INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) ADOPTION AND EARNINGS MANAGEMENT OF LISTED CONSUMER GOODS COMPANIES IN NIGERIA

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ABSTRACT

The study has empirically evaluated the impact of IFRS adoption on the earnings management of the Nigerian Listed consumer goods companies. The study has utilized the annual reports and accounts of 11 companies in the consumer goods sector listed on the Nigerian Stock Exchange for the period of eight (8) years from 2008 to 2015. Research hypotheses were developed to enable proper examination of the relationship between research variables. From the regression analyses, the study has revealed a significant decrease in the earnings management of Nigerian consumer goods sectors after the IFRS adoption. Therefore, the research recommends that, in a situation where a country not willing to adopt IFRS, they try as much as possible to minimize the number of permissible accounting accounting alternatives as doing so will reduce the possibility of earnings management.

Keywords: International Financial Reporting Standard, Earnings Management

1. INTRODUCTION

Recently there has been a push towards the adoption of IFRS which was issued by the International Accounting Standard Board (IASB). The rapid growth in international trade, cross border financial transaction and investment unavoidably includes the preparation and presentation of accounting reports that are useful across different nation's borders, has brought the adoption of IFRS by both developed and developing countries (Armstrong, Barth, Jagolinzer & Riedl 2010).

Despite the widespread adoption, few studies have directly addressed the impact of IFRS adoption on the financial reporting quality in an emerging market. Current and previous studies concentrated on the effect of such adoption in European countries. Although, there have been a number of studies on the value relevance of accounting information before and after IFRS adoption in developed countries (Gjerdeknivsfla & saettem. 2008; Alali and Foote 2009; Alfaraih 2009; Kargın 2013; Dimitropoulos, Asteriou, Kousenidis, & Leventis, 2013). Meanwhile, several studies were conducted by many scholars in order to examine whether voluntary and/or mandatory adoption of IFRS has increased accounting quality (Barth, 2008; Chua, Cheong, & Gould, 2012; Houqe, van Zijl, Dunstan, & Karim, 2012; Iatridis, 2012; Lin, Riccardi, & Wang, 2012; Palea, 2012; Samarasekera, Chang, & Tarca, 2012; Dimitropoulos, et al., 2013; Ismail, Kamarudin, Zijl and Dunstan., 2013; Ahmed, Neel, & Wang, 2013; Houqe, Easton, & van Zijl, 2014) and find both positive and negative results on the effect of IFRS on financial reporting quality.

Similarly, the Federal Government of Nigeria mandated all public quoted companies to prepare their financial statements in line with IFRSs from January 2011 and to start reporting by December 31, 2012. The period given is in order to both prepare their 2012 financial statements and to retrospectively restate their comparative period (2011) financial statements, (Nigerian Stock Exchange, NSE report 2011).

In addition, it has been agreed by many researchers that quality of the content of financial statements is determined by economic, political and institutional factors of manager and/or auditor incentives (Warfieid *et al.*, 1995; Leuz, Nanda, & Wysocki, 2003; Gordon, Jorgensen, & Linthicum, 2010). Also, Hamid, Hashim, and Salleh, (2012) believe that intention improve the confidence of stakeholders and pressure from affiliated parties are part of the motives behind earning management. It is agreed that earning management is generally motivated by the extent, important role and functions played by the reported earnings in the financial reports, which include management compensation plan, bonus contract, valuation of firm, valuation of initial public offer, debt covenant, negotiation with labour unions to just mention but a few.

Consequently, this study adopt a wider approach in describing earnings management as a deliberate actions by the management within the boundaries of generally accepted accounting principles to achieve a predetermined reported earnings (Healy & Wahlen, 1999; Ismail *et al.*, 2013). Therefore, the higher the deviation of earnings from its actual reported earnings, the lower the quality of such reported earnings. This is consistent with several studies such as (Barth et al., 2008; Chua et al., 2012; Ahmed et al., 2013; Dimitropoulos *et al.,* 2013).

