on the work of Burgstahler and Dichev (1997), Barth *et al.*, (1998), Zhang (2000), Hayfa, Nadia and Sarra (2013)and Sanni (2016) which considered that the carrying value of the business and profit are two complementary variables that explain the share value. This relationship is then expressed as follows:

Pre-IFRS regression:

$R_{it}^{pre} = \alpha_0 + \alpha_1 EPS_{it}^{pre} / P_{i,t-1} + \alpha_2 EPS_{it}^{pre} / P_{i,t-1} + \alpha_3 Size_{it} + \varepsilon_{it}$……………………………(1)

Post-IFRS regression:

$R_{it}^{pos}t = \alpha_0 + \alpha_1 EPS_{it}^{post} / P_{i,t-1} + \alpha_2 EPS_{it}^{pos}t / P_{i,t-1} + \alpha_3 Size_{it} + \varepsilon_{it}$…………………………(2)

In order to consolidate results from model (1), additional tests had been performed by estimating model (2). The test of value relevance is conducted with Equation 3 based on the Bartov*et al.,* (2005) model. An increase in the amount of evidence is expected because this model includes all firm-years observations.

$R_{it} = \alpha_0 + \alpha_1 Post + \alpha_2 EPS_{it} / P_{i,t-1} + \alpha_3 EPS_{it} / P_{i,t-1} + \alpha_4 Size_{it} + \alpha_5 Post^*EPS_{it} / P_{i,t-1} + \alpha_6 Post^* EPS_{it} / P_{i,t-1} + \varepsilon_{it}$ ……………………………………………………………(3)

Where:

P_{it}: stock price of firm (i) at the end of the year (t);

EPS_{it}: earnings per share of the company (i) produced during the year (t).

Size = Company size (proxy by log of total assets)

R_{it} : Market return of firm (i) during year (t).

So: $R_{it} = EPS_{it} / P_{i,t-1} + EPS_{it} / P_{i,t-1}$

Post is a dummy variable that equals one if financial reporting is based on IFRS (after mandatory transition in 2012) and zero otherwise. Coefficients $\alpha_5$and α_6 on the interaction terms of the IFRS dummy variable (POST) and earnings (EPS and EPS) reflect the differential effect of the transition from Nigerian GAAPto IFRS. If earnings reported under IFRS provide greater value relevance than Nigerian GAAP, then these coefficients (α_5 and/or α_6) are significantly positive.

In order to evaluate the adoption of IFRS on financial reports, a comparative analysis of accounting and financial data measured using two different accounting standards sets, namely Nigerian GAAP and international ones was conducted. The whole period covering 6 years (2009-2014) was split into two sub-samples. The first sub-sample focused on the years 2009-2011 (Pre-IFRS) and the second focused on the years 2012-2014 (Post-IFRS). The data used for this study were sourced from the published financial statements of First Bank (Nigeria) Plc and publications by Nigerian Stock Exchange. First Bank Nigeria Plc had been purposely selected for this work, being the oldest bank in Nigeria and one of the top leading banks in the country. The effect of the adoption of IFRS on the earnings quality of the bank is expected to have ripple effects on the banking industry in Nigeria,

ANALYSIS AND DISCUSSION O FINDINGS

Pre-IFRS Adoption Period

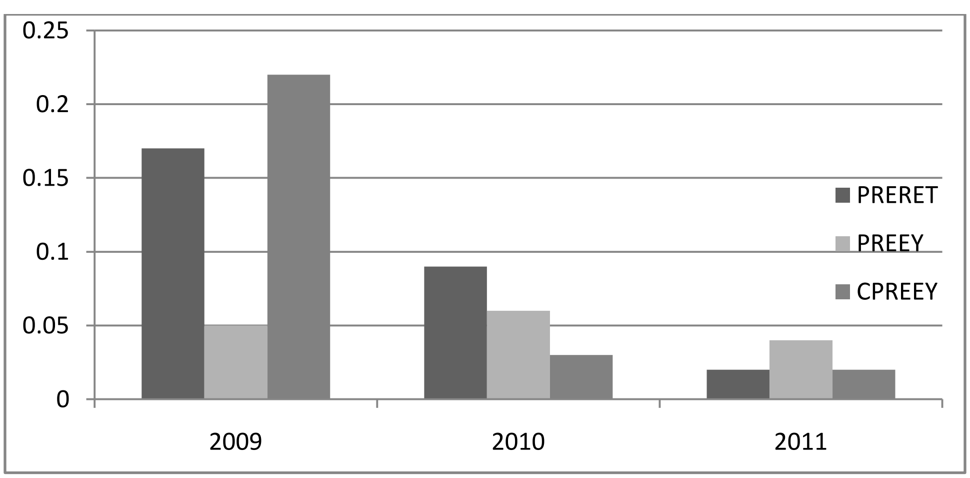
The mean of Preret (Pre-IFRS return) (0.93) almost equals its median (0.09) (Table 1).

