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IMPACT OF IFRS ADOPTION ON THE QUALITY OF FINANCIAL REPORTS IN NIGERIA

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ABSTRACT

This study is aimed at examining the impact of IFRS adoption on the on the quality of financial reports in Nigeria. Data obtained from questionnaires on sampled respondents were analyzed using the regression model. The results show that IFRS adoption improves transparency and comparability of financial reports. To constantly improve on the transparency and comparability of financial statements, it is recommended that International Financial Reporting Standards be reviewed to allow for more disclosure in the financial reports.

***Key Words**: IFRS, Adoption, Comparability, Financial report, Transparency*

1.1. Introduction

The growth of foreign capital markets and accessibility of quick global communication have placed on accounting the need to create useful and comparable information across territorial borders (Rivera, 1989). In view of promoting a system of unified accounting system globally, brought about the development of a global set of accounting standards that will be adopted by the different countries of the world. As a result of the move towards the convergence of accounting practice, the International Accounting Standard Board (IASB) was formed and tasked to create a high quality set of standards that would unify accounting practices across borders. Thus, the creation of the International Financial Reporting Standards (IFRS). The IFRS is said to achieve the following: promote transparency; enhance comparison of financial reports across territories; reduce cost of capital due to increase in investors' confidence; enhance cross border investment among others.

The financial reports are said to enhance cross border information if they are of high quality i.e. if they are transparent and comparable to investors across borders and thus will lead to improved cross-border investments. This exactly is one of the many benefits been fronted for the adoption of IFRS across the globe. However, studies have shown that despite the adoption of IFRS in some countries, cross-border investments did not significantly improve thus. Does this mean that the quality of financial reports in those countries did not improve? If this is so, why then do countries need to invest a lot of resources into the adoption of IFRS with little or no yield from such investments. Studies of such have shown varying result in the adoption of IFRS on the transparency and comparability of financial report. To this end, this study is poised to examine if the adoption of IFRS has positively improved the quality of financial reports in Nigeria.

1.2. Objective of the Study

The aim of this study is to ascertain the level of transparency of financial reports of listed firms within Nigeria since the application of IFRS. In a bid to achieve the main objective of this study, the following specific objectives are to be achieved:

i. Investigate the result of IFRS adoption on the transparency of financial reports in Nigeria; and

ii. Assess the result of IFRS adoption on the comparability of financial reports in Nigeria.

1.3. Research Hypotheses

The following null hypotheses are formulated for this study:

i. H_0: The adoption of IFRS has not significantly improved the level transparency of financial reports of listed firms in Nigeria,

ii. H_0: The adoption of IFRS has not significantly improved the level of comparability of financial reports in Nigeria.

2.0. Theoretical Framework

This study is based on the process theory. Accounting rules in any geographic territory does not develop in a just in one day. They change over time within a time frame. There have been technical changes which happened at different levels of the development of accounting rules in many countries (Baylin *et al*, 1996). The present drive on the application of IFRS shows a significant growth in accounting rules development plan across territories.

Specifically, this study is hinged on the life-cycle theory of process, the dialectic theory of process, the evolutionary theory of process and the teleology theory of process.

Life-Cycle Theory of Process

Life-cycle process theory is based on the supposition that transformation in an organization's setup are driven by a set of fundamental reasons, rules, or events in the confines of the organization. In life-cycle process model, transformation and advancement transforms in a process of set reactions (unitary), in which characteristics are modified in a process and continue in the following processes (cumulative), and all the processes interact such that they come from a fundamental event (conjunctive) (Van de Ven and Poole, 1995).

Dialectic Theory of Process

This theory is traced from the Hegelian supposition that a firm or setup functions in a world characterized by varying components, i.e. arguments for and arguments against, which contend continuously to achieve influence (Van de Ven and Poole, 1995). The contending components may happen within a setup stirred up by circumstances such as varied life-cycle programs and incompatible goals, and may also happen externally from the setup stirred by varying developments within setups (Van de Ven, 1992). In the dialectic process theory, transformations are set by the corresponding equilibrium of power between the conflicting components (the arguments for and the arguments against). Transformation happens once these varying components lose their corresponding equilibrium power. If a varied component (argument for) gets adequate power to oppose the present state of affairs (arguments for), there will exist a timeframe of consistent variance within the two components, and the conciliation of the different expectations in a new component, i.e. argument for (Van de Ven, 1992; Van de Ven and Poole, 1995; Rodrigues and Craig, 2007). During this period, this argument transforms to be a new 'argument for'. Nevertheless, there exist a chance that the variation between these conflicting components which result in the argument of the displacement by the argument against. Within the surrounding of organizational development, transformation extends when an argument for is either changed by an argument against or simply taken over by an argument against (Van de Ven and Poole, 1995).

Evolutionary Theory of Process

The third family of process set of theories is the evolutionary process theory. Within process theory, (Van de Ven and Poole, 1995) did not equal evolution with transformation, but made reference to evolution as aggregated transformation in the structural forms of a set-up elements across different industries, communities, or societies. Van de Ven, 1992; Van de Ven and Poole, (1995) stated that, between evolutionary process theory, transformation in an entity setting is equal to biological evolution, where transformation happens in a steady process of variation (the formation of the new forms), selection (picking the best forms), and retention (maintaining selected entity forms).

Teleology Theory of Process

Another portion of the process theory is teleology process theory, which, in variance to lifecycle theory, does not demand critical reasoning to drive organizational transformation. Teleology theory posits that "purpose or goal is the final cause for guiding movement of an entity" (Van de Ven and Poole, 1995). This theory is constructed upon the premise that "the developing entity is purposeful and adaptive; by itself or in interaction with others. It socially constructs an envisioned end state and selects from alternatives a course of action to reach it" (Van de Ven, 1992). This proven assumption means that transformation happens due to progress towards, a set of ultimate objectives, in which organizational set-ups design the objectives to work towards in a bid to achieve them, and always observe the process of attaining those objectives. Since a setup is formed by its internal and external environment, transformation process in the framework of teleology process model is viewed to involve a repeated process of creation, implementation, measuring, and adjustments of objectives (Van de Ven and Poole, 1995). While there are no underpinning programs that act as a yardstick for weighing, measuring the transformation process are performed by watching at if an organizational setup upgrades at its desired objectives (Van de Ven and Poole, 1995).

2.1. Empirical Review

Investors have preference in investing locally than in external territories. This 'local preference' may be reasonable with the existence of information asymmetries that are to the demerit of the foreign fund providers or where there are increasing outflow involved in acquiring information about foreign investments. In Nigeria, transnational companies report to the international finance market. It seems reasonable to have international financial reporting benchmarks. Cross border listing is now common place, accounting firms are beginning to follow their growing corporate clients into other countries in order to maintain services and governments are engaging in wide range reviews that recognizes the importance of reassuring the markets and the public at large that corporate reporting and governance frameworks are sufficiently robust. Francis, Cai and Wong, (2010), studied the effect of IFRS adoption on global market integration and watched the effect of IFRS application on the level of integration of capital markets for the G8 countries (Canada, France, Germany, Italy, Japan, Russia, the UK and the US). Of these, the four EU countries were mandatory adopters during the period covered by the research (1995-2008). Integration was assessed by the level to which variations in the stock market indices for each country were related. Their result showed that all the countries' stock markets showed a high degree of international integration when mirrored with their non-adopting contemporaries, the IFRS application countries seemed to garner a higher integration of their capital market after IFRS application.

Francis, Huang and Khurana, (2012), examined the role of international GAAP in cross-border mergers and acquisitions (M&A). They studied, the effect of mandatory IFRS adoption on cross-border merger and acquisition (M&A) activity. Their sample covered 32 countries (13 from the EU) and compared M&A activity in 2004 and 2006. They found out that though there was a general improvement in M&A activity following the IFRS adoption, the improvement was visible for country pairs with a low level of comparability in GAAP in the pre-IFRS application period. In another view, investors in countries that adopted IFRS improved their cross-border M&A activity more post-IFRS adoption in countries where there was a huge variance in GAAP in the pre-IFRS period.

Yu, (2010) carried out a study titled 'accounting standards and international portfolio holdings: analysis of cross border holdings following mandatory adoption of IFRS'. He examined transformation in mutual fund holdings in business entities subsequently from the compulsory adoption of IFRS. The sample consisted of 4,399 companies, 650 voluntary IFRS adopters, 3,474 mandatory adopters, and 274 non-adopters (which form a control group) from 28 countries (nine non-EU) where IFRS was made compulsory for the study time frame of 2000-2007. He discovered that subsequent to the compulsory IFRS adoption, the quota of shares held by foreign mutual funds increased by 270 percentage points for mandatory adopters, by 240 percentage points for voluntary adopters, and effectively remains unchanged for non-adopters. In addition, he discovered that the effect of mandatory IFRS adoption on foreign mutual fund holdings was positively related with the level of national accounting variance pre-adoption, with territorial distance and with language variances. The result showed that IFRS adoption has a larger effect on foreign investment as it reduces accounting variances. Accounting harmonization also diminishes the check to foreign investment otherwise restricted by language and distance. Yu (2010) also discovered that the effect of mandatory IFRS adoption on foreign mutual fund holdings is positively correlated with the level of enforcement in the various complying country, though his finding relied on which proxy is used to measure enforcement.

In Nigeria, some studies on the influence of IFRS adoption on Nigeria's cross border investment have been undertaken. Okpala, (2012) carried out a study on 123 respondents consisting of preparers of financial statements of listed companies and investment analysts. His result in respect to cross border investment shows a perceived positive influence of IFRS adoption on Nigeria FDI inflow and economic growth. Also, Adetula, Nwobu and Owolabi, (2014) carried out a study to examine the relationship between IFRS adoption and FDI. Their result showed that the longer a country uses IFRS, the higher the FDI. Adetula *et al* (2014) added the perception of business managers and preparers of financial statements towards FDI is important as it determines their willingness to adopt IFRS. This study is posed to validate some of this claims contained in earlier studies done in the Nigerian environment.

