Adoption of International Financial Reporting Standards (IFRS) And Quality Of The Central Bank Of Nigeria (CBN) Financial Reports

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ABSTRACT

The study examines the effect of IFRS adoption on the quality of CBN financial reports. Consequent upon the adoption of IFRS in Nigeria and the staged implementation plan necessitating Publicly Listed Entities (PLCs) and significant Public Interest Entities (PIEs) to implement IFRS by 1st January 2012, CBN was required to adopt this set of standards. The study employed the descriptive and explanatory research design while secondary data was obtained from CBN Annual Reports and Statistical Bulletins from 2005 to 2015 indicating pre and post IFRS adoption era. Data analysis was conducted by means of the descriptive and inferential statistics while the Autoregressive Distributed Lag (ARDL) was used as the regression model. The result showed that at 5% level of significance, IFRS adoption has a significant effect on the quality of CBN financial reports though positively in the short-run but negatively in the long-run. IFRS standards which are much more targeted towards special legal entities as central banks should thus be looked into as it will invariably influence the quality of her financial reports.

Keywords: Adoption, IFRS, Quality, Central Bank, Financial Reports

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1. INTRODUCTION

In recent times, academic researches abound on having a uniform set of accounting standards which guides the preparation and presentation of entities' financial statements globally. Ikpefan and Akande (2012) elucidated that global convergence could be best explained by its objective as given in the International Accounting Standards Committee Foundation (IASCF) constitution. They stated that the ultimate goal of the International Accounting Standards Board (IASB) and other accounting standard setters are to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting that requires quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions; and also promote the use and rigorous application of those standards.

Members of the accounting domain have looked forward to the adoption of IFRS (Adetula, Owolabi & Onyinye, 2014). In July 2010; the Nigerian Federal Executive Council approved January 1, 2012, as the effective date for convergence of accounting standards in Nigeria with IFRS. A staged implementation plan was developed to ensure Publicly Listed Entities (PLCs) and significant Public Interest Entities (PIEs) to implement IFRS by 1st January, 2012 (IAS Plus, 2017). CBN, being a part of the significant Public Interest Entities is required to adopt IFRS. Moreover, she is saddled with the main responsibilities of regulating national monetary policies, ensuring price stability, promoting a sound financial system; providing economic and financial advice to the Federal Government of Nigeria, among other duties. Hence, this study was carried out to examine the effect of IFRS adoption on the quality of CBN financial reports.

2. LITERATURE REVIEW

International Financial Reporting Standards (IFRS), the Central Bank of Nigeria (CBN), and Quality of financial reports measurements

The Central Bank of Nigeria (CBN) is a special legal entity due to her nature and operations. IFRS examined in relation to the conduct of her activities therefore include: IFRS 1 (First-time adoption of IFRS), IFRS 3 (Business Combinations), IFRS 5 (Non-current Assets held for Sale and Discontinued Operations), IFRS 9 (Financial Instruments), IFRS 10 (Consolidated Financial Statements), IFRS 12 (Disclosures of Interests in Other Entities), IFRS 13 (Fair Value Measurement), IFRS 15 (Revenue from Contracts with Customers) and IFRS 16 (Leases). KPMG (2009) investigated central banks financial reporting practices by sampling ten (10) central banks, evaluating the level of their conformity to accountability and transparency requirements. It was found that majority of the central banks studied published their full audited financial statements on their websites or in annual reports, while the others published set of summarised audited financial statements. It was also observed that there has been increase in the adoption of recognized financial reporting frameworks by central banks.

Later, KPMG (2012) sampled eighteen (18) central banks and found out, among others, that disclosures of financial instrument are generally influenced by the International financial reporting framework being used. It also envisaged that financial instrument disclosures could significantly contribute to risk exposures, which might be an upshot of new policy instruments being put into use.

