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INTERNATIONAL FINANCIAL REPORTING STANDARDS ADOPTION AND EARNINGS MANAGEMENT: THE FUNDAMENTAL EFFECT FRAMEWORK

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ABSTRACT

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The study mainly examined effect of adoption of International Financial Reporting Standards on earnings management and earnings quality in banks using a new approach - Fundamental Effect Framework. Specifically, effect on profit after tax, net interest income and ratio of loan loss provisioning of the Nigerian banks were examined. Ex-post facto research design was adopted. Secondary data on nine listed deposit money banks were analyzed using Paired Student t-test. The banks were those whose annual financial reports for 2011 and 2012 were available and contained figures under Nigerian GAAP and IFRS-equivalent of the 2011 figures. Findings revealed that IFRS adoption in Nigeria results in insignificant rise in earnings management and low earnings quality as measured by Profit After Tax and Ratio of Loan Loss Provision but leads to insignificant reduced earnings management and improved earnings quality in terms of net interest income. It is concluded that though some individual banks recorded significant reduction in earnings management under IFRS, fundamentally, the adoption in has no significant effect on earnings management and earnings quality of the banks based on the reported performance as at the date of the mandatory adoption in Nigeria. The study recommends inter-alia that IFRS Foundation and the national reporting authorities in all IFRS jurisdictions should monitor implementation and application of IFRS9 to minimize likely manger's discretion under the "forward - looking expected- credit loss" model of the IFRS 9.

Contribution/Originality: This study examined the effect of adoption of International Financial Reporting Standards on earnings management and earnings quality in banks using a new approach - Fundamental Effect Framework.

1. INTRODUCTION

The evolution of the modern firm could be linked to the development of the international financial markets which followed industrial revolution in the 20th century (Chassagnon, 2011). As noted by Kapás (2008) the industrial revolution which began in Britain served as a catalyst for the emergency of the modern firms in the 1920s. The modern firm contrasts with the traditional firm whose entire operations are carried out by an entrepreneur with the sole objective of profit maximization (Jhingan & Stephen, 2009; Nwaubani & Orikara, 2019). The complex structures, divisions and varied objectives of the modern firm necessitated the separation of ownership

of the firms from their day to day management. The separation involves the professional managers and management teams running the businesses on behalf of the owners.

The managers are expected to render periodic reports of their performances before the owners of the firms. Over time, the quest of the owners for managers to show proper accountability has become statutory as governments get involved in providing codes of corporate governance and enabling environments to protect the interests of the varied stakeholders. The company law of various countries mandates the Executive Management of a firm to prepare and lay before the shareholders/owners of the firm, annual accounts and reports showing the performance of the company. The financial statements are what potential investors and creditors look at when they make the decision whether or not to do business with the firm.

However, over the decades and particularly in the recent decades, the world has witnessed some of the worst accounting and financial scandals traceable to misrepresentation of facts and figures in financial reports (Corporate Finance Institute- CFI, 2020). Colossal financial losses were recorded leaving behind ruins in corporate and individual lives. Some of the scandals involved Satyam Computer Services (2009, India), Bernie Madoff (2008, USA), Lehman Brothers (2008, USA). In 2018 alone, the world witnessed notable accounting scandals resulting in collapse of many big names in the corporate world such as Carillion- a UK Construction giant, Patisserie Valerie- also a UK café chain, General Electric-US, Ted Baker-UK among others (Blackburn, 2019).

Preparation of financial statements is guided by accounting principles and concepts prescribed by accounting standards. The accounting concept which forms the fundamental basis of preparation of financial statements of private sector business activities is the accrual concept. This concept requires that revenues and expenses be recorded in the period in which they occur and not when they are received or paid.

The accounting standards also allow some level of flexibility in the application of the principles and concepts. The flexibility in turn has allowed management of firms to bring to bear, their personal professional discretion in deciding how to apply some of the accounting principles.

As posited by Maigoshi, Latif, and Kamardin (2016) in order to influence earnings managers adopt some strategies to manage the accrual concept. Some of the strategies involve: bad debt estimation, inventory valuation approach, depreciation policy, revenue recognition method among others. For instance, the managers bring their professional personal judgment to bear on how much loan loss provision to make and the appropriate period the provision relates to. The manager's personal judgment around these items affects the reported earnings and earnings quality. This discretionary judgment of the managers can therefore be exploited to manage reported earnings of the firm. In a simple context, earnings management can be seen as the exploitation of the flexibility in the application of some accounting principles over some transactions with the intent to produce financial statements which meets predetermined earnings level of the preparers. The predetermined earnings may be misleading as they may not represent the real earnings. According to Hill (2019) earnings management involves making financial reports look better through creative exploitation of the discretion in the application of the accounting techniques. In the opinion of Hasan and Rahman (2017) earnings management negatively affects quality of financial reports. In Nigeria earnings management practices have increased in recent years and are linked to the collapse of commercial banks in Nigeria (Farouk & Isa, 2018). The issue of poor financial reporting in Nigeria was considered to have exacerbated the effect of the 2007-2009 global financial crisis which swept through the nation's banking system in 2009 (Sanusi, 2010).

The International Financial Reporting Standard (IFRS) were developed to narrow the discretionary judgment and promote global unified application of the accounting principles. The adoption of the IFRS has the potential of reducing earnings management and enhancing earnings quality. Adoption of IFRS by a country entails an attempt to change the country's accounting standards with international financial reporting standards (Nwaubani & Okoro, 2018). According to the authors, the need for each country to adopt the IFRS is clearly appreciated among stakeholders. The adoption is expected to improve transparency in financial reporting and enhance financial

reporting quality by reducing earnings management (Hasan & Rahman, 2017; Manju & Mahadevaswamy, 2016). The Nigerian banking sector was one of the sectors that mandatorily adopted the IFRS on January 01, 2012 (Herbert, Tsegba, Ohanele, & Anyahara, 2013; Sanusi., 2012).

To evaluate the real effect of IFRS adoption on earnings management and earnings quality, the fundamental effect approach first established and applied in Nwaubani and Okoro (2018) is followed in this study. The fundamental effect approach/framework focuses on the fundamental difference between application of IFRS and country's Generally Accepted Accounting Principles (GAAP) with respect to certain accounting principles and issues. This approach is elaborated under Statement of the Problem and Methodology.

1.1. Objective of this Study

The main objective of this book is to examine the effect of adoption of International Financial Reporting Standards (IFRS) on earnings management and earnings quality in banks.

Specific objectives are:

1. Determination of effect of IFRS adoption on average profit after tax (APAT) of the Nigerian banks.
2. Examination of the effect of IFRS adoption on average net interest income (ANII) of the Nigerian banks.
3. Evaluation of the effect of IFRS adoption on average ratio of loan loss provisioning (LLP/TLA) of the Nigerian banks.

The hypotheses were formulated and tested at 5% significance level in null form as stated below:

Ho1: IFRS adoption has no significant effect on average profit after tax (APAT) of the Nigerian banks.

Ho2: The effect of IFRS adoption on average ratio of loan loss provisioning (LLP/TLA) of the Nigerian banks is not significant.

Ho3: IFRS adoption does not have significant effect on average net interest income (ANII) of the deposit money banks.

1.2. Statement of the Problem

A number of empirical studies have been carried out on the effect of IFRS adoption on earnings management and earnings quality in banks in and outside Nigeria. The studies adopted various models. For instance, Odoemelam, Okafor, and Ofoegbu (2019) –Nigeria employed fixed effects approach in modified Ohlson model, Malofeeva (2018) - Russia adopted multiple linear regression model covering post adoption period, Hasan and Rahman (2017) - Bangladesh adopted extended modified Jones model with multiple regression known as Chung, Firth, and Kim (2005) model, Uwuigbe, Agba, Jimoh, Olubukunola, and Rehimetu (2017) - Nigeria employed pre and post adoption approach with regression model, Hassan (2015) -Nigeria followed pre and post adoption model with two steps multiple regression framework while Mechelli and Cimini (2013) - European Union and Rudra and Bhattacharjee (2012) –India employed multiple regression with constructed composite index of earnings management and dummy variable

The pre and post adoption era approach commonly adopted for a study of this nature, is ordinarily affected by a lot of concomitant factors during the post adoption period. Factors such as economic conditions, financial, regulatory and enforcement of reforms in the post adoption era normally affect performance outcomes in the period. Adopting the fundamental effect approach, first conceptualized and adopted in Nwaubani and Okoro (2018) focuses on the IFRS-equivalent of the relevant GAAP performance indexes at the date of adoption. Therefore, the fundamental effect framework attempts to establish the effect of the IFRS adoption on earnings management and earnings quality based on the fundamental differences between the two standard regimes devoid of the influence of the concomitant factors during the post adoption period. This framework is adopted for this study and constitutes a major motivation for the study.

Another challenge associated with previous empirical works is the conflicting outcomes over the effect of IFRS adoption on earnings management and quality. While Odoemelam et al. (2019) -Nigeria, Hassan (2015) -Nigeria, Sellami and Slimi (2016) -South Africa and Mechelli and Cimini (2013)-EU documented less earnings management and enhanced earnings quality in the post IFRS adoption era; Mongrut and Winkelried (2019) – Latin America, Malofeeva (2018) - Russia, Uwuigbe et al. (2017)-Nigeria, Uwuigbe, Emeni, Uwuigbe, and Ataiwrehe (2016) - Nigeria and Rudra and Bhattacharjee (2012)-India reported increased earnings management and less earnings quality in the period after the adoption. Even Said (2019)- Canada reported no effect. Part of the motivation for this study is an attempt based on the fundamental effect framework at resolving the conflicts.

2. CONCEPTUAL FRAMEWORK

2.1. Earnings Management

Earnings management involves the use of discretionary judgment by managers in financial reporting and in handling financial transactions in order to present a misleading financial reports to stakeholders (Ceccobelli & Giosi, 2019). In the view of Tuovila (2019) earnings management refers to the exploitation of the application of the company's accounting practices by management to achieve some financial expectations which may not be real. Earnings management can also be viewed as management action intentionally carried out with the aim of achieving desired results which do not represent the real outcomes (Goel, 2016).

According to Mechelli and Cimini (2013); Chen, Tang, Jiang, and Lin (2010) earnings management could be seen as the manipulation of firms' economic performance with the intention to mislead the stakeholder and users. Going further (Mechelli & Cimini, 2013) share the opinion of Callao and Jarne (2010) that earnings management equally manifests when insiders manipulate real transactions so as to influence the earnings level for selfish reasons. The authors posit that this practice is commonly used during strict accounting regulatory controls. In the opinion of Maigoshi et al. (2016) earnings management is seen as a situation where managers employ accounting judgments to handle a transaction in a manner that misrepresent the true economic position of the firm in order to influence the outcomes of contractual agreements that are dependent on reported accounting numbers. Two of the early definitions of earnings management were given by Schipper (1989) and Healy and Wahlen (1999). While Schipper, views earnings management as “a purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain”, Healy and Wahlen considers earnings management as a reasonable and legal management decision making and reporting intended, to achieve stable and predictable financial results.

2.1.1. Categorization of Earnings Management

Earnings management could be categorized into accrual-based earnings management and real earnings management (Maigoshi et al., 2016). In accrual-based earnings management, managers play around accounting estimates based on allowed discretions in application of accounting principles over items such as bad debt estimation, depreciation policy, revenue recognition method, inventory valuation approach among others to influence reported earnings (Goel, 2016; Maigoshi et al., 2016).

Accrual-based earnings management does not affect the cash flow or cash position of the reporting entity as it revolves mainly around non-cash expenses such as depreciation, loan loss provisioning to alter the reported earnings. Accrual-based earnings management can be either discretionary or non-discretionary. Non-discretionary accrual based earning management involves obligatory payments which the firm has recognized in its books at the end of the accounting period, but is yet to make the actual payment. Few typical examples include performance induced bonus and tax liabilities. In discretionary accrual based earnings management on the other hand, managers apply their discretionary judgment in the accounting treatment of the transactions in order to influence the reported earnings (Goel, 2016).

In contrast to accrual-based earnings management, real earnings management involves altering the timing or structure of real activities of a firm with the intention of altering the firm's earnings. In this case the firms deliberately alter their operating activities to meet earnings target usually in the short run (Braam, Nandy, Weitzel, & Lodh, 2015). The structure or timing of real activities such as disposal of fixed assets, production, advertising expenses among others are deliberately changed with the aim of achieving a desired earnings level. For instance management may decide to dispose their assets by their year end to enhance both earnings and liquidity. Also it may structure staff loans such that they would be completely paid off before year end in order to project a firm with low volume of risk assets. Furthermore, in a case of a deposit money bank, management may tactfully suspend lending particularly close to its year end in order not to exceed a desired risk assets threshold.

Real earnings management directly influences cash flow position of the organization. It features more in highly regulated and monitored firms and is often common with politically exposed organizations in order to conceal gains from political connections. This is because real earnings management is not easily detected compared to accrual earnings management. Also organizations may employ real earnings management in order to avoid taxes on profits, by making use of offshore subsidiaries. management. It is opined that firms have been shifting from accrual-based earnings management practices to real earnings management (Ali & Kamardin, 2018).

2.1.2. Earnings Management and Financial Reporting Fraud

According to Mongrut and Winkelried (2019) the discretion available to the managers within the legal framework could be exploited by the managers to manipulate accounts in order to create favorable financial performance. Such manipulation may overstate profits, understate or conceal losses. This view is consistent with the opinion of Jones (2011) who describes accrual earnings management as creative accounting- a term which refers to accounting practices that may comply with requirements of accounting standards but deviate from the substance of the requirements. The deviation is considered to give the preparers/firm some undue advantages over the users of the accounts. Jones identifies excessive complication and the use of creative ways of characterizing income, assets and liabilities and the intent to mislead the users as key features of creative accounting.

Other terms used interchangeable with earnings management are innovative accounting, aggressive accounting, cooking the books (seen as fraudulent) among others. Creative accounting often connotes financial reporting fraud as the lines of distinction between the two terms are blurred. However, Rosner (2003) considers quantitative materiality as the major factor which distinguishes aggressive accruals management from financial reporting fraud. In Rosner's view, material earnings overstatement is considered fraudulent while earnings management involving lower or immaterial earnings manipulations is seen as legitimate earnings management.

2.1.3. Motive for Earnings Management

Earning management is made possible by the permissible flexibility allowed by accounting standards in the application of some accounting rules and principles. The mangers/executives exploit this flexibility to produce financial statements that inflate or level earnings (Tuovila, 2019). The question is what could motivate a firm/manager to engage in earnings management?

The answer may be found in the structure and complexities of the modern firm. In a typical modern firm, the management is separated from the ownership with the managers running the business on behalf of the shareholders/owners. This structure introduces the age-long issue of conflicting interests of stakeholders and information asymmetry between the owners of the firm and the management/managers (Gavana, Gottardo, & Moisello, 2019). The conflict of interests could extend to major shareholders and minority shareholders. To ensure that managers act in the best interest of the owners of the firm, enhancement of their interest is tied to performance of the organization. In this scenario when the organization is doing well, the managers are also seen to be doing well, and vice versa.

The motives for engaging in earnings management/creative accounting depend on the interested parties involved. According to Jones (2011) some of the interested parties include managers, investment analysts, auditors, regulators, shareholders among others. While creative accounting provides the managers with the leeway to deliver the performance they desire, the existing shareholders seem interested in increase in share prices. By contrast, other parties/ groups are harmed due to creative accounting. Specifically, some of the suggested motives for which firms engage in earnings management (Goncharov & Zimmermann, 2007; Malofeeva, 2018; Tuovila, 2019) include:

1. Aspiration of top executives to receive bonus-related pay tied to the firm's earnings performance.
2. The desire to influence the companies' stock prices particularly during initial public offers – IPOs.
3. The urge to ensure that firm's performance seems to meet or beat analysts' forecast.
4. The desire to comply with restrictive loan covenants.
5. An attempt at reducing tax payments.
6. The desire to level/smooth earning in order to present an image of consistent profits over accounting periods with little fluctuations.
7. The intention to cover up fraud.
8. The desire to influence offer prices in management buyouts and mergers and acquisitions.
9. The intention to influence outcome of contract bids tied to accounting numbers.

2.2. Accounting Standards: Meaning and Relevance in the Global Business Community

According to Nwaubani and Okoro (2018) and Akabom-Ita (2013) accounting standards are the principles, opinions, interpretations, rules and regulations which guide organizations in preparing their financial reports. Financial performances of business entities are communicated to the various stakeholders through financial reports. The reality of borderless businesses implies that stakeholders of the 21st century firms often cut across many economies. The relevance of accounting standards in the global business community drives from financial reporting and mainly appreciated in the pointer they provide on how accounting information should be recorded, reported in the financial statements and interpreted so as to make the information reliable, useful and relevant to the global users. However, because of the national peculiarities, national accounting standards differ across nations. It is believed that such differences negatively affect the quality and the relevance of accounting information (Ding, Hope, Jeanjean, & Stolowy, 2007; Nwaubani & Okoro, 2018).

2.2.1. National and International Accounting Standards

There are national and international accounting standards though the former could be seen as losing relevance because of the push for adoption of the latter. National accounting standards are set by the accounting standards board of each nation while international accounting standards are accounting standards issued by the International Accounting Standards Board (IASB) and its predecessor, the International Accounting Standards Committee- IASC (ICAEW, 2018; Nwaubani & Okoro, 2018). The international standards consists international financial reporting standard (IFRSs) and international accounting standards (IASs). IFRS are standards issued by IASB under the supervision of IFRS Foundation after 2001 when IASC was reconstituted into IASB while IAS were standards issued by IASC from 1973 to 2001. Some IASs have been amended for improvement or replaced by relevant IFRSs while others are still in force.

The international accounting standards are designed to apply to the general purpose financial statements of all profit-oriented entities including government business enterprises (Deloitte Global Services Limited - Deloitte/IASPLUS, 2020a). Government Business Enterprises (GBEs) are defined by the International Public Sector Accounting Standards Board (IPSASB) as equally profit-oriented entities. As noted by the authors, general purpose financial statements are meant to meet the informational needs of shareholders and other enlarged stakeholders over the performance of the profit-oriented entities. The following are components of a complete set of

financial reports- statement of financial position, a statement of comprehensive income, a statement of cash flows, a statement of changes in equity, a summary of accounting policies, and explanatory notes. The IFRS are a single set of high-quality global accounting standards for promoting transparency and consistency in financial reporting (IFRS Foundation, 2020). The global business community had long expected the IFRS. Therefore, concerted efforts are being made to promote their global adoption.

The 2019 Global Status Report by The International Federation of Accountants (IFAC) on IFRS adoption documents that the adoption has been on the rise with over 95% of the 173 IFAC member organizations having fully or partly adopted the standards (IFAC, 2019). This view is also supported by the profiling of jurisdictions carried out by Deloitte Touche and Tohmatsu in which IFRS adoption information was sort for in 175 jurisdictions. The outcome equally indicates a rise in the IFRS adoption (Deloitte/IASPLUS, 2020b).

2.2.2. Accounting Standards in Nigeria: SAS and IFRS

International Financial Reporting Standards (IFRS) were officially adopted in Nigeria on January 1, 2012 (Nwaubani & Okoro, 2018). The January 01, 2012 date was for banks and other significant public quoted entities while other entities were expected to follow suite on future dates (Baba, 2013). Specifically, other public interest entities and Small and Medium Enterprises (SMEs) in Nigeria had December 31, 2013 and December 31, 2014 respectively as their effective adoption dates. *However, when a complete version of IFRS 9 – a standard on Financial Instruments (loan loss provisioning issues) was issued by International Accounting Standards Board (IASB) on 24 July 2014, banks were required to adopt it mandatorily from January 01, 2018 (Deloitte Global Services Limited - Deloitte/IASPLUS, 2020a).* The banks in Nigeria also complied with the adoption date.

The Generally Accepted Accounting Principles (GAAP) in the country before the 2012 date were as specified in the Statement of Accounting Standards (SAS) which were issued by Nigerian Accounting Standards Board (NASB). The SAS represented the Nigerian national accounting standards. NASB was established in 1982 as the only recognized independent body in Nigeria responsible for the development and issuance of statement of Accounting Standards covering all sectors of the economy and regulatory agencies of government (Edogbanya & Kamardin, 2014). NASB was initially a private initiative of Institute of Chartered Accountants of Nigeria(ICAN). However, from January 2012, NASB was replaced by Financial Reporting Council of Nigeria (FRC) - a Federal Government Parastatal under the supervision of the Federal Ministry of Industry, Trade and Investment. It was established by the Financial Reporting Council of Nigeria Act, No. 6, 2011. One of the responsibilities of FRC is development and publishing of accounting and financial reporting standards to be followed in the preparation of financial statements of public entities in Nigeria (Financial Reporting Council (FRC) of Nigeria-FRC, 2020).

2.2.3. Credit Impairment Recognition Models of IAS 39 and IFRS 9: The Emergence of IFRS 9

The International Accounting Standards (IAS) 39 - Financial Instruments: Recognition and Measurement, was first issued in 1998 and was subjected to various amendments until April 2009 when it was amended for annual improvements to IFRS (Deloitte Global Services Limited-Deloitte, 2017). IFRS 9 was later in November 2009 issued in part to replace IAS 39 in phases until full replacement of IAS 39 was achieved. The final and complete version of the IFRS 9 was issued in 2014 with a mandatory effective implementation date of January 01, 2018 (subject to local endorsement requirements). The implementation of the final version of the IFRS 9 marked an end to IAS 39 as the final version supersedes all previous versions of the IFRS 9.

The credit impairment recognition model under IAS 39 until its final replacement was an 'incurred loss model' which required that credit losses should not be recognized until a credit loss event occurred (Ernest & Young, 2014). The authors were of the opinion that the incurred loss model of IAS 39 suggestively contributed to the delay in recognizing the credit losses which lead to the global financial crisis of 2007. The incurred loss model was considered as a serious setback for the IAS39. As a result of this obvious lapse, there was global outcry for a review

of this standard. The G20 in playing a leading role tasked world accounting standard setting bodies to develop a single set of high-quality global standards. In answer to this clarion call, the International Accounting Standards Board had to quickened its project to change IAS 39 in phases (PricewaterhouseCoopers -PWC, 2014). The impairment requirements of the final version of the IFRS 9 are based on a forward-looking “expected credit loss”(ECL) model. The “forward-looking “expected credit loss” model involves considerable manager’ discretion over how loan loss provisioning would be affected by information on expected changes in macroeconomic conditions (PricewaterhouseCoopers -PWC, 2014). The model has three stages: assets with 12-months expected credit loss (ECL), assets with lifetime ECL without objective evidence of impairment and assets with lifetime ECL which have objective evidence of impairment at the reporting date. The allowance for considerable management discretion in deciding how the expected credit loss would be affected by macroeconomic conditions could be seen as still a window for earnings management by firms.

2.2.4. Clarification on Applicable International Accounting Standards for Banks on Official Adoption Date in Nigeria

For purposes of clarity, it is necessary for the author at this point to identify which International Accounting Standard was in force for banks on the January 01, 2012 date of official adoption in Nigeria. This clarification is necessary because the term “International Accounting Standards” generally refers to both IASs and IFRSs. Prior to the official adoption date in Nigeria, the deposit money banks in Nigeria were preparing their annual reports according to the requirements of Nigerian GAAP/SAS and matters concerning risk asset impairment were addressed as required by SAS10/CBN Prudential Guidelines (PWC, 2011). As reported by Deloitte Global Services Limited-Deloitte (2017) the IFRS 9 issued in November, 2009 passed through phased amendments until the final version was achieved/issued in July 2014 with implementation date of January 01, 2018. This implies that on the January 01, 2012 date of mandatory adoption of IFRS in Nigeria, IFRS 9 was not in force rather, the applicable international standard/IFRS on that date was IAS39. In view of this fact, and the fundamental effect frame work adopted in this book, analysis herein is focused on SAS10/CBN Prudential Guideline and IAS 39.

As already hinted credit loss provisioning under IAS39 was based on “incurred loss’ model while SAS 10 prescribed “perceived loss” approach. The incurred loss approach leads to delay in recognizing and treatment of credit impairment and thus appears to become a legitimate tool for earnings management. This delay could be likened to postponement of the evil days. Furthermore, it could be seen as a disregard for the age-long accounting principle of conservatism. The outcome of this manager’s action gives rise to false higher reported earnings figure which otherwise would have been less if a conservative or more conservative approach had been followed.

On the other hand, the SAS10/CBN prudential guidelines required more conservative approach as they incorporated and treated informed-anticipated impairments. This approach was most likely to produce lower earnings but of improved quality. The lower earnings stems from early recognition of credit impairment and suspension of interest on subsequent bad and doubtful loans. It may be noted that apart from IAS 39 and IFRS 9, there are other International Standards either as IAS or IFRS applicable to the banks. Some of them include IFRS 1-for first time adoption, IAS 1-for presentation of financial statements, IFRS 3-for business combinations, IFRS 7-for financial instruments disclosures, IAS 7 - for statement of cash flow among others.

2.3. Theoretical Framework

The theoretical framework of this study is anchored on the Agency Theory and Theory of the Firm.

2.3.1. The Agency theory

The agency theory is credited to Stephen Ross and Barry Mitnick who published their works in 1973 (Mitnick, 2006; Nwaubani, 2019). As Mitnick (2006) put it “The first scholars to propose, explicitly, that a theory of agency be created, and to actually begin its creation, were Stephen Ross and Barry Mitnick, independently and roughly

concurrently". Ross is said to have originated the economic theory of agency while Mitnick is the first to propound the institutional aspect of agency theory. However, the basic concepts in the two approaches are considered similar. Some authorities such as Jensen and Meckling (1976) and Fama (1980) have also been credited with doing pioneering work on some aspects of the agency theory particularly in the area of conflict of interests in relation to the modern firm (Daly, 2015).

The Agency Theory focuses on the nature of the principal-agent relationship, the rights and duties of the parties involved, the agency problems and its mitigants using regulations, various corporate governance practices and observations aimed at controlling decisions and actions of the agents in the modern firm (Nwaubani, 2019). The thrust of the agency theory is the problem of conflicting interests among the parties in the relationship/contract (Daly, 2015). With respect to the modern firm, the directors and managers are the agents of the shareholders- their principal. The divergence of interests between the principal (shareholders) and the agents (directors and managers of the firms) is known as the agency problem which makes it necessary for the shareholders to adopt ways of monitoring the managers and motivating them towards maximizing interests of the shareholders. Many approaches open to the firms/owners towards monitoring the interests of directors/managers include among others, adoption and observation of national corporate governance codes, adoption and implementation of national and international accounting standards such as the International Financial Reporting Standards (IFRS) as made mandatory by legislation. These actions attract agency costs to the firm.

The agency problem tends to conflict with objective decisions that are in the best interest of the shareholders and other stakeholders because of likely personal interests of the agents. The agency problems are integral part of the agency theory which in turn intertwined with the firm theory. The Agency Theory is relevant to this study since the banks are typical modern firms with the owners/shareholders being clearly separated from the directors/managers who handle the daily running of the banks. With the management being handled by managers separate from the shareholders, principal-agent relationship is established with attendant agency problems. Mandatory adoption and implementation of International Financial Reporting Standards (IFRS) is obviously one of the ways the shareholders could mitigate divergent activities of the managers in areas of earnings management via loan loss provisioning. IFRS Standards promote transparency by improving the international comparability and quality of financial statements (IFRS Foundation, 2020). Equally, the IFRS adoption could be employed by managers (agents to exploit the allowable discretions to drive their interest through management of earnings in order for them to earn higher performance bonuses to the detriment of the shareholders.

2.3.2. The Firm Theory

The firm theory on the other hand, could be considered to involve a number of economic theories which explain and predict the nature of the firm, its existence, behavior, structure, and relationship with all stakeholders and the market (Nwaubani, 2019). The traditional firm is a single business entity whose entire operations are carried out by an entrepreneur with profit maximization as the main objective (Jhingan & Stephen, 2009). It measures profit as the difference between a firm's total revenue and total cost and maintains that for the objective of profit maximization to be realized, the firm is expected to maximize its revenues and minimize or stabilize its costs. The traditional firm is in contrast to the modern firms which are characterized by varied goals, separation of ownership from management, complex structures and stakeholders and naturally corporate politics (Nwaubani, 2019). Modern firms are run by managers/directors while shareholders are the owners with separate roles and motives from those of the managers.

One of the key originators of the neo-classical firm theory is Ronald Coase who propounded the Transaction Cost Theory of the Firm (Teer, 2003). According to Ronald Coase, people are motivated to organize their production in firms when the transaction cost of coordinating production through the market exchange, given imperfect information, is greater than within the firm. Transaction cost is the cost of providing for some good or

service through the market mechanism rather than having it provided from within the firm. The need for a rethink of the neo-classical/ traditional firm theory was supported by the empirical studies of Adolf Berle and Gardiner Means, who observed that separation of ownership from control was a new feature of large American corporations then (Cheffins, 2018; Cheffins & Bank, 2009).

In the 1960s the profit maximization view of the neo-classical/traditional theory of the firm faced stiff challenge from alternative theories of the firm notably, the managerial and behavioral theories. The managerial theorists consider that managers would seek to maximize their own interests- salary, prestige, status, power, job security, sales growth at the expense of the owners of the firm who are separate from the managers. Such actions of the managers would have implications for firm behavior in contrast to profit-maximizing goal. Some notable managerial theories of the firm include the theories developed by Baumol (1959); Baumol (1962); Marris (1964) and Williamson (1964).

The behavioral theories of the firm just as their managerial counterparts, faulted the neoclassical theory of the firm assumption of profit maximization as the main motive for the existence of the firm. The thrust of the behavioral theories is the explanation of how wide range of decisions are taken within the firm and the outcomes of such decisions in terms of contributions to value added among others (Todeva, 2007). The decisions are influenced by varied and conflicting interests which derive from ownership rights, responsibilities, control over resources and power among others. The rationality of the decisions is limited as the usual complexities and uncertainties under which firms operate constitute a barrier to the cognitive ability of the decision makers. Therefore, the rationality of the decisions can be described as bounded (Augier & Prietula, 2007). Key pioneers of the behavioral theories include (Cyert & March, 1963; Simon, 1955, 1956).

Both managerial and behavioral theories of the firm recognize the separation of ownership from control, complexities, varied interests and motives and conflict of interests and the principal-agency issues associated with the modern firm. The relevancy of the Firm Theory to this study derives from the fact that managers could in pursuit of their interests exploit some discretionary aspects in the International Financial Reporting Standards (IFRS) as it is adopted, to report low quality but high earnings which do not serve the interests of the shareholders in the long run. According to Yahaya, Kutigi, and Mohammed (2015) empirical studies have documented that the extent of discretionary behavior by managers which give rise to earnings management depends on accounting regime (such as IFRS), the economic cycle, among others.

Equally, the mandatory adoption of the IFRS could limit the divergent activities of the managers and compel them to disclose more vital information about performance of the firm for the benefits of the owners. As noted by IFRS Foundation (2020) IFRS Standards strengthen accountability by reducing the information gap between shareholders and the managers/agents and providing information required to hold management to account.

2.4. Review of Empirical literature

Extensive research works have documented a growing gap between firms' market indicators and financial information, particularly reported earnings (Lev, 2018). According to the author, reported earnings of most firms are no longer real. The author is basically, referring to earnings management and by extension, quality of accounting information. This is because level of earnings management is one of the criteria for measuring accounting quality (Yahaya, Yusuf, & Dania, 2015). Also according to Kouki (2018) earnings management is seen by several studies as a measure of the accounting quality. In this empirical review, an attempt is made to bring to the fore the empirical views of previous researchers on the influence of IFRS adoption on earnings management and earnings quality in banks. The empirical review is categorized into two: Review from within Nigeria and Review from other countries across the world. In both categories, the empirical evidence of the trend of the influence of IFRS adoption on earnings management is provided. The trend gives an insight into how earnings management has

affected earnings quality and hence quality of accounting information as a result of IFRS adoption by the banking sector.

2.4.1. Empirical Review from Nigeria

Dang, Zubairu, and Ame (2018) examined the effect of mandatory IFRS adoption on accrual-based earnings management / quality of financial reporting of Deposit Money Banks (DMBs) in Nigeria using difference-indifference (D-in-D) design. Panel data regression approach was used in analyzing the data collected from secondary sources. The finding showed that mandatory IFRS adoption has no significant effect on accrual-based earnings management of DMBs in Nigeria. Elosiuba and Okoye (2018) examined the effect of the IFRS adoption on performance of banks listed on the Nigerian Stock Exchange. Secondary data on eight selected listed banks were collected for the period 2011 and 2012 representing GAAP and IFRS adoption periods respectively. The data covered four performance indices namely profitability liquidity, loan grants and market value. Gray comparability index for the banks was computed for each of the banks on each variable. Then the One Sample Test was employed for the analyses while the t-statistic was used to test the hypotheses. The results showed that mean values for profitability, liquidity and market value are greater in the NGAAP era of 2011 than in the IFRS period of 2012, implying that the IFRS adoption has negative impact on bank profitability and liquidity. With respect to the profitability, the outcome could be seen to imply that the IFRS adoption resulted in reduced earnings management hence lower profitability.

Uwuigbe et al. (2017) examined the ability of current earnings in predicting future earnings of listed Nigerian banks in NSE after the adoption of IFRS. Secondary data on 11 listed banks in Nigeria were collected for the period 2010-2014 with pre-adoption period as 2010 -2011 and post-adoption period as 2013 -2014. The data were analyzed using panel data regression with the aid of Statistical Packages for Social Sciences (SPSS 21). Finding indicated a reduction in the ability of current year earnings to predict future earnings after IFRS adoption. The reduction implies increased earnings management in the post IFRS adoption which tends to align with the view of Lev (2018). Eneje, Obidike, and Chukwujekwu (2016) examined the effect of IFRS adoption on the mechanics of loan loss provisioning for Nigerian Banks. The authors analyzed how the change in the recognition and measurement of loan loss provision affects the accounting quality of the banks. Secondary data obtained from the deposit money banks' annual reports covering the 2005 to 2015 were used. Descriptive statistics and the ordinary least square multiple regression approach were used to analyze the data. It was found that the limitation to recognize only incurred losses under IAS 39 significantly reduces income smoothing thereby improving earnings quality but delays recognition of future expected losses thus reducing asset quality.

Hassan (2015) examined the effect of IFRS adoption on earnings management of deposited money banks in Nigeria via selected firm attributes. Balanced panel data from a sample of 14 listed banks covering a period six years of 2008 to 2013 were used. The six years was categorized into pre and post adoption years. Multiple regression approach with Chung et al. (2005) model for estimating discretionary component of loan loss provisions was adopted in analyzing the data. The outcome showed that earnings quality of listed deposit money banks in Nigeria in the post IFRS adoption period recorded significant improvement when compared to pre adoption era along the selected firm-attributes (leverage, profitability, liquidity, bank size and bank growth). The improved earnings quality in post adoption year translates to reduced earnings management. Yahaya, et al. (2015) examined the effect of IFRS adoption on earnings management behavior of quoted deposit money banks in Nigeria. Specifically the study investigated how the change in the recognition and measurement of banks' loan loss provision, affects earnings management behavior. Secondary data on a sample of 15 listed deposit money banks for the periods 2004 to 2008 (before voluntary adoption) and 2009 to 2013 (post adoption-voluntary and mandatory adoption) were used. The data were analyzed employing multiple regression in which IFRS adoption was captured as 1. Findings

revealed that non-performing loans remained relatively stable over the adoption period with slight rise in earnings. These findings are indication that earnings management is not significantly affected by the IFRS adoption.

Abata (2015) evaluated the impact of IFRS adoption on financial reporting practice in the Nigerian banking sector. The study employed comparative index approach for the analysis and thereafter used t-test for testing for significant difference. The sample consisted of 14 listed banks and secondary data were used. The outcomes confirmed that IFRS adoption has positively and significantly impacted on financial reporting in the Nigerian banking industry. The significant positive effect on financial reporting indicates that the adoption improves earnings quality and reduced earnings management. Yahaya, et al. (2015) examined the effect of the adoption of the International Financial Reporting Standards on the financial statements of Listed Deposit Money Banks in Nigeria. Ex-post facto design was employed -comparing the period 2004 to 2008 and 2009 to 2013. The study made use of logistic regression with dummy variable as the dependent variable while the independent variable were: profitability growth, leverage, liquidity, size, investment and age. The result indicated that IFRS adoption has positively impacted the overall financial performance including earnings quality of banks in Nigeria.

2.4.2. Review from Outside Nigeria

In Latin America, Mongrut and Winkelried (2019) examined the effect of earnings management in the six largest Latin American economies - Argentina, Brazil, Chile, Colombia, Mexico, and Peru. Panel data on 871 listed firms (including banks) for the period 2000 to 2016 and extracted from Thomson Reuters Eikon database were used. The firms operated in 18 of the 20 North American Industry Classification System (NAICS) sectors. An approach proposed by Kothari, Leone, and Wasley (2005) which was a further modified Jones. (1991) model was adopted to analyze the data. The findings showed *inter-alia* that IFRS adoption unintentionally increases earnings management (opacity). Increased earnings management documented by Mongrut and Winkelried (2019) is constituent with the opinion of Lev (2018). In Canada however, no impact was recorded as Said (2019) evaluated the impact of the adoption of IFRS on earnings management in Canadian publicly listed firms (inclusive of the banking sector). Panel data of 791 firms with 19,869 firm-year observations from 2000 to 2018 were utilized. The Modified Jones model was employed in analyzing the data. The findings suggested that IFRS adoption in Canada has no impact on earnings management in publicly listed firms.

Ceccobelli and Giosi (2019) investigated the purposes of earnings management in the banking industry via loan loss provisions. Secondary data from a sample of 156 banks from 19 European countries under the Single Supervisory Mechanism (SSM) for the period 2006-2016 were used. The data were analyzed using regression model. Specifically, the banks were tested for income smoothing, capital management, and signaling purposes. Findings strongly support income smoothing and signaling purpose. However, findings showed no evidence for capital management purpose. Also the result revealed that non-discretionary components of loan loss provisions (basically non-performing loans) did not play major role during the global financial crisis. Kouki (2018) examined the effect of investor protection on earnings management before and after IFRS adoption. A sample of 106 companies listed on Germany, France and Belgium stock markets for the pre-IFRS (2000-2004) and post-IFRS (2006-2011) periods was used. Kothari et al. (2005) approach - one of the modified versions of the Jones. (1991) model was adopted for the analysis. Findings revealed that IFRS adoption and investor protection significantly increased earnings management.

Malofeeva (2018) examined the effect of International Financial Reporting Standards (IFRS) adoption on earnings management in Russia. A sample consisting 361 firm-year observations of Russian public firms from various industries (including banks) for the period 2010 to 2015 was used. Modified Jones Model (Dechow, Sloan, & Sweeney, 1995) focusing on discretionary accruals was employed to analyze the data. Results showed among others that IFRS adoption increases earnings management. Sellami and Slimi (2016) investigated the effect of mandatory adoption of IFRS on earnings management in South African companies. A sample of 276 firm-year observations of

46 firms drawn from the 413 South African listed companies was used. A regression model was employed to analyze the data. Specifically, the study examined the relationship between mandatory adoption of IFRS, discretionary accruals and corporate governance mechanisms after controlling for other some factors that could influence earnings management. Results indicated that mandatory adoption of IFRS in South Africa lowers earnings management and hence improves the quality of accounting information.

Trabelsi and Trabelsi (2014) examined the value relevance of accounting information for the banks listed in the Dubai Financial Market for the period 2008 - 2013. Empirical tests were based on the return and the price models of Easton and Harris (1991) and Feltham and Ohlson (1995). A sample comprising 12 banks listed on Dubai Financial Market from January 2008 to March 2013 with 214 firm-quarterly observations was used. Overall, the results showed that accounting information is associated with market valuation. The earnings are positively and significantly related to stock prices and stock returns implying reduced gap between firms' market indicators and financial information. This translates to reduced earnings management in the post adoption era.

3. RESEARCH METHODOLOGY

The research design adopted for this study is ex-post facto since the examination focuses on what has happened before and after the adoption of IFRS by the Nigerian banking sector. Secondary data on nine listed deposit money banks on the Nigerian Stock Exchange were used. The banks were selected through purposive sampling technique and consist those banks whose annual financial reports for 2011 and 2012 were available and contained figures under Nigerian GAAP/SAS (December 2011) and IFRS-equivalent of the 2011 figures (as at January 01, 2012) in the 2012 financial report. The 2011 and 2012 annual reports provided the required data which were analyzed using descriptive statistics and Paired Student t-test with the aid of SPSS (20).

3.1. The Selected Variables Approximating Earnings Management

The variables are carefully selected firm-level performance indicators which are usually affected or represented in discretionary accruals. A number of empirical studies have used discretionary accruals to represent earnings management (Dechow et al., 1995; Hassan, 2015; Kothari et al., 2005; Kouki, 2018). Also in Saidu, Ocheni, and Muktar (2017) loan loss provision was used as a proxy for earnings management. The variables are: average profit after tax (APAT), average net interest income (ANII) and average ratio of loan loss provision (LLP/TLA). The indicators are grouped under Nigerian GAAP (SAS) and IFRS (IAS). The nine selected banks are: Access Bank Plc, Eco Bank Plc, Fidelity Bank Plc, First bank of Nigeria Plc, First City Monument Bank Plc, Guaranty Trust Bank Plc, Stanbic IBTC Bank Plc, United Bank for Africa Plc, and Zenith Bank Plc.

3.2. Analytical Procedure and Model Specification

The analytical procedure followed in this book involved computation of the means of the various performance indicators under the Nigerian GAAP/SAS and IFRS-equivalent (of the SAS) and testing for significant difference for each variable employing paired student t-test at 5% significance level. Descriptive statistics was also employed and further analysis carried out on the performance of each bank along the three selected performance indicators. The effect of the IFRS adoption is measured by the difference between the mean of each variable under the Nigerian GAAP/SAS and IFRS- equivalent. This view is supported by Yahaya, et al. (2015) who suggest that the extent of discretionary behavior by managers which gives rise to earnings management depends on accounting regime (such as IFRS) among others.

The model adopted in this book is a modified version of a Paired Student t-test model for unequal variances followed by Nwaubani. and Orikara (2019) and it is given as:
is given as

$$T = \frac{\bar{X} - \bar{Y}}{S_d / \sqrt{n}}$$

Where:

T = the t-test statistic.

σ = the Standard deviation for the paired data.

n = the sample size/number of years.

\bar{X} and \bar{Y} are the respective means of the pair of variables in X and Y categories which are NGAAP/SAS data before IFRS adoption and IFRS equivalent data as at the date of adoption.

The justification for the use of 2011/SAS data and their translated IFRS-equivalent is that this approach tends to eliminate the effects of concomitant factors such as socio-macroeconomic variables which also would influence performance of the deposit money banks in the post adoption era. More importantly, the actions or inaction of managers in the post adoption era (from 2012 financial report) such as taking advantage of some of the prescribed accounting treatment of some items by the IFRS standards to manipulate earnings were eliminated. The avoidance of such actions was achieved because translation of the 2011 SAS (NGAAP) accounting figures into their IFRS-equivalents was done by a software. This approach therefore, aims at isolating and showcasing the real effect of the IFRS adoption reasonably attributable to the fundamental differences between SAS/CBN prudential guidelines and IFRS (IAS). This fundamental framework follows the approach first established and used in [Nwaubani and Okoro \(2018\)](#). This present work is the first to adopt the fundamental framework in a study involving earnings management.

3.3. Measurement of the Variables

The measurement of the selected variables are shown in [Table 1](#) below.

Table-1. Measurement of variables of the study.

S/n	Variable	Measurement/Proxied as:	A priori Expectation
1	Average Profit After Tax-APAT	Profit Before Tax less Total Tax Payable for the Year of each bank or as given in the annual report.	+/-
2	Ave Net Interest Income-ANII	Gross Interest Income Less Interest Expenses for the Year for each bank or as given in the annual report.	+/-
3	Ratio of loan loss provision to Total Loans (LLP/TL	Loan Loss Provision divided by Total Loans & Advances of each Bank or as given in the annual report.	+/-

4. DATA PRESENTATION

Table-2. Average profit after tax for the nine selected banks (in N' billions).

Bank	SAS a	IFRS b	Change in PAT(a-b)	%Change
Access	13.70	5.20	8.50	62.04%
Ecobank	-2.30	19.00	-21.30	926.09%
FCMB	-11.60	11.00	-22.60	194.83%
Fidelity	6.00	4.00	2.00	33.33%
FBN	47.50	23.10	24.40	51.37%
GTB	51.70	51.60	0.10	0.19%
StanbicIBTC	6.50	6.60	-0.10	-1.54%
UBA	-16.40	-8.00	- 8.40	51.22%
Zenith	37.14	48.70	-11.56	-31.13%
Average	14.69Bn	17.91Bn	-3.22	- 21.90%

[Table 2](#) above indicates that average profit after tax is higher under IFRS. One of the likely factors responsible for this outcome could be traced to “incurred loss” model in IAS 39 (IFRS) which required that credit loss should not be recognized until a credit loss event had occurred. The model delayed recognition of credit impairment

leading to under provisioning and less charge to profit. Thus, it seems earnings management is increased under IAS/IFRS.

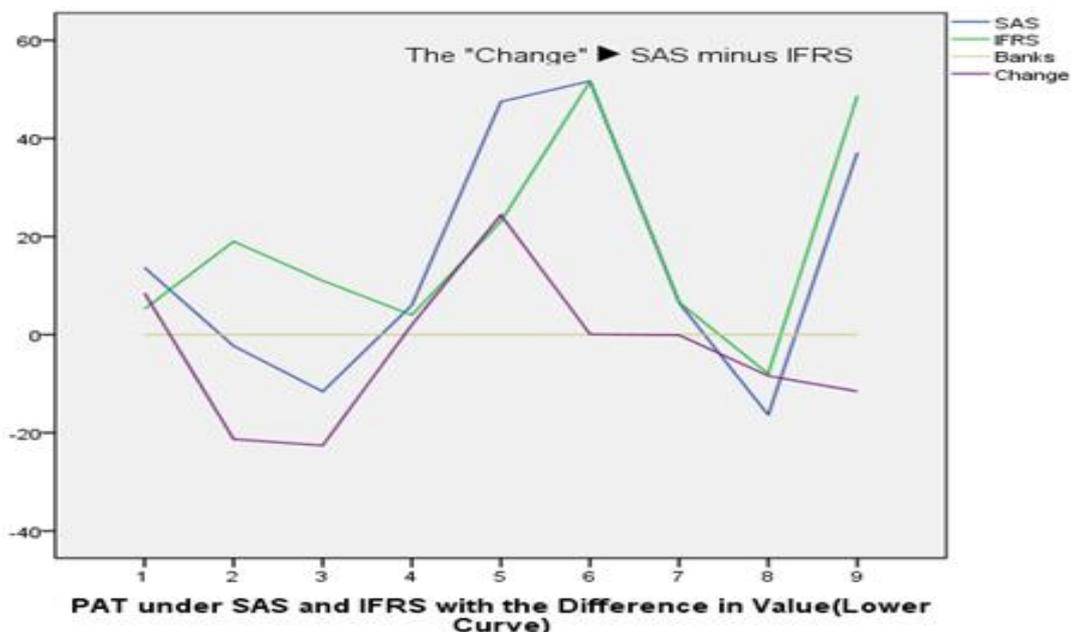


Figure-1. Graph of the average profit after tax of the selected banks under SAS and IFRS with differences in means.

The movements in Table 2 are graphically represented as in Figure 1 above. The Figure 1 is further analyzed under Discussion of Findings.

Table-3. Average net interest income (ANII) of the selected nine banks(In N’ Billions).

Bank	SAS a	IFRS b	Change in NII(a-b)	%Change
Access	48.00	51.00	-3.00	-6.25%
Ecobank	28.20	31.30	- 3.10	-11.00%
FCMB	28.10	31.30	- 3.20	-11.39%
Fidelity	29.20	30.50	-1.30	-4.45%
FBN	178.00	167.00	11.00	6.17%
GTB	99.00	94.00	5.00	5.05%
StanbicIBTC	29.80	27.60	2.20	7.38%
UBA	62.00	56.00	6.00	9.67%
Zenith	118.00	122.00	-4.00	-3.38%
Average	68.92Bn	67.86Bn	1.06	1.53%

Table 3 shows that the average net interest income of the banks is higher under the Nigerian GAAP (NGAAP). One of the explanations for this position may derive from level of discretion allowed the manger under NGAAP in applying his professional judgment in classifying loans for the purpose of interest income suspension among others. With the discretion, the manager could favor low interest income suspension hence higher interest income. Manager’s discretion under IAS 39 (which was the operative IFRS on the date of mandatory IFRS adoption in Nigeria) was much more curtailed. The lower average net interest income shown under IFRS suggests lower earnings management under IFRS regime. The graphical representation of Table 3 is given in Figure 2 below and is discussed further under Findings.

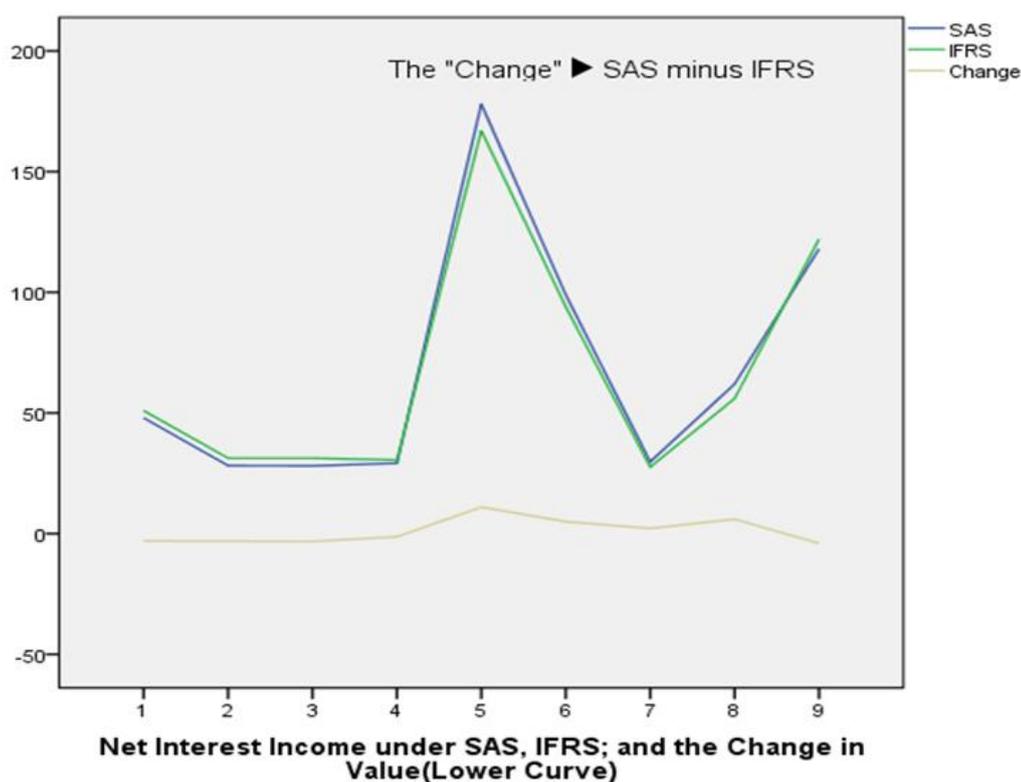


Figure-2. Net interest income under SAS and IFRS with differences in the means.

Table-4. Average ratio of loan loss provisions to total loans and advances (ALLP/TL)- of the banks.

Bank	SAS -a	IFRS-b	Change(a-b)	%Change
Access	2.95	3.90	-0.95	-32.20%
Ecobank	0.02	3.72	- 3.70	-18,500%
FCMB	12.70	6.70	6.00	47.24%
Fidelity	1.70	5.80	-4.10	-241.17%
FBN	2.50	2.80	-0.30	12.00%
GTB	2.80	2.80	0.00	0.00%
StanbicIBTC	1.60	1.30	0.30	-18.75%
UBA	3.00	1.50	1.50	50.00%
Zenith	3.50	1.90	1.60	-45.71%
Average	3.42%	3.38%	0.04	1.16%

Table 4 presents ratio of loan loss provisions to total loans and advances (LL/TL) of the selected banks under SAS and IFRS/IAS39. The ratio of loan loss provisions is one of the instruments for earnings management (Dechow et al., 1995; Hassan, 2015; Kothari et al., 2005; Kouki, 2018). Under the "incurred loss" model in IAS 39/IFRS managers could provide for credit impairment only when a credit-loss event had occurred. This requirement checkmated the ability of a manager to engage in earnings management exploiting loan loss provisioning avenue. On the other hand, the "perceived loss" model prescribed by SAS/NGAAP provided the managers the opportunity to bring their personal judgment to bear on recognition and treatment of credit impairment. This situation suggests presence of earnings management under the SAS and less under IFRS. However, this would be confirm by the hypothesis testing.

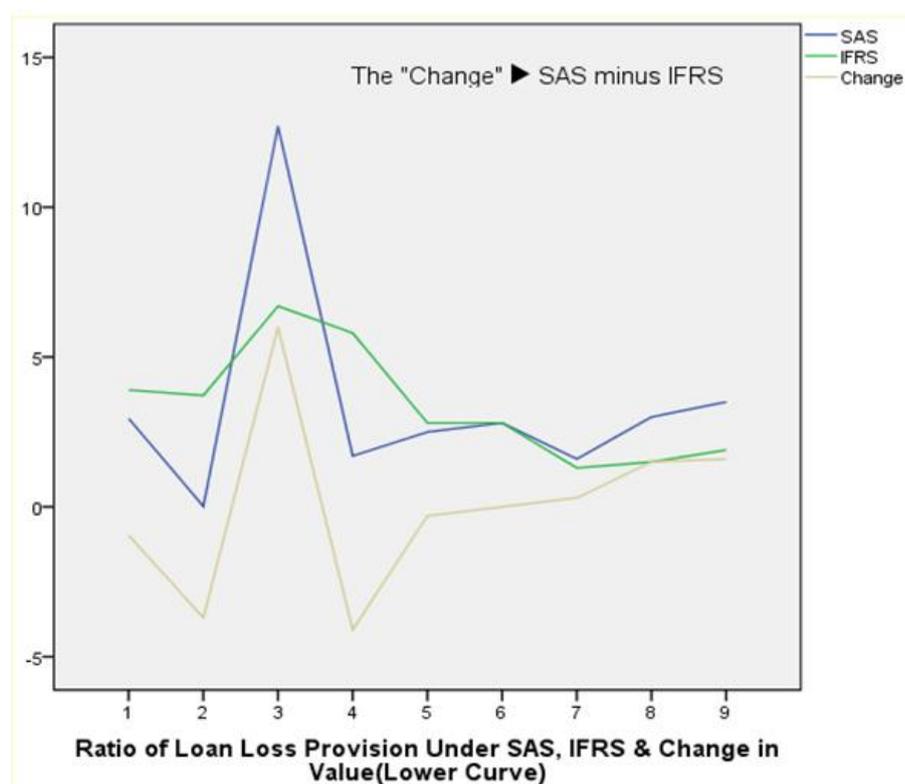


Figure-3. Ratio of loan loss provisions under SAS and IFRS with differences in the means.

4.1. Results of the Paired Student T-test

Table-5. Profit after tax result.

T-Test- Profit after Tax; PAT

Paired Samples Statistics					
		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	SAS	14.6933	9	25.10036	8.36679
	IFRS	17.9111	9	20.35064	6.78355

Paired Samples Correlations

		N	Correlation	Sig.
PAT	SAS & IFRS	9	.808	.008

Paired Samples Test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
PAT	SAS - IFRS	-3.21778	14.77788	4.92596	-14.57706	8.14151	-6.53	8	.532

From the result of the paired t-test on Table 5 above, the IFRS adoption gives higher Profit After Tax with a mean of -3.21778 when compared with NGAAP. This implies presence of higher earnings management. However, the increase is insignificant with p-value of 0.532. Detailed analysis is given under Discussion of Finding below.

Table-6. Net interest income result.

T-Test- Net Interest Income; NII

Paired Samples Statistics					
		Mean	N	Std. Deviation	Std. Error Mean
NII	SAS	68.9222	9	52.59524	17.53175
	IFRS	67.8556	9	49.44442	16.48147

Paired Samples Correlations				
		N	Correlation	Sig.
NII	SAS & IFRS	9	.997	.000

Paired Samples Test									
		Paired Differences					t	Df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
NII	SAS – IFRS	1.06667	5.28134	1.76045	-2.99293	5.12626	.606	8	.561

From the result of the paired t-test on Table 6 above, the IFRS adoption results in lower Net Interest Income with a positive a mean of 1.0666 when compared with NGAAP. This suggests lower earnings management. However, the reduction is not significant with p-value of 0.561. Further analysis is given under Discussion of Findings below.

Table-7. Loan loss provision result.

Paired Samples Statistics									
		Mean	N	Std. Deviation	Std. Error Mean				
LLP	SAS	3.4189	9	3.63290	1.21097				
	IFRS	3.3800	9	1.87045	.62348				
Paired Samples Correlations									
		N	Correlation	Sig.					
LLP	SAS & IFRS	9	.563	.115					
Paired Samples Test									
		Paired Differences					t	Df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
LLP	SAS – IFRS	.03889	3.00788	1.00263	-2.27317	2.35095	.039	8	.970

From the result of the paired t-test on Table 7 above, the IFRS adoption results in slightly lower Loan Loss Provisioning with a positive mean of 0.3889 when compared with NGAAP. This implies higher earnings management. However, the increase is highly insignificant with p-value of 0.970. Detailed analysis is given under Discussion of Results below.

The Table below summaries the analysis and the results of the Paired Student t-test at 5% Significance Level.

Table-8. Summary of the results of the paired student t-test (aggregate means).

Variables	Under SAS Mean	Under IFRS Mean	Change in Mean (IFRS-SAS)	% Change in Mean	Std Deviation	Sig.(2 tail) P-value	Correlation(r)	Sig(2Tail)/Pv-Value-Correlation
Profit After Tax (APAT)	14.69	17.91	-3.22.	-21.9%	14.7778	0.532	0.808	0.008
Net interest income(ANII)	68.92	67.86	1.06	1.53%	5.2813	0.561	0.997	0.000
Ratio of loan loss provision to total loans (LLP/TLA)	3.42%	3.38%	0.04	1.16%	3.007	0.970	0.563	0.115

5. DISCUSSION OF FINDINGS

As the summarized result of the Paired Student t-test on [Table 8](#) above shows, the IFRS adoption gives rise to a lower loan loss provision which contributed to higher profit after tax /earnings with low earnings quality. This implies that IFRS as represented by IAS 39 increases earnings management and lowers earnings quality. The earnings quality is considered low because of the under-provisioning which suggests that the higher reported earnings are not real as some charges to the earnings have been ignored. Also [Figure 3](#) above (correlation graph of LLP/TLA under SAS and IFRS)- reproduced below, indicates the sharp difference between the “perceived loss” model of NGAAP/SAS and the “incurred loss” approach of the IAS39/IFRS with regards to LLP. The SAS though, gave a lot of discretion to the managers on issues of loan loss provisioning, the “perceived loss” approach demanded that the managers would have to be proactive unlike in the “incurred loss” model of IAS 39 in which they had to wait until a credit loss event had occurred. The inherent delay in IAS 39/IFRS in recognizing credit impairment was fingered as the main culprit behind the 2007/2009 global financial meltdown ([Ernest & Young, 2014](#)).

The sharp divide between the two accounting regimes in respect of loan loss provisioning is portrayed by the insignificant positive relationship (p-value of 0.115) between them as displayed in [Figure 5](#) reproduced below. In the [Figure 3](#), the most pointed curve (the first curve) is the SAS curve while the second curve (a bit bell-shaped) is the IFRS curve. Below the IFRS curve is the graph of the differences in means of the LLP/TLA under the two regimes. This is a sharp contrast with regard to the correlation between SAS and IFRS among the other two variables with (p-values of 0.008-APAT and 0.000-ANII). This insignificant correlation between the loan loss provisioning under the SAS and IFRS could also be linked to the fact that as at January 01, 2012 date of mandatory IFRS adoption in Nigeria, the SAS accounting figures for 2011 were translated to their IFRS-equivalents by use of computer software.

The software was expected to have followed the IFRS /IAS incurred loss model strictly being guided by the procedures set out to be followed in first time adoption as in IFRS 1. This fact minimized managers’ discretion/intervention in the translation process and thus in the results obtained as IFRS-equivalent figures. This is the essence of the fundamental effect framework adopted in this Study - to showcase the effect of the adoption on earnings management and earnings quality traceable to the fundamental differences between the two accounting regimes. However, looking at the closeness of the means of the ratio of Loan loss provisioning under the two regimes with just 0.04 difference in means, the under provisioning/earnings management is not considered significant. The Paired Student t-test result on the LLP confirms the insignificant increase in earnings management under IFRS with a related P-value of 0.9700.

With respect to profit after tax variable, [Table 8](#) indicates that APAT rose from about N15billion under NGAAP to N18Billion under IFRS. This implies increased presence of earnings management and by extension lower earnings quality. However, the Paired Student t-test result also on [Table 8](#) shows that the increased earnings

management is not significant with p-value of 0.532. Thus, the IFRS adoption does not have significant effect on earnings management.

The finding in this work confirming that IFRS/IAS 39 adoption has insignificant effect(increase) on earnings management is consistent with the findings in Dang et al. (2018); Yahaya, et al. (2015) all in Nigerian but contradicts the outcomes in Ceccobelli and Giosi (2019) -European countries, Mongrut and Winkelried (2019) - Latin America, Kouki (2018) -Germany, Belgium and France, Malofeeva (2018)-Rusia, Uwuigbe. et al. (2017) - Nigeria where the studies documented significant increase in earnings management following IFRS adoption. Again the rise in earnings management revealed with respect to LLP and PAT in this work (though insignificant), conflicts with the results in Eneje et al. (2016) -Nigeria, Sellami and Slimi (2016) -South Africa, Hassan (2015) - Nigeria, Mechelli and Cimini (2013) -EU, where IFRS adoption resulted in significant reduction in earnings management and by extension improved earnings quality.

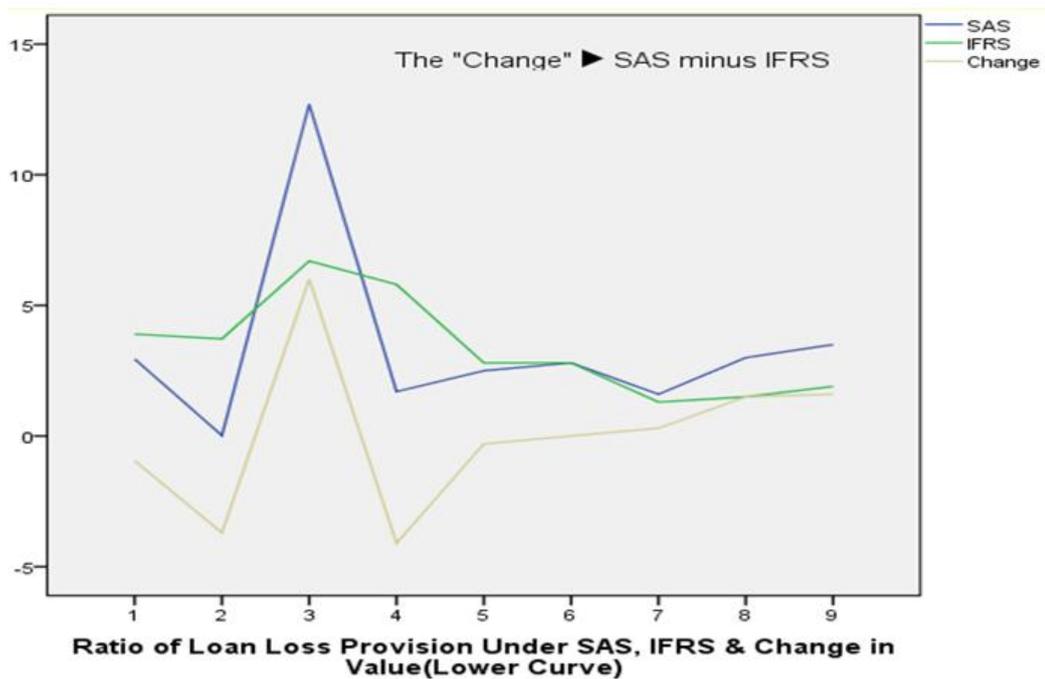


Figure-5. Reproduced.

In order to discuss the effect of the IFRS adoption on Net Interest Income and its implications on earnings management, we have to refer to the Table 8 again. The Table depicts that the IFRS adoption results in lower net interest income. The lower net interest income may be explained by the fact that IAS 39(which was the operative IFRS as at the adoption date in Nigeria) stipulated “incurred Loss” model” while the Nigerian GAAP prescribed “perceived loss” model. The “perceived Loss” model allowed the managers considerable discretion in applying their personal professional judgment in classifying loans for the purpose of interest income suspension among others. With enough discretion at their disposal, the managers could favor low interest income suspension in order to report higher earnings. Manager’s discretion under IAS 39 was much more restricted because of the “incurred loss” requirement. The lower average net interest income shown under IFRS implies lower earnings management and improved earnings and earnings quality. However, the hypothesis testing indicates an insignificant reduced earnings management and insignificantly improved earnings quality with p-value of 0.561 at 5% significance level.

The insignificant reduced earnings management is also implied from Figure 2 (correlation graph of NII under SAS and IFRS) reproduced below. From the Figure 2 below, the correlation between SAS and IFRS figures is positive and almost perfect with r-value of 0.997 and p-value of 0.000. Also the curve of the difference in the means of the NII under the two regimes (the lower curve) is more of flat. These features imply that the factors which

shaped the net interest income were almost the same under the two accounting regimes when viewed from the industry average perspective. This outcome of insignificant reduction in earnings management and insignificantly improved earnings quality under IFRS agrees with the findings in Dang et al. (2018); Yahaya, et al. (2015). It also aligns with the general result of lower earnings management as recorded in Eneje et al. (2016); Sellami and Slimi (2016); Hassan (2015); Mechelli and Cimini (2013). Equally, the lower earnings management seen in NII variable conflicts with the rise in earnings management observed in PAT.

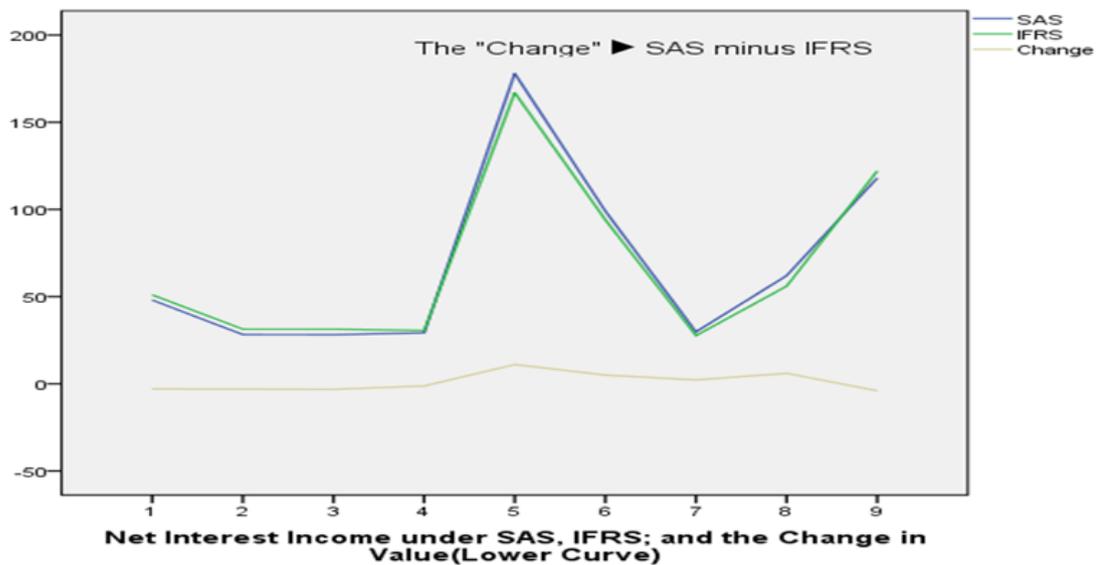


Figure-2. Reproduced.

It may be noted that IAS 39 had been fully replaced by IFRS 9 in 2018 which was the effective implementation date for the latter. IFRS 9 stipulates forward-looking “expected loss” model which is close to the “perceived loss” approach of NGAAP but is much more elaborate and objective. Comparing NGAAP and IFRS /IFRS9 may produce a different result from the findings recorded in this present work.

Though the analytical procedure followed in this work focuses on the average industry performance, a closer look at Table 2– 4 throws more light on the performance of the selected individual banks in terms of earnings management and earnings quality. From Table 2 (reproduced below), it could be seen that Ecobank posted a loss of N2.3billion(Nigerian Naira) under NGAAP/SAS in its 2011 financial year. However, when the loss was translated to IFRS (according to IAS 39), it turned out to be a huge profit of N19.billion - 296% change. Based on the descriptive statistics, this scenario suggests that the IFRS as seen from IAS 39, significantly increases earnings management and reduces earnings quality. Also from the same Table 2, FCMB made a loss of N11.6billion under NGAAP in 2011 but when the loss was translated under IFRS, it became N11.00billion profit- 194% change. This is another indication that IFRS (as IAS39) promotes earnings management based on descriptive statistics. The position of the two individual banks under IFRS lends support to the findings with respect to APAT and to the findings in Ceccobelli and Giosi (2019) -European countries, Mongrut and Winkelried (2019) -Latin America, Kouki (2018) -Germany, Belgium and France, Malofeeva (2018) -Rusia, Uwuigbe. et al. (2017) -Nigeria where the empirical findings revealed significant increase in earnings management following IFRS adoption.

To assess presence of earnings management in terms of net interest income (NII) of the individual banks, we refer to Table 3 (reproduced below). The Table indicates that UBA reported NII of N62.8billion under NGAAP in 2011. However, when the amount was translated to IFRS according to IAS38/IFRS, it became N56billion- about 10% fall. Also, StanbicIBTC and First Bank Nigeria achieved NII of N29.8billion and N178.00billion respectively under NGAAP in 2011. However, when the figures were translated to IFRS according to IAS 38/IFRS, the resulting NII became N27.6billion(7.7% decrease) and N167.00billion(6% fall).

Reproduced Table-2. Average profit after tax for the nine selected banks (in N' billions).

Bank	SAS a	IFRS b	Change in PAT(a-b)	%Change
Access	13.70	5.20	8.50	62.04%
Ecobank	-2.30	19.00	-21.30	926.09%
FCMB	-11.60	11.00	-22.60	194.83%
Fidelity	6.00	4.00	2.00	33.33%
FBN	47.50	23.10	24.40	51.37%
GTB	51.70	51.60	0.10	0.19%
StanbicIBTC	6.50	6.60	-0.10	-1.54%
UBA	-16.40	-8.00	- 8.40	51.22%
Zenith	37.14	48.70	-11.56	-31.13%
Average	14.69Bn	17.91Bn	-3.22	- 21.90%

Based on these (descriptive) statistics, the NII perspective of the three individual banks suggests that IFRS (as IAS 39) reduces earnings management while improving earnings quality. This is consistent the result of the t-test on NII which according to Table 8 shows that based on average industry NII, IFRS adoption results in reduced earnings management and increases earnings quality. However, the reduction is statistically insignificant

Reproduced Table-3. Average net interest income (ANII) of the selected nine banks (In N' Billions).

Bank	SAS a	IFRS b	Change in NII(a-b)	%Change
Access	48.00	51.00	-3.00	-6.25%
Ecobank	28.20	31.30	- 3.10	-11.00%
FCMB	28.10	31.30	- 3.20	-11.39%
Fidelity	29.20	30.50	-1.30	-4.45%
FBN	178.00	167.00	11.00	6.17%
GTB	99.00	94.00	5.00	5.05%
StanbicIBTC	29.80	27.60	2.20	7.33%
UBA	62.00	56.00	6.00	9.67%
Zenith	118.00	122.00	-4.00	-3.38%
Average	68.92	67.86	1.06	1.53%

In terms of ratio of loan loss provisioning(LLP), Table 4 (reproduced below) suggests that managers had more opportunity to manipulate earnings through LLP under NGAAP than under IFRS(IAS 38). For instance Ecobank under NGAAP/SAS provided 0.02% of its total loan and advances as its loan loss provision in 2011. But when this was translated to IFRS(IAS 39), it became 3.72 (18,500% rise). Also, Fidelity provided 1.7% under SAS but this became 5.8 (241% increase) under IFRS. The positions of the two banks show that, in terms of loan loss provisