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INTERNATIONAL FINANCIAL REPORTING STANDARDS ADOPTION AND EARNINGS MANAGEMENT PRACTICE: EVIDENCE FROM LISTED COMPANIES IN NIGERIA

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ABSTRACT
This paper investigates the effect of International Financial Reporting Standards (IFRS) on Earnings Management Practice of listed companies in Nigeria. The study was considered on the perspective of the users (Financial Analysts) of the financial reports. Primary source of data was adopted and a sample of 11 Financial Analysts' firms operates in Benin City, Edo State. Statistical analysis used in the study was Pearson Product Moment Correlation and the result shows that IFRS adoption has negative impact on Earning management practice in Nigeria listed companies. Based on the findings, the study concluded that the adoption of IFRS has not reduced earnings management practice in Nigeria listed companies. Rather, IFRS a principles-based standard has created more opportunities for managers to manipulate earnings, due to high level of flexibility and subjectivity characterized by the standards. The study therefore, recommends a need for strong enforcement of good corporate governance; ethical environment should be observed by the government, Central Bank of Nigeria & other regulatory bodies; and the users should analyse cautiously the information provided in the financial statements. The study also recommends for future research to extend the scope of the study to cover large sample size of data.

Key Words: IFRS, Financial Reports, Earnings Management.

Introduction

The fundamental reason why both the developed and developing countries, like Nigeria adopted International Financial Reporting Standards (IFRSs) is the need for listed companies in the stock exchange to prepare and present their financial statements following the globally accepted and high quality standards. Nigeria sees this as a welcome development considering the numerous benefits perceived in applying the standard. High-quality financial reporting which IFRS have the potential to support, according to Owolabi and Iyoha (2012), should contain financial information that discloses events / activities timely and faithfully in the period in which they related. As such, this quality found in the use of high-quality standard will aid the users, such as; financial Analysts, Shareholders, Management, Government, Creditors and others to efficiently allocate resource on their disposal, by reducing disseminating of information asymmetry and improving pricing of securities (Ahmed, 2003; Spiceland et al, 2001 cited in Okpala, 2012). IFRS aim, according to Herbert (2010) as cited in Herbert, Tsegba, Ohanele and Anyahara (2013) is to produce credible and comparable Information that is in the public interest through general purpose financial statements. The investors required management to provide a financial statement which must be relevant as at when needed, reliable, understandable and comparable with one accounting period to another.

However, numerous studies indicates that today countries in the world are facing crisis of "trust" in the financial markets. This is supported by the study in European Countries by Vladu and Cuzdriorean (2013). They concluded that fear has been created in the mind of Investors, that the information provided by the management will not be fair to make economic decision because of high rate of accounting scandals related to fraud and manipulation of financial statement by the Managers. Similarly, a study in Nigeria by Hassan (2015) indicates that financial information quality remains weak compare to many developed jurisdictions. Thus, this translated in the hampering of the growth of efficient stock markets. In addition, a common complain among investors in Nigeria, according to Shehu (2011) as cited in Hassan (2015) is that financial information on company performance is either unavailable or, if available, lacks credibility. Furthermore, Hassan (2015) noted that this lack of credibility of the financial management practiced among managers of investors' resources. Consequently, accounting standards regulators, according to Jaggi and Sun (2012) worries about the negative implications that earnings management caused to information quality of the financial statements. However, they concluded that users of the financial statement should analyze cautiously the information provided by financial statements which may be manipulated, while the Board of Directors (BODs) and Investors should be aware of the opportunistic behaviour that managers can adopt to meet their personal interest. Consequently, this has attracted various research interests to examine the impact of IFRS adoption on earnings management practices by managers. However, most of the studies conducted on this subject so-far, to the best of knowledge are mainly in the European Continent and provided in conclusive evidence. For instance, Barth, Landsman and Lang (2008), finds evidence of less earnings management after the adoption of IFRS. Contrarily, Callao and Jarne (2010) finds evidence of an increase in earnings management when adopting IFRS. Tort (2013) also concluded that variation in earnings management might be due to some

space created for manipulation under IFRS as compared to Domestic standards. The little effort made in Africa continent, like Nigeria, is the studies conducted by Yahaya, Kutigi and Mohammed (2015) concluded that the restrictions to incurred losses under IFRS significantly reduced the potentiality of the banks to involve in earnings management behaviour. This study considered the Nigerian listed deposit money bank without other listed companies in the stock exchange. As a result, this has created an obvious gap, to examine the subject from different research context and data sets. it is against this backdrop that this study aims to examine the impact of IFRS adoption on earnings management practice in Nigerian listed companies. The main research question upon which an attempt is meant to provide answer in the course of the study is:

To what extent IFRS adoption reduce earnings management practice in Nigerian listed companies? This question raised is therefore to address, from the perspective of users (Investors) represented by selected financial analysts practicing in Benin City, Edo State. The financial analysts are selected, according to Clement and Tse (2003) and Mangena (2004) because they are principal users of financial reports. They have good investment knowledge according to Gebhardt, Reichadt and Wittenbrink (2004) which provide good financial and investment information that meet the expectations of their Clients (Investors). Thus, the result of this study is expected to be useful to all users of financial statements, Accounting Standards regulators and future researchers. The remainder of this paper is organized as follows: Section 2 provides a review of the related literature; Section 3 discusses the methodology and material used; Section 4 presents the data analysis and interpretation. Section 5 wraps up the paper with summary, conclusion and recommendations.

1. **REVIEW OF RELATED LITERATURE**

The obvious reason why Nigeria adopted IFRS is because of the recognition of the need to have high-quality financial reports (Owolabi & Iyoha, 2012). The roadmap for Nigeria to adopt IFRS was traced to 28 July 2010, according to Madawaki (2012) the Nigerian Federal Executive Council approved January 1, 2012 as the effective date for the transition of Nigeria GAAPs (Generally Accepted Accounting Principles) with IFRS. Okpala (2012) stated that the adoption was planned to commerce with public listed companies in 2012 and by the end of 2014, all stakeholders would have complied to the requirement of the standard. Accounting standard setters set rules and regulation to be followed by companies when preparing and reporting the financial statement. In particular, investors require a high-quality financial report to make quality decision on their limited resources. However, standard setters are worried about biased estimates managers of investors' resource are exercising on the financial statement. To support this statement, Raliman and Alli (2006) stated that managers could involve in earnings manipulations to meet their demand. Accordingly, Managers take advantage to meet their expectations because of the gap that exist between ownership and management.

Empirical evidence shows that managers may engage in earnings management; if they have debt covenants based on profitability on the enterprise, in order to avoid the risk of cancellation

(DeAngelo, DeAngelo, Skinner, 1994; Defond & Sloa & Sweeney, 1995). In addition, according to Shuto (2007), states managers manipulate earnings to increase their compensation or bonus plans, increase the result of the company to meet capital market expectations, and to meet analysts predictions. According to Enomoto, Kimura and Yamaguchi (2015) and Leuz, Nanda and Wysocki (2003), the practice of earnings management by managers depends on the legal frame work (i.e code law and common law) and the level of countries' investors protection. In comparing this system, the code law system practiced a rule-based accounting system which is likely to be very descriptive and is generally considered to be a system which relies on a series of detailed rules or accounting requirements that prescribe how financial statements should be prepared. Such a system is considered less flexible, but often more comparable and consistent. Some would argue that rule-based systems can lead to looking for "loopholes". By contrast, the common law system involves a principle-based system which relies on Generally Accepted Accounting Principles (GAAPs) that are Conceptually Cased and are normally under-pinned by a set of key objectives. They are more flexible than a rule-based system and required judgment and interpretation which could lead to inconsistencies between reporting entities and can sometimes lead to the manipulation of financial statements. Thus, IFRSs are based on the conceptual framework for financial reporting, they are often regarded as being a principles-based system. However, previous studies indicated that earnings management by managers has not reduced after the adoption of IFRS. Evidence from the United Kingdom (UK) by Xu (2014), the study uses discretionary accruals to detect earnings management base on modified jones model. The finding reveals that IFRS adoption does not reduce the level of earnings management practices. Similarly, evidence from India by Rudra and Bhattacharjee (2012), the study used regression model and the result indicated that firms adopting compared more likely to smooth earnings compared to non-adoption firms. In addition, Capkun, Collins and Jeanjea (2013) cited in Yahaya, Kutigi and Mohammed (2015) that IFRS which is principles-based standard is flexible and which created space for accounting choice has led to a greater earnings manipulation (Income Smoothing). Similarly, Callao and Jarne (2010) finds evidence of an increase in earnings management when adopting IFRS instead or original national (domestic) standards. They added that the increase could be traced to higher flexibility and subjectivity in application of valuation criteria such as fair value. Tort (2013) also supported this findings and his study concluded that the variation in Income Smoothing by managers might be due to some chance created by IFRS when compared to national standards. Mikova (2011), the findings do not support the debate that IFRS have positive relation on reporting quality. The study demonstrated that other relevant factors, such as, institutional legal framework should be considered in creating more efficient capital markets. However, the research sample was adopted in the European Union and contains a very little portion of companies. Kaaya (2015), evidence in Indian, the result indicates that IFRS is a critical determinant for quality reporting but not a vital factor to guarantee quality reporting. However, the study fails to be specific whether IFRS has the potentiality to reduce earnings management behaviour in listed companies.