Moreover, literature shows that IFRS framework provides certain qualitative features of financial information which are in the general purpose financial reporting (Pascan & Neag, 2013; Pascan, 2015). In measuring the quality of the financial reports, Pascan (2015) examined the value relevance approach, credit relevance approach, extent of earnings management practices, timeliness of loss recognition, accounting quality and conservatism. Earnings management practices identified were: absolute discretionary accruals, earnings management to meet or beat a target, accruals quality, managing toward small positive earnings, income soothing and absolute value of abnormal accruals. Adebiyi (2017) discovered that discretionary accruals, a proxy for financial reporting quality have positive association with board size and board independence.

Conceptual Framework
The conceptual framework shows how IFRS adoption connects with the quality of CBN financial reports. The level of IFRS adoption was determined using IFRS checklist as provided by IAS Plus (2016). Modified Jones Discretionary accruals was adopted to proxy for quality of the financial reports. This shows the difference between Total Accruals (TAC) and Non-discretionary Accruals. The study computed Total Accruals as the difference between net income and cash flow from operations (using cash flow statement approach). TAC was regressed on the non-discretionary accruals components; the latter measured in terms of change in revenue (total income) of CBN less change in receivables, plus gross property, plant and equipment, divided by the book value of total assets.

Accounting fundamentals were used to separate accruals into non-discretionary (normal) and discretionary (abnormal) components. The value of the abnormal component determines the quality of the financial report. This implies the larger the value of discretionary accruals, the lower the quality of the financial report and the lower the value of discretionary accruals, the higher the quality of the financial report.

3. METHODOLOGY

The study made use of descriptive and explanatory research design while the study focused on the Central Bank of Nigeria (CBN). It adopted the time series data as secondary data was obtained from CBN annual reports and statistical bulletin for years 2005-2015. The descriptive statistics involved the use of trend analysis. An a-priori expectation between the variables suggested a positive relationship between Quality of financial reports and Level of Adoption of IFRS (Isabel & Manuel, 2015; Pena & Franco, 2017); and also between Quality of financial reports and Board Size (Adebiyi, 2017). In order to examine the stationarity of the series, some pre-estimation diagnostic tests were conducted using the Augmented Dickey-Fuller and Phillips-Perron tests. Since the order of integration of the variables was different, the study adopted bound approach to co-integration test. Lag selection criteria tests were used to select the optimal lag length of one. Autoregressive Distributed Lag (ARDL) was then conducted to show the short and long-run dynamic relationships among the explanatory and response variables.

Model Specification
The long run relationship model used for the study was given as:

$$QFR_t = \alpha_0 + \alpha_1 LA_t + \alpha_2 BZ_t + \varepsilon_t \quad \text{--} \quad (1)$$

The short run model was also given as:

$$\Delta QFR_t = \alpha_0 + \sum_{i=1}^{p} \gamma_i \Delta QFR_{t-i} + \sum_{i=0}^{q_1} \delta_i \Delta LA_{t-i} + \sum_{i=0}^{q_2} \varphi_i \Delta BZ_{t-i} + \rho ECM_{t-1} + \varepsilon_t \ldots\ldots(2)$$

Where Δ was the first-difference operator and ECM_{t-1} was an Error Correction Model, QFR = Quality of Financial Reports Indicator (Discretionary accruals), LA = Level of Adoption, BZ = Board Size.

4. RESULTS AND DISCUSSION

Effect of IFRS Adoption on the Quality of CBN Financial Reports
Table 1 showed the regression results between the variables used in the study.

Hypothesis (H_o):
There is no significant effect of the level of adoption of IFRS on the quality of CBN financial reports.

Model (Long run):
QFR = -44.647 -7.145*LA + 18.362*BZ
The model was derived from Table 1 below.