Most of the studies in Nigeria were concentrated on the adoption, benefits, and challenges of implementation of IFRS in the country (Okafor and Ogiedu 2011; Okaro 2011; Oyedele 2011; Ikpefan and Akande 2012; Madawaki, 2012; Demaki, 2013; Isenmila & Adeyemo 2013). However, despite all studies conducted by various scholars yet there are limited empirical research carried out on the impact of IFRS adoption on financial reporting quality particularly in Nigeria. To the best of researcher knowledge no empirical study was conducted to evaluate the impact of IFRS adoption using consumers' goods sector of the nation. As such, this researchis to be conducted in order to fill this existing gap and also to dig out whether the adoption of IFRS has improved the financial reporting quality in Nigeria by considering value relevance and earnings management of those entities.

Therefore, the objective of this study is to determine the impact of IFRS adoption on financial reporting quality through earnings management of firms in Nigerian consumer goods companies

The paper was structured in five (5) sections: section one was the background to the study, section two is the literature review and hypotheses development, section three is the research methodology. Section four is the results and discussions of the findings; section five is the conclusion and recommendation.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Many researchers argued that quality of the content of financial statements is determined by economic, political and institutional factors of manager and/or auditor incentives (Warfieid *et al.,* 1995; Leuz, Nanda, & Wysocki, 2003; Gordon, Jorgensen, & Linthicum, 2010; Hamid, Hashim, and Salleh, 2012) believe that intention improve the confidence of stakeholders and pressure from affiliated parties are part of the motives behind earning management. It is agreed that earning management is generally motivated by the extent, important role and functions played by the reported earnings in the financial reports, which include management compensation plan, bonus contract, valuation of firm, valuation of initial public offer, debt covenant, negotiation with labour unions to just mention but a few.

Earning management as describes above is a deliberate actions by the management within the boundaries of generally accepted accounting principles to achieve a predetermined reported earnings (Ismail *et al.*, 2013). Healy and Wahlen, (1999). The high the deviation of earnings from its actual reported earnings, the lower the quality of such reported earnings. This is consistent with several studies (Ahmed et al., 2013; Barth et al., 2008; Chua et al., 2012; Dimitropoulos *et al.*, 2013) expressed that earnings quality as such reported earnings that are free from earnings management.

Analysts view earnings as of high quality when it reflect actual current operating performance, serve as good index for projecting future cashflow and portrays the actual market value of the reporting entity (Dechow & Schrand, 2004). Goncharov and Zimmermann, (2006) believed that accounting standards provide users with different number of choices, and hence, there application may result in different reported earnings quality. As every accounting choice has its-own costs and these costs raises if changes in accounting choices are exercised frequently, and earning management is expected to be high in a regime that create avenue for making some judgment. Capkun, Collins, and Jeanjean, (2013) argued that IFRS that went into effect in 2005 give room for many accounting choices to a single transaction and provides for many subjective judgments in reporting, hence it will lead to reported earnings with high management discretions.

Ismail *et al.*, (2013) investigate the difference in earning quality of Malaysian companies after the mandatory adoption of IFRS as reporting standard even though named as Malaysia Financial Reporting Standard (MFRS) and found that there are improvements in the earning quality after the adoption of IFRS due to lower earning management. But in contrast to this, Goncharov and Zimmermann, (2006) investigate whether the level of earning management differs among the three accounting standards that listed companies can use in their financial reporting (namely, German GAAP, IFRS and US GAAP), the finding was that earnings management of financial reports produced using US GAAP is significantly lower than that of IFRS and German GAAP and the level of earnings management between IFRS and German GAAP is almost the same. This matched with the findings of several studies as IFRS can only increase accounting quality in a country where their local GAAPs are of less quality than IFRS. In the same vein, Lin *et al.*, (2012) evaluated whether accounting quality change after the switching from US GAAP to IFRS by German firms and revealed that accounting numbers exhibit more earning smoothing after the change, which on the overall applied that US GAAP resulted in higher earning quality than IFRS.