Leventis, Dimitropoulos and Anandrajan (n.d), evidence in Europe Commercial banks. The study concluded that the implementation of IFRS in the EU appears to have improved earnings

quality by mitigating the tendency of bank managers to engage in earnings manipulation using loan loss provision of listed commercial banks. However, the study fails to extend the scope to other listed companies in the EU countries.

Capkun, Collins and Jeanjean (2016) evidence in EU countries, the study reveals that there is increase in earning management (smoothing) after countries adopted IFRS. The study collectively suggested that the increased flexibility of IFRS and lack of clear guidance in implementing the standards are more vital factors that explain earnings smoothing changes around IFRS adoption.

Contrarily, several empirical studies indicated that IFRS adoption has minimized the extent of earnings management practices by managers of resources. According to Mechelli and Cimini (n.d), evidence from Rome, indicates a positive relation between the reduction of earnings management and the adoption of IFRS. However, the study failed to reveal the relation between such reduction and the existing divergence between IFRS and domestic standards. Similarly, Cai, Rehman and Courtenay (2012), evidence in New Zealand, the findings indicates that IFRS adoption by countries reduces earnings management behaviour by managers. However, the study failed to reveal the extent IFRS adoption will reduce the earnings management by managers. Moreover, the study adopted very little sample of companies in New Zealand.

Relating this debate to Africa Union, empirical evidence in Nigeria by Yahaya et al (2015) the study investigates how the change in the recognition and measurement of banks' loan loss provision affects earnings management behaviour. The study concluded that the restriction to incur losses under IFRS significantly reduced the ability of banks to engage in earnings manipulation. However, the study failed to consider other listed companies in the Nigeria stock exchange. Moreover, the research sample from the deposit bank is not sufficient to justify that the adoption of IFRS in Nigeria reduces earnings management practices by quoted companies.

2.2 Summary of Related Literature Review.

The literature reviewed indicates that most of the investigation of the impact of IFRS adoption on earnings management was conducted in the European Union (Countries). Their findings were centered on the issue of rule – based system and principles – based system (Barth, Landsman & land, 2008). Jeanjean and stolowy (2008) find that more flexible rules involves a higher level of subjectivity in the application of accounting criteria, creating a wider opportunity for managers to exercise judgments on the preparation of the financial statement. Also supported by Beest (2009), is that managers engages in accounting decisions lesser in the rule – based system than a principles – based system. Managers is given the opportunity to manipulate earnings through the use of Accrual – based and other valuation bases, such as first – in – first – out (FIFO) or weighted Average bases. IFRS requires the use of either of the bases to value inventories, except last – In – First out (LIFO). As a result, Managers have the opportunity to make choice on the bases that will meet their expectation, either to increase earnings or reduce earnings. In the case of Nigeria, Yahaya et al (2015) failed to recognise that IFRS, principles – based standard, is characterized with more flexibility, subjectivity and gives opportunity to managers to manipulate

earnings in the financial statements. Moreover, the study adopted secondary data, narrowed to bank as one of the users (but not the principal user) and without considering other companies listed in the stock exchange. Therefore, this has created a gap, to examine the subject in the perspective of the principal user of the financial statement.

2. METHODOLOGY

This aspect of the research work focuses on the research methodology adopted for the purpose of achieving the objective of the study. The population , sampling size as well as the instrument used.

2.1 Population of the study

The population of this study consist the financial/investment analysis which is the principal user of the financial reports. To qualify to respond to the questionnaire, the respondent must be responsible for the investment analysis, speak on behalf of the others.

2.2 Sampling size

A simple of 60 persons was selected at random, representing 80% of the total entire population. The reason is it is not possible to cover all the staff in the analysis firms, the famous Yamene technique sample selection techniques will be adopted by the study. The calculation of the sample size will be done as follows:

$$n = \frac{N}{1+N*(e)^2} \quad \text{------------------------} \quad (3.1)$$

Where n= the sample size

N= the population size

e= acceptable sampling error

*95% confidence interval is assumed (p=0.5)

3.3 Instrument

The instrument was a 7-term survey questionnaire with a 9-5 Likert scale response option. Strongly Agreed (SA), Agreed (A), Undecided (U), Disgraced (D) and Strongly Disagreed (SD). The validity of the questionnaires was confirmed by the experts. Pilot surveyed as adopted as the reliability test and it yielded correlation coefficient of 0.88

2.3 Estimation Techniques

The techniques of estimation adopted for this study is the simple correlation coefficient. Specifically, the Pearson Product Moment Correlation Coefficient was used for data analysis. The computation is done through the following formulae:

$$r = \frac{N\sum XY - (\sum X)(\sum Y)}{\sqrt{[N(X^2) - (\sum X)^2 [N(Y^2) - (\sum Y)^2]}}$$

Where r represents the correlation coefficient.

