IFRS ADOPTION AND EARNINGS MANAGEMENT: MODERATING ROLE OF INSTITUTIONAL OWNERSHIP IN NIGERIA

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ABSTRACT

Listed companies in Nigeria were mandated since 2012 to shift from the Nigerian generally accepted accounting principles (NGAAP) to the international financial reporting standards (IFRS). However, it is been debated without consensus whether the adoption of the IFRS lead to the reduction of opportunistic earnings management. This study examines the moderating role of institutional ownership on the relationship between IFRS adoption and earnings management. The study assumes that institutional investors could influence firm to make adequate disclosure because of the IFRS adoption that can minimize asymmetric information that could lead to lower earnings management.

Keywords: Earnings Management, Discretionary accruals, IFRS, Institutional Investors.

1. INTRODUCTION

The split of risk bearing and decision making in large firms leads to information asymmetry where one party has access to information than the other. The asymmetric advantage enjoyed by the managers in a large organization as decision makers sometimes motivate them to take decisions that suit their interest not that of the risk bearers who are the owners of the business (Waweru & Riro, 2013). Earnings management is the term used to describe such opportunistic act of the decision makers when it involves manipulation of financial reporting system. The common method used to manage earnings is accruals as it gives the managers a wide range of options to determine the earnings a company reports in any given time (García-Meca & Sánchez-Ballesta, 2009). Earnings management led to collapse of many companies around the word such as Enron (US) and One Tel (Australia), Nortel (Canada), Parmalat (Italy), American International Group (AIG), Lehman Brothers and Merrill Lynch. In Nigeria the collapse of Oceanic and Intercontinental banks are similar examples (Okugbo & Okike, 2011). Equally, the Cadbury case in 2006 when the company intentionally adjusted its earnings upward to the tune of $100, which led to the nose-diving of the share price of the company (Abdullahi, Enyinna & Stella, 2010).

As the separation of risk bearing and decision making became necessary and more efficient in a complex firms, so the control in order to reduce the opportunistic behavior of the decision takers that are not in the best interest of the risk bearers (Fama & Jensen, 1983). Accordingly, regulators insist that firms comply with corporate governance guidelines in order to reestablish the confidence of the shareholders and improve the quality of accounting.
numbers. Regulators further insist that firms adopt the new accounting standard, which is international financial reporting standards (IFRS) in order to increase the level of disclosure in financial reporting and improve the quality of accounting information (Pelucio-Grecco, Geron, Grecco & Lima, 2014; Verriest, Gaeremynck & Thornton, 2012). They argue that IFRS reduces the information asymmetry, which leads to lower earnings management.

Institutional ownership is the equity ownership by corporate organizations such as investment companies, insurance firms or banks (Koh, 2003). Extant studies establish an association between institutional ownership and earnings management (Koh, 2007; Lefort & Urzúa, 2008). They argue that institutional investors ensure effective monitoring on the management, which curb earnings management. Marra, Mazzola and Prencipe (2011) establish the moderating role of IFRS adoption on the relationship between board monitoring and earnings management. Miko (2016) establish the moderating role of institutional ownership on the relationship between some audit committee characteristics and earnings management. However, no study explores the moderating effect of institutional ownership on the association between IFRS adoption and earnings management. This study introduces institutional ownership to moderate the relationship between IFRS adoption and earnings management in Nigeria.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

IFRS was developed in the year 2001 by the International Accounting Standard Board (IASB) to provide a single set of high quality, understandable and uniform accounting standards. This is to help users of financial statement worldwide to understand them more than those prepared under the generally accepted accounting practice (GAAP) (Taiwo & Adejare, 2014). IFRS is seen as a global GAAP that ensure quality, comparable, transparent and easy to interpret financial statements (Okpla, 2012). The quality and transparency of financial reporting minimizes the possibility of earnings management. In the US, after the corporate scandals the congress passed the SOX Act (2002) in order to reform the US financial reporting system (Agoglia, Dourink & Tsakumis, 2011). The SEC and the financial accounting standard board (FASB) consider reforms designed to constrain aggressive financial reporting. These reforms include a shift toward more principles-based accounting standards, which is IFRS. The SEC directed conversion from the US GAAP to IFRS.

In Nigeria, the Federal Executive Council (FEC) on July 28, 2010 officially accepted the recommendation of the committee on the road map on the adoption of IFRS. In December the same year (2010) after the approval of the federal executive council (FEC), the Nigerian accounting standards board (NASB), (now designated as financial reporting council of Nigeria (FRCN) issued an implementation roadmap for Nigerian’s adoption of IFRS which set a January 2012 date for compliance for publicly quoted companies and banks in Nigeria (Taiwo & Adejare, 2014). All listed companies in the Nigerian stock exchange (NSE) adopted IFRS since 2012.

The question is whether the adoption of the IFRS reduces earnings management. Several studies established relationship between IFRS adoption and earnings management with conflicting results (Akinleng, 2014; Barth, Landsman & Lang, 2008; Cormier, 2013; Daske et al., 2008; Ikpefan & Akande, 2012; Kang, 2013; Pelucio-Grecco, et al., 2014; Raffournier, ...
Those that established negative relationship between IFRS adoption and earnings management argue that it decreases information asymmetry, improve accounting quality, enhance relevanc of accounting numbers by enforcements disclosure from the managers which reduces earnings management. Furthermore, it is empirically established that firms with stronger governance mechanisms engage in more transparent IFRS restatements, provide better disclosure quality and comply with IFRS more rigorously than weaker governance (Verriest et al., 2012). On the other hand, other studies established positive relationship between IFRS adoption and earnings management (Burgstahler, Hail & Leuz, 2006; Cang, Chu, & Lin, 2014; Haw et al., 2011; & Jeanjean & Stolowy, 2006). They document that IFRS adoption increase earnings management. Specifically, Haw et al. (2011) using a sample of Chinese listed firms, found that IFRS adoption creates more new opportunities for managers to manage earnings with fair value. Similarly, a study in 22 European countries reveals that IFRS adoption had no significant impact on both real and accruals earnings management practice (Doukakis, 2011). Other studies that disputed the effect of IFRS adoption on reduce earnings management include a meta-analysis by Ahmed, Chalmers & Khelif (2013) and Burgstahler et al. (2006).

Similarly, prior empirical studies establish relationship between institutional ownership and earnings management (Cheng & Reitenga, 2009; Grossman & Stiglitz, 1980; Jarrell & Poulsen, 1987; Koh, 2003; Lakhal, 2015). They exert that institutional investors minimize asymmetric information and effectively monitor the management, which reduce earnings management. Institutional investors strengthen the corporate governance mechanisms such as audit committee in an organization for effective monitoring of the financial reporting process, which leads to lesser agency problem. Susanto and Pradita (2016) in Indonesia established that corporate governance mechanisms curb real earnings management in a company with institutional investors. In contrast, the findings of other studies show that institutional ownership does not curb earnings management (Latif & Abdullah, 2015; Siregar & Utama, 2008). In China, Wen and Hsu (2015) finds that discretionary accruals increase with institutional investors.

Due to the opposing views on the effect of IFRS adoption on earnings and institutional ownership on and earnings management, this study introduces a moderator and hypothesizes that:

H1: Institutional ownership significantly moderates the relationship between IFRS adoption and earnings management in Nigeria.

3. CONCEPTUAL FRAMEWORK

The framework 3.1 below presents the conceptual framework of this study. It shows the moderating effect on the relationship between IFRS adoption and earnings management.
4. METHODOLOGY

This study will employ multiple regressions to measure the moderating role of institutional ownership on the relationship between IFRS adoption and earnings management. The study intends to employ the performance adjusted discretionary accruals Model (2005) to measure discretionary accruals a model introduced by Kothari, Leone and Wasley (2005); IFRS adoption is a dummy variable indicating “1” if the firm adopts IFRS, otherwise “0” adapted from Ramanna and Sletten (2013). Institutional ownership is measured as the number of shares owned by the institutional investors to the total numbers of shares issued in the firm (Hsu & Wen, 2015; Siregar&Utama, 2008).

5. CONCLUSION

This study is unique being the first to introduce institutional ownership as a moderator to moderate the relationship between IFRS adoption and earnings management. Firstly, many studies establish divergent results on the relationship between IFRS adoption and earnings management. Secondly, other studies document conflicting findings on the relationship between institutional ownership and earnings management. Exploring institutional ownership as a moderator is expected to strengthen the relationship between IFRS adoption and earnings management. The findings of this study will add to the literature on corporate governance and earnings management. The result will equally benefit the regulators such as SEC, FRCN and NSE. Other stakeholders such as shareholders and prospective investors will benefit from this study. The study will also serve as an avenue for future researches to consider other form of equity ownership as a moderator on the relationship between IFRS adoption and earnings management.

REFERENCES