Doukakis, (2010) assessed the earning components and earning persistent of the listed firms in Athens Stock Exchange after the adoption of IFRS and indicated decreases in earning persistent and earning component as a result of the failure of IFRS measurement and reporting guidelines in improving them. It is also evident that mandatory adoption of IFRS had no significant effect on real or accrual-based earnings, but firms earning management incentives has a dominance role in shaping financial reporting quality than accounting standard (Doukakis, 2014), Barth *et al.*, (2008) Zéghal*et al.*, (2011), Soderstrom& Sun, (2007) and Dimitropoulos*et al.*, (2013) conducted their studies within European countries and document that financial reports prepared using IFRS exhibit less earning management.

Recently, Houqe, Easton, & van Zijl, (2014) conducted study in a civil law countries where negative effects were recorded during early adoption period (Germany, France and Sweden) and the result from the analysis suggest that mandatory adoption of IFRS improve information quality in this countries. Several researchers investigate the causes of these mixed results and suggest that the mixed results may be due to difference in methodological approaches to the researches, level of enforcement, incentives, corporate governance, period of study and other economic, political and institutional factors that may affect the financial reporting quality (Zéghal*et al.*, 2011; Bova & Pereira, 2012; Ahmed *et al.*, 2013; Christensen *et al.*, 2013; Doukakis, 2014)

The study null hypothesised that IFRS adoption has no significant effects on earning management of listed consumer goods companies in Nigeria.

H1.IFRS adoption has no significant effects on the earnings management of firms

3. METHODOLOGY

The population of the study consists of all (27) consumer goods companies listed in the Nigerian. However, to have accurate and reliable findings at the end of the study, one-point filtered was used to derive the working population, where company must have been listed without delisting on the NSE between 31st December, 2008 and 31st December, 2015. This is to enable the researcher have full consolidated financial statement for the periods of study (2008 to 2015). Hence the research solely relied on secondary data from the published audited financial statement. This criterion is established with a view to ensuring that the companies have their published financial statements for the period covered by this study. After this filtration sixteen companies were excluded, 13 of these companies were delisted in 2010, while 3 of these were delisted in 2014, these companies where delisted because of the failure to file quarterly and annual financial statement as required under the law of NSE. This is aimed to protect public interest from trading in the securities of the companies with no current information regarding their financial status. Consequently, the number of companies listed in the consumer sector of NSE becomes eleven (11), therefore, a new population is derived. The whole new population was taken as sample size for the study in view of the fact that the population can be maintained and the data for the study are readily available. Hence the best sample is the complete population itself, because every element of the population is represented in it (Asika, 1991).

In addition, the study considered only consumer goods companies listed on Nigerian Stock Exchange for period of four (4) years both before and after the adoption of IRFS as financial reporting standard (i.e. 2008 to 2015), pre-IFRS (2008 to 2011), and post-IFRS (2012 to 2015).

Variables Measurements and model specification

Dependent Variable

In order to measure earnings management for both pre and post IFRS adoption period, this study employed the modified version of Jones model (1991) proposed by dechow*et al* (1995) which has been used by other studies like Teoh , Welch, and Wong (1998) and Xie et al. (2003) to determine the discretionary accruals. Following Dechow et al. (1995, the total accrual component of earnings is given by:

$$TACC_{it} = NI_{it} – CFFO_{it} \ldots\ldots (1)$$

Where:

TACC it = total accruals for firm i in year t, which is the different between cash flows from operation and net income before extra-ordinary item, interest and tax

NI_{it} = net income for firm i in year t,

$CFFO_{it}$ = operating cash flow for firm i in year t.