3.0. Methodology

Quantitative research is used for this study. The objective of quantitative research is to develop and employ mathematical models, theories and/or hypotheses pertaining to natural phenomena. The population of this study consists of all financial members and professional of the Institute of Chartered Accountants of Nigeria which were 12,512 and 13,865 respectively given a cumulative total of 26,377 elements. The survey instrument used in this study to gather data is the questionnaire. In drawing the sample, the following parameters were set; 95% confidence level, 5% confidence interval which led to a sample size of 379 in all. 567 copies of the questionnaire were administered using the convenience method. Each respondent was asked to fill out a questionnaire indicating his or her agreement or disagreement with each statement on a 5-point Likert scale ("1"= Strongly Disagree; "2"= Disagree; "3"= Neutral; "4"= Agree; "5" = Strongly Agree).

ANOVA was used to test the significance of the model. To derive useful meaning from the data generated, the multiple regression model was used to test for the relationship and also the degree of association between the independent variable (IFRS adoption) and the dependent variable i.e. quality of financial report. This is represented in the model:

$QFR = \beta_0 + IFRS\, x + \mu_2$

For the purpose of this study, this model can be re-written as:

$Trans = \beta_0 + IFRS\ x + \mu_2$……………………….i

$Comp = \beta_0 + IFRS\ x + \mu_2$……………………….ii

Where

QFR = Quality of financial report

IFRS = international financial reporting standards

Therefore

β_0 = Intercept where QFR is zero

Trans = Transparency

Comp = Comparability

4.0. Data Analysis and Discussion of Findings

Test of hypotheses

The stated hypotheses are tested below:

1. **H_0: The adoption of IFRS has not significantly improved the level transparency of financial reports in Nigeria**

The response data from respondents are shown in Table 1.

Table 1. IFRS based financial statements in Nigeria shows more financial information disclosures than financial statements based on SAS

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	253	51.7	51.7	51.7
	Agree	212	43.4	43.4	95.1
	Disagree	15	3.1	3.1	98.2
	Undecided	9	1.8	1.8	100.0
	Total	489	100.0	100.0	

Source: Field Survey

From Table .1., 51.7% strongly agreed that IFRS financial statements in Nigeria show more financial information disclosures than financial statements based on SAS. Overall, the results show that respondents agree that IFRS adoption has promoted transparency of financial reports in Nigeria.

Table 4.2. ANOVA Result

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	57.479	4	14.370	34.692	.000
Within Groups	200.476	484	.414		
Total	257.955	488			

Source: Field Survey

From Table .2. the p value of 0.000 which is lower than our alpha value set at 0.05. Thus we reject the null hypothesis which states 'the adoption of IFRS in Nigeria has not promoted transparency of financial reports in Nigeria. This is in accordance with the public view as shown in the response of most of the respondents.

2. **H_0: The adoption of IFRS has not significantly improved the level of comparability of financial reports in Nigeria.**

Data from respondents are shown in Table 3.

Table4.3. Investors can now compare financial statements prepared in Nigeria against IFRS based financial statements prepared in a foreign country

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	254	51.9	51.9	51.9
	Agree	221	45.2	45.2	97.1
	Disagree	7	1.4	1.4	98.6
	Strongly Disagree	1	.2	.2	98.8
	Undecided	6	1.2	1.2	100.0
	Total	489	100.0	100.0	

From Table .3., 51.9% of the correspondents strongly agreed that investors can now compare financial statements prepared in Nigeria against IFRS based financial statements prepared in a foreign country. Overall, the results show that respondents agree that IFRS adoption has enhanced comparability of financial reports in Nigeria.

Table .4. ANOVA

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	76.270	4	19.067	67.188	.000
Within Groups	137.354	484	.284		
Total	213.624	488			

From table 4., the p value of 0.000 is lower than our alpha value set at 0.05. Thus we are to reject the null hypothesis which states that 'the adoption of IFRS in Nigeria has not enhanced the comparability of financial reports in Nigeria. This is in accordance with the public view as shown in the response of most of the respondents.

5.1. Conclusion

From this study, we conclude that:

i. there is a strong relationship between IFRS adoption and the quality of financial reports in Nigeria. As the results shows that IFRS adoption has a positive relationship with the transparency and comparability of financial reports in Nigeria.

ii. the quality of investment decisions is based on the quality of the information provided by the financial reports.

Based on the above conclusions and also in line with the process theory of change in response to the environment, the following suggestions are proffered:

i. The international financial reporting standards needs to be continuously reviewed to see how more disclosures would be made in the financial reports to accommodate diverse users' needs;

ii. The Nigerian regulatory agencies should continuously ensure strict compliance monitoring and ensure that all financial reports by business entities are compliant to IFRS;

iii. Professional and educational bodies are to ensure that accountants and students of accounting practice are thoroughly trained and retrained on the preparation of financial reports on IFRS.

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