Table 1: Descriptive Statistics on Pre-IFRS Adoption Variables

	PRERET	PREEY	CPREEY	SIZE
Mean	0.09333333	0.05	0.09	6.376666667
Median	0.09	0.05	0.03	6.37
Minimum	0.02	0.04	0.02	6.3
Maximum	0.17	0.06	0.22	6.46
Standard Deviation	0.07505553	0.01	0.112694277	0.080208063
Skewness	0.19945783	3.4972E-15	1.716720428	0.371443282

The data is positively skewed, indicating the presence of severe outliers. All the other variables: Pre-IFRS earning yield (Preey), Change in pre-IFRS earning yield (Cpreey) and Company size (Size) are also positively skewed also indicating the presence of severe outliers. When a set of data is affected by outliers, wrong inferences might be made. One of the best ways of removing outliers is to winsorize the data at 1% and 99% percentiles, using STATA (Ayoola, 2015). The data were therefore winsorized.

Figure 1: Pre-IFRS Variables



All the three variables fluctuated during the 2009-2011 pre-IFRS adoption period in line with the economic situations in Nigeria. Preret moved from 0.17 in 2009 to slightly above 0.5 in 2010 and to less than 0.5 in 2011. Preey increased marginally in 2010 and fell in 2011. Cpreey was at its peak in 2009, fell drastically in 2010 and increased marginally in 2011.

Fractional regression analysis was used for this study because the dependent variable (Preret) is in fraction (i.e. less than 1). The robust command was used to take care of serial correlation.

The result of the analysis shows that the Chi^2 p-value =0.0000, indicating that the model used was suitable for the study (Table 2).

Table 2: Fractional Regression Analysis of Pre-IFRS Adoption Period

```
------------------------------------------------------------------------------

fracglmpreretpreeycpreey size, link (logit) vce (robust)
note: size omitted because of collinearity

Fractional Logistic Regression                  Number of obs   =          3
                                                Wald chi2(0)    =          .
Prob> chi2     =     0.0000        .
Log pseudolikelihood = -.85646316               Pseudo R2       =     0.0796

------------------------------------------------------------------------------
             |               Robust
preret |      Coef.   Std. Err.      z    P>|z|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
preey |    5.01927   1.93e-08  3.9e+09   0.000      5.01927     5.01927
cpreey |   7.780001   1.02e-09  7.7e+09   0.000     7.780001    7.780001
size |          0  (omitted)
       _cons |  -7.048191   1.19e-09 -5.9e+09  0.000    -7.048191   -7.048191
------------------------------------------------------------------------------
```

The earnings quality was proxied by Preey and Cpreey. The coefficient of both are positive (5.01927 and 7.7800 respectively) and are significant (p = 0.000).