The parameters for calculation of non-discretionary accruals (NDA) are estimated by using the following equation:

$$\frac{TACC_{it}}{A_{it-1}} = \alpha\left(\frac{1}{A_{it-1}}\right) + \beta_1\left(\frac{\Delta REV_{it}}{A_{it-1}}\right) + \beta_2\left(\frac{PPE_{it}}{A_{it-1}}\right) + \varepsilon_{it} \text{..(2)}$$

Where,

$TACC_{it}$ = total accruals for firm i in year t,

A_{it-1} = total assets for firm i in year t-1,

ΔREV_{it} = change in net revenue for firm i in year t,

PPE_{it} = property, plant and equipment for firm i in year t,

$\alpha\ \beta_1\ \beta_2$ = coefficient parameters,

ε_{it} = error term for firm i in year t.

The NDA are calculated using the estimated parameters obtained from equation (4):

$$\frac{NDA_{it}}{A_{it-1}} = \hat{\alpha}\left(\frac{1}{A_{it-1}}\right) + \hat{\beta}_1\left(\frac{\Delta REV_{it} - \Delta AR_{it}}{A_{it-1}}\right) + \hat{\beta}_2\left(\frac{PPE_{it}}{A_{it-1}}\right) \text{............................(3)}$$

Where:

ΔAR_{it} = change in accounts receivable for firm i in year t,

$\hat{\beta}_1\ \hat{\beta}_1\ \hat{\alpha}$ = coefficient parameters estimates

Change in accounts receivable is not included in estimating the parameters but is included in calculating non-discretionary accruals. Similarly, in order to control heteroscedasticity, all variables are lagged by Total asset (Teoh*et al.*, 1998, Ashbaugh*et al.*, 2003, Kam, 2006, Hutchinson *et al.*, 2008, Gulzar*et al.*, 2011, Gonzalez *et al.*, 2012, Alves, 2012).

Finally, DAC_{it} are calculated as the difference between TA and NDA

$$DCA_{it} = \frac{TACC_{it}}{TA_{it-1}} - NDCA_{it} \quad \ldots\ldots(4)$$

DAC=a0+ β1 SZ+ β2 GR+ β3 LEV + β4 EI + β5 DI +β6 TU + β7 CFO +β8 AU + εit.... (5)

DAC=a0+ β1 SZ+ β2 GR+ β3 LEV + β4 EI + β5 DI +β6 TU + β7 CFO +β8 AU + β9 IFRS + εit.. (6)

Where:

TA= Total accruals

NDA=Non-discretionary accruals

DAC= Discretionary accrual.

SZ= Natural logarithm of the market value of equity.

GR= Percentage change in sales.

LEV= Total debt divided by total book value of equity.

EI= Percentage change in ordinary shares

DI= Percentage change in total assets.

TU= Sales divided change in total assets

CFO= Cash flow from operation divided by total assets

AU= Dummy variable equal to 1 if the company is audited by one of big 4 auditing firm.

IFRS= Dummy variable equal to 1 for IFRS adoption.

Independent Variable

IFRS adoption was used as the independent variable to examine whether its adoption has any effects on the Nigerian Financial reporting quality, therefore IFRS adoption was measured with a dummy variable "1" and "0" for pre IFRS adoption as used by previous studies like (Wan ismail, Kamarudin, Zijl & Dunstan, 2013; Umobong & Akani, 2015).

Control Variables

This study employed some control variables (firm size, growth, leverage, ordinary shares, total liabilities, turnover, cash flow from operation, audit firm) this is done to minimize the measurement errors and increase the validity of the interpretation.

Firm size: Firm size (FS), it is measured by taking the natural Log of total asset. Such control was necessary because the bigger the company, the larger the expected level of earnings management (Anderson *et al.*, 2003; Dabor & Adeyemi 2009; Hassan *et al* 2011 & Kurawa & Saheed, 2014).

Growth: This study measured growth as the percentage change in sales, as used by the previous studies of (Anderson *et al.* 2003; & Umobong & Akani, 2015).