3. DATA PRESENTATION, ANALYSIS AND INTERPRETATION.

This section of the research work shows the empirical result. The analysis are also done and findings are obtained from the analysis.

4.1 Test of Statistical Hypothesis

Hypothesis 1

Ho: There is no possible relation between IFRS adoption and reduction of earnings management practices in Nigeria.

H1: There is possible relation between IFRS adoption and the reduction of earnings management in Nigeria.

Table 1: Response by investment analysis to the relationship between IFRS adoption and the reduction of earnings management in Nigeria.

S/N	Names of Companies	Option from Investment Analyst				
		SA	A	U	D	SD
1.	Bestworth Assets ltd	0	1	1	2	1
2.	Valueline Securities Investment ltd	0	1	2	1	1
3.	UIDC Securities ltd	0	1	1	1	2
4.	Mainland Trust ltd	0	2	1	1	1
5.	Partnership Investment ltd	0	1	2	1	1
6.	Kapital Care trust & Securities	0	1	1	1	2
7.	ICMG Securities ltd	0	1	1	2	1
8.	Foresight Securities Investment ltd	0	1	1	2	1
9.	Heartbeat Investment ltd	0	1	1	1	2
10.	Cash craft Asset Management	0	1	1	2	1
11.	Aims Assets Management ltd	0	1	1	1	2
	Total	**0**	**12**	**13**	**15**	**15**

Source: Field Survey, September, 2016.

Table 2: Question 1 of the questionnaire administered: IFRS adoption has positive effect to the reduction of earnings management practice in Nigeria.

Option	Point	Response (Y)	(XY)	(X^2)	(Y^2)
SA	5	0	0	25	0
A	4	12	48	16	144
U	3	13	42	9	196
D	2	15	30	4	225
SD	1	15	15	1	225
	15	**55**	**135**	**55**	**790**

Source: Author's Computation, September, 2016.

Where: $\sum X = 15$, $\sum Y = 55$, $\sum XY = 135$, $\sum X^2 = 55$

$\sum Y^2 = 790$, $N = 5$

$$r = \frac{N\sum XY - (\sum X)(\sum Y)}{\sqrt{[N(\sum X^2) - \sum X^2]\,[N(\sum Y^2) - \sum Y^2]}}$$

$$r = \frac{5 \times 135 - 15 \times 55}{\sqrt{[5(55) - 15^2]\,[5(790) - 55^2]}}$$

$$r = \frac{675 - 825}{\sqrt{(275 - 225)(3950 - 3025)}}$$

$$r = \frac{-150}{\sqrt{50 \times 925}}$$

$$r = \frac{-150}{\sqrt{46250}}$$

$$r = \frac{-150}{215.058}$$

$r = -0.69749$

$r = -0.70$

Decision: The r calculated of -0.70 is less than 0.5 level of significance. The Null hypothesis is accepted. IFRS adoption has negative relation on earnings management practices in Nigeria.

5. SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of Findings

The research work centered on the relationship between IFRS adoption and earnings management practice in Nigeria. The results of hypothesis tested revealed that IFRS adoption has no influence to reduce earnings management practice in Nigeria listed companies.

5.2 Conclusion

This study which examined the IFRS adoption and Earnings management practices in Nigeria listed Companies. Based on the findings, it was concluded that IFRS adoption has no influence to reduce earning management practice in Nigeria listed companies. This is because IFRS is a principles-based standard that is characterized with more flexibility, subjectivity and give loopholes for managers to exercise judgment on the valuation of accounting variables and thereby, will increase earnings manipulation in Nigeria listed companies.

5.3 Recommendations

5.3.1 Recommendations for the Study:

i. Corporate government should be encourage and strengthen. This will help to reduce the rate managers falsify earnings and thereby increasing quality financial statement to enable the users make good decision about their investment.

ii. The government, Central Bank of Nigeria and other regulatory bodies should ensure that ethical environment are observed by way of sanctioning those managers that engaged in earnings management in the detriment of the users of the financial statements.

5.3.2 Recommendation for Future Research

The study research sample only covered the financial Analysts based in Benin City, Edo State. Their view might not be sufficient to conclude that IFRS adoption does not reduce the earnings management practice in Nigeria listed companies. Therefore, the study recommends for further research on the subject to extend the scope to cover large sample size of data.

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