TABLE 1: Autoregressive Distributed Lag (ARDL) Results (ARDL (1, 1, 0)**)**

Variable	Coefficient	Std. Error	T-Statistic	Prob.
		(A) Short Run Model		
D(LA)	7.841**	3.754	2.089	0.044
D(BZ)	8.846	8.003	1.105	0.276
CointEq(-1)	-0.482***	0.132	-3.637	0.001
		(B) Long Run Model		
LA	-7.145**	3.175	-2.250	0.03
BZ	18.362	15.747	1.166	0.251
C	-44.647	38.238	-1.168	0.25

R-squared	0.517	Mean dependent var	-1.068
Adjusted R-squared	0.466	S.D. dependent var	4.16
S.E. of regression	3.041	Akaike info criterion	5.171
Sum squared resid	351.357	Schwarz criterion	5.376
Log likelihood	-106.177	Hannan-Quinn criter.	5.247
F-statistic	10.151	Durbin-Watson stat	1.673
Prob(F-statistic)	0.000		

Source: Authors' Computation (2017), underlying data from CBN annual reports and statistical bulletin 2005-2015.
QFR = Quality of Financial Reports indicator (Discretionary accruals), LA = Level of adoption of IFRS, BZ = Board Size.
Figures approximated to 3 decimal places.
*** and *** represent significance level of 5% and 1% respectively.*

The study employed Autoregressive Distributed Lag (ARDL) approach following the fact that all the variables were not integrated of the same order. To adequately report on the short and long–run dynamic relationships among the explanatory and response variables, the study estimated the coefficient of the explanatory variables in the short and long-run models. The selected ARDL representation was ARDL (1, 1, 0). This implies that in determining the result, the lag of QFR [QFR(-1)], LA, lag of LA [LA(-1)], BZ together with the constant (C) were considered altogether. From Table 1, the R^2 (coefficient of determination) was 0.517 implying that about 51.7% of the variations in the Quality of Financial Reports (QFR) was jointly explained by the Level of Adoption of IFRS (LA) and the Board Size (BZ). Also, the Durbin Watson (DW) statistics of 1.67 suggested the absence of serial correlation. It indicated that there was no correlation between the error terms of each of the variables. The F-statistics was highly significant at 1% level of significance. These supported the usefulness of the model.

Table 1 also showed that the coefficient of the Error Correction Model (ECM) was negative and highly significant. This confirmed the existence of a stable long-run relationship between the variables. It depicted the speed of adjustment to restore equilibrium in the dynamic model following a disturbance. The coefficient of the ECM was around -0.482, suggesting that a deviation from the long-run equilibrium was corrected by about 48.2% after each quarter.

As regards the coefficients of the Level of Adoption (LA) and Board Size (BZ), the results showed that the current Level of Adoption (LA) has a significant effect on the Quality of CBN Financial Reports (QFR) positively in the short-run but negatively in the long-run at 5% level of significance. This means that in the short run, Level of Adoption of IFRS improves the Quality of the Financial Reports whereas it dampens the Quality of the Financial Reports in the long run. Thus, the null hypothesis (H_0) was rejected which implied that there is a significant effect of the level of adoption of IFRS on the quality of CBN financial reports. On the other hand, the result failed to show any significant effect of the Board Size (BZ) on the Quality of Financial Reports (QFR). This implied that board size was not a major determinant of the quality of CBN financial reports during those years.

This result supported the findings of Pena, *et al.* (2017) who made use of panel regression to assess the impact of IFRS on the quality of financial information; the latter measured in terms of stock returns and proxies of earnings management (to estimate discretionary accruals). It also agreed with the works of Bouchareb, Ajina and Souid (2014), Boumediene, Boumediene and Nafti (2014); and Pascan (2015). It sustained the findings of Isabel, *et al.* (2015) that reviewed 67 published articles on Social Sciences Citation Index (SSCI) on the effect of adopting IFRS; and discovered that IFRS adoption has an effect on information quality, among others.

5. CONCLUSION AND RECOMMENDATION

This study assessed the effect of IFRS adoption on quality of the Central Bank of Nigeria (CBN) financial reports. It shed light on the degree to which CBN complied with IFRS. It was found out that the level of IFRS adoption has a significant effect on the quality of her financial reports, though positively in the short-run but negatively in the long-run. Given the nature and the mode of operation of central banks, it would be necessary to have IFRS standards which take particular cognizance of special legal entities, as this would help enhance the quality of her financial reports. This study, therefore, adds to the existing body of knowledge by providing empirical information on the adoption of IFRS and quality of CBN financial reports.

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