Leverage: Leverage in this study is measured as a proportion of long-term debt to capital i.e. debt and equity, which is adopted from the studies of (Anderson *et al.* 2003; Kurawa & Saheed, 2014; & Umobong & Akani, 2015).

$$\text{LEVERAGE} = \frac{\text{LONG TERM DEBT}}{\text{DEBT + EQUITY}}$$

Ordinary shares: An ordinary share in this study was measured with the percentage change in ordinary shares, as adopted from the study of Li, Liu & Luo (2014).

Total liabilities: Total liabilities in this study were measured as the percentage change in total liabilities as used in the previous study of Liu *et al.*, (2014).

Turnover: Turnover in this study was measured as the proportion of sales to total assets as used in the previous study of Nnadi, (2011).

Cash Flow from operation: Cash flow from operation was measured with the proportion of cash flow from operation to the total asset as adopted from the study of Xu (2014).

Audit Firm: Audit firm was measured as a dummy variable equal to "1" if the company is audited by one of big 4 auditing firms and" 0" for otherwise as used in the previous studies of (Xu, 2014 & Umobong & Akani, 2015).

4. RESULTS AND DISCUSSION

Table 4.1 and 4.2 below presents the results of regression analysis on the relationship between IFRS adoption and earnings management for the pre and post adoption periods.

Table 4.1 Regression of earnings management pre IFRS Adoption

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
Model	B	Std. Error	Beta	T	Sig.	Tolerance	VIF
1 (Constant)	51.130	17.498		2.922	0.00		
SZ	-1.196	1.328	-0.206	-0.901	0.37	0.309	3.23
GR	0.020	0.101	0.028	0.200	0.84	0.811	1.23

LV	-0.047	0.747	-0.013	-0.062	0.95	0.362	2.76
EI	0.063	0.065	0.147	0.978	0.33	0.722	1.38
DI	-0.007	0.015	-0.065	-0.461	0.64	0.822	1.21
TU	0.424	0.848	0.084	0.501	0.62	0.580	1.72
CFO	-8.310	11.447	-0.106	-0.726	0.47	0.764	1.30
AU	-14.143	7.248	-0.507	-1.951	0.06	0.241	4.15
R^2=0.425							
Ad.r squared= 0361							
F. Stat=3.260							

a. Dependent Variable: DAC

Source: Generated by the researchers from the Annual Reports and Accounts of the sampled companies, using SPSS (Version 22)

Table 4.1 presents results of the pre IFRS adoption period, from the side of control variables result shows that only auditors is significantly related to discretionary accruals with a p-value and t- value of 0.063 and -1.951 respectively at 5 percent level of confidence, while firm size, growth, leverage, ordinary share, total liabilities, turnover and cash flow from operation were found to be insignificantly related to discretionary accrual with p-values of 0.377, 0.843, 0.951, 0.338, 0.649, 0.621 and 0.475 at a t-values of -0.901, 0.200, -0.062, 0.978, -0.461, 0.501 and -0.726 respectively.

Moreover, Variance Inflation Factor (VIF) test was carried out, the results of which provide evidence of the absence of collinearity. This is because the results of the VIF test has a minimum of 1.216 and maximum of 4.158 this clearly shows absence of collinearity. Hence, VIF of 5.00 still proof absence of collinearity, (Doane & Steward 2007, Barde 2009 & Muhammad 2009)

Table 4.2 Summary of Regression of Earnings Management Post IFRS Adoption

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
Model	B	Std. Error	Beta	T	Sig.	Tolerance	VIF
1(Constant)	44.452	26.619		1.670	0.10		
SZ	2.243	1.308	0.263	1.715	0.09	0.848	1.17
GR	-0.045	0.045	-0.148	-.994	0.33	0.897	1.11
LV	-6.164	2.098	-0.545	-2.939	0.00	0.581	1.72
EI	0.008	0.012	0.101	0.658	0.51	0.840	1.19
DI	-0.004	0.047	-0.013	-0.091	0.92	0.929	1.07
TU	16.750	4.817	0.660	3.477	0.00	0.554	1.80
CFO	-118.426	36.162	-0.645	-3.275	0.00	0.515	1.94
AU	18.487	9.886	0.306	1.870	0.07	0.748	1.33
IFRS	-8.487	3.244	-0.380	-2.616	0.01	0.772	1.29