Post-IFRS Period

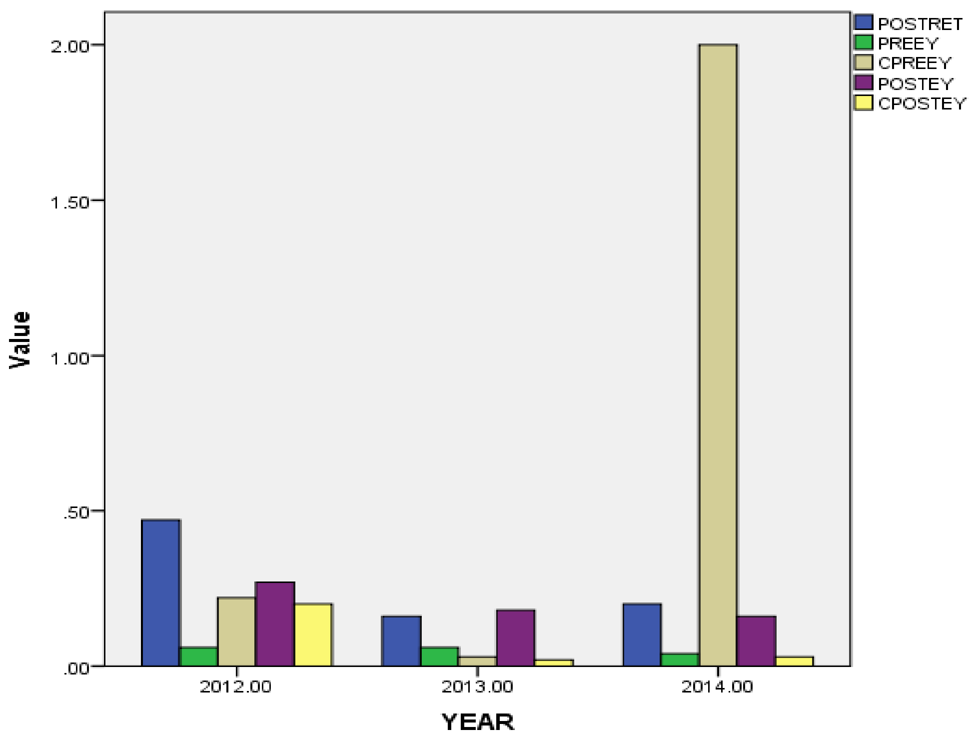
Table 3: Descriptive Statistics on Post-IFRS Adoption Variables

	POSTRET	PREEY	CPEEY	SIZE	POSTEY	CPOSTEY
Mean	0.276666667	0.05	0.09	6.563333333	0.203333333	0.0833333
Median	0.2	0.05	0.03	6.57	0.18	0.03
Minimum	0.16	0.04	0.02	6.5	0.16	0.02
Maximum	0.47	0.06	0.22	6.62	0.27	0.2
Standard Deviation	0.168621865	0.01	0.112694277	0.060277138	0.058594653	0.1011599
Skewness	1.623046487	3.4972E-15	1.716720428	-0.49161305	1.507808484	1.7130289

The mean of four of the Post- IFRS variables are greater than the median (Table 3). These are: Post-IFRS return (Postret) (0.277, 0.20); Change in pre-IFRS earning yield (Cpeey) (0.09, 0.03); Post-IFRS earning yield (Postey) (0.20, 0.18) and Change in Post-IFRS earning yield (Cpostey) (0.083, 0.03). The mean of Pre-IFRS earning yield (Preey) is equal to the median while the mean of Company size (size) is slightly less than the median.

Postret had its highest peak in 2012 (Figure 2) which is quite unusual as share prices fell in 2012 – the IFRS implementation year – due to uncertainties of the influence of IFRS on the market. It decreased in 2013 and picked up again in 2014.

Figure 2: Post-IFRS Variables



Postey had its peak in 2012 and fell marginally in 2013 and 2014. Cpreey got to its peak in 2014, indicating a positive confidence the market had on the earnings quality of financial reports prepared with IFRS, two years after the adoption became mandatory in Nigeria.

Fractional regression analysis was used for this study because the dependent variable (Postret) is in fraction. The data was made robust to take care of serial correlation (Table 4).

Table 4: Regression Analysis on Post-IFRS Adoption Period

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------------------------------------------------------------------------------

fracglmpostretpreeycpeeypostsizeposteycpostey, link (logit) vce (robust)
note: postsize omitted because of collinearity
note: postey omitted because of collinearity
note: cpostey omitted because of collinearity

Fractional Logistic Regression                   Number of obs   =          3
                                                 Wald chi2(1)    =          .
Prob> chi2     =     0.0000          .
Log pseudolikelihood = -1.6314184                Pseudo R2       =     0.0779

------------------------------------------------------------------------------
             |               Robust
postret |      Coef.   Std. Err.      z    P>|z|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
preey |  -17.19186   7.27e-10 -2.4e+10   0.000    -17.19186   -17.19186
cpeey |   7.190343   3.64e-11  2.0e+11   0.000     7.190343    7.190343
postsize |         0  (omitted)
postey |          0  (omitted)
cpostey |         0  (omitted)
       _cons |  -.8424268   2.84e-11 -3.0e+10   0.000    -.8424268   -.8424268
------------------------------------------------------------------------------
```

The p – value of the Chi^2 is 0.0000 indicating that the model was suitable for the study. Collinearity existed between Postsize, Postey and Cpostey and the variables were therefore omitted from the output in Table 4.

Postsize was removed and the two proxies for earning quality (Postey and Cpostey) served as independent variables and regressed against Postret (Table 5).

Table 5: Further Regression Analysis on Post-IFRS Variables

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------------------------------------------------------------------------------
fracglmpostretposteycpostey, link (logit) vce (robust)

Fractional Logistic Regression                   Number of obs   =          3
                                                 Wald chi2(1)    =          .
Prob> chi2     =     0.0000          .
Log pseudolikelihood = -1.6314184                Pseudo R2       =     0.0779

------------------------------------------------------------------------------
             |               Robust
postret |      Coef.   Std. Err.      z    P>|z|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
postey |   7.459383   5.33e-10 -1.4e+10   0.000     7.459383    7.459383
cpostey |    12.2746   3.44e-10  3.6e+10   0.000      12.2746     12.2746
       _cons | -.5610311   7.52e-11 -7.5e+09   0.000    -.5610311   -.5610311
-------------------------------------------------------------------------
```

The result in Table 5 shows that the coefficient of Postey (7.45) is positive and significant (p = 0.0000). That of Cpostey is also positive (12.27) and significant (0.0000).

For IFRS to have an improvement on the earnings quality of financial reports, the coefficients of Post-IFRS earning yield (Postey)and/or Change in Post-IFRS earning yield (Cpostey) must be positive and significant (Hayfa*et al.,*2013; Sanni, 2016).

Table 6: Summary of Coefficients

Pre-IFRS	Pre-IFRS earning yield (Preey) Coefficient = 5.01 p- value = 0.00 Decision = Significant	Change in pre-IFRS earning yield (Cpreey) Coefficient = 7.78 P- value = 0.00 Decision = Significant
Post –IFRS	Post-IFRS earning yield (Postey) Coefficient = 7.46 P- value = 0.00 Decision = Significant	Change in Post-IFRS earning yield (Cpostey) Coefficient = 12.27 p- value = 0.00 Decision = Significant

The summary of the coefficients in Table 6 shows that the coefficient of Pre-IFRS earning yield increased by 48.9% (from 5.01 to 7.46). The coefficient of Change in pre-IFRS earning yield increased by 57.7% (from 7.78 to 12.27). These further confirm the assertion that there is improvement in the earning quality of financial reports of First Bank Nigeria Plc after the adoption of IFRS.

These results confirm many previous studies that have analyzed the value relevance of accounting figures prepared using IFRS (Leuz & Verrecchia, 2000; Bushman & Smith, 2001; Dumorntier & Maghraoui, 2006; Gassen & Sellhorn, 2006; Li, 2010; Armstrong, Barth, Jagolinzer & Riedl, 2010; Hayf, Nadia & Sarra, 2013; Sanni, 2016). They however negate other works that posited that the adoption of IFRS does not necessarily improve the earning quality of financial statements as other factors outside the adoption of IFRS influence earning quality of financial statements (Clarkson, Hanna, Barth, Landsman & Lang, 2007; Erick, 2011; Richardson & Thompson, 2011).

CONCLUSION

The adoption of IFRS is expected to have an effect on how the financial markets interpret accounting information. IFRS adoption should lead to positive improvements of the value relevance of accounting data as opposed to domestic standards of the individual countries. The value relevance of accounting data implies the ability of accounting data to reflect contemporaneously market prices or market returns. This has been demonstrated by First bank Nigeria Plc whose earning quality improved significantly after the adoption of IFRS. It should be noted however that improvements on earning quality do not depend on the adoption of IFRS alone but on other factors like the economic and political conditions of the country. These factors had not been considered in this work. Also, there are many variables that can be used to proxy earning quality. This work has restricted itself to earning yield and changes in earning yield before and after that adoption of IFRS.

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