R^2=0.521
Adj.r squared= 0.480
F.Stat=3.260

a. Dependent Variable: DAC

Source: Generated by the researchers from the Annual Reports and Accounts of the sampled companies, using SPSS (Version 22)

Meanwhile table 4.2 present the post IFRS adoption results, from the side of control variables firm size, was found to be significantly related to discretionary accrual at p-values of 0.099,with a t value of 1.715, this implies that earnings management is less in the big companies, while leverage is found to be significantly related to discretionary accruals with a p-value of 0.007 and a t-value of -2.939, this implies less leverage companies have more earnings management, in other words, earnings management is less in the highly leveraged firms. Turnover was found with significant relationship with discretionary accruals with a p-value of 0.002 at a t-value of 3.477, this signifies that, there is less earnings management in the companies with more turnover, therefore as the firms' revenue is increasing the tendencies of manipulating earnings reduced.

Similarly, cash flow from operation was found to have significant relationship with earnings management with a p-value of 0.003 at a t-value of -3.275, this implies less earnings management in the companies with good cash flow from operating activities as a result of increase in the companies' turnover.

Finally, auditors was found to be significantly related to discretionary with a p-value of 0.074, at a t-value of 1.870, this signifies that earnings management is less in the companies audited by big 4 audit firms, hence big firms are able to employ the services of one of the big audit firms.

Also, Variance Inflation Factor (VIF) test was carried out, the results of which provide evidence of the absence of collinearity. This is because the results of the VIF test has a minimum of 1.076 and maximum of 1.942 this clearly shows absence of collinearity. Hence, VIF of 5.00 still proof absence of collinearity, (Doane & Steward 2007, Barde 2009 & Muhammad 2009)

Furthermore, from the other side of independent variable which is the IFRS adoption, measured with a dummy variable, results shows significant relationship between IFRS adoption and earnings management at p-value of 0.015 with a t-value of -2.616. This suggests that the adoption of IFRS as reporting standards is significantly associated with lower level of earnings management. In other words, the extent of reported earnings departure from normal earnings is lower after the adoption of the new standard, suggesting that earnings quality is higher after the adoption of IFRS. This result is consistent with that of Wan Adibah, *et.al.* (2013).

Similarly, the R^2 shows that the coefficient of determination for earnings management during the IFRS adoption period is relatively higher, 52.1 percent for the post adoption period is greater than that of pre adoption period with 42.5 percent. In view of this, the study does not support the null hypothesis which states:

H1: IFRS adoption has no significant effect on the earnings management of firm.

The study proved that earnings management are higher during the Statement of Accounting Standard (SAS) regime and an increased in earnings quality is witnessed during the current IFRS regime which is consistent with the works of Soderstrom & Sun, (2007); Barth *et al.,* (2008); Paananen, (2008); Zéghal *et al.,* (2011), Lin et al., (2012), Dimitropoulos *et al.,* (2013); and Ismail *et al.,* (2013) and contradict the works of Ahmed *et al.,* (2013).

5. CONCLUSION AND RECOMMENDATIONS

The aim of this study is to evaluate the impact of IFRS adoption on the financial reporting quality in Nigeria for the sample of listed companies in consumer goods sector of the Nigerian stock exchange. The analysis of sample study shows that IFRS adoption in Nigeria has reduced earnings management of firms.

In line with the increase in financial reporting quality identified by the study after IFRS adoption, the study recommended that in a situation where countries are not willing to adopt IFRS as their financial reporting standards, they should try as much as possible to minimize the number of permissible accounting alternatives as doing so will reduce the possibility of earnings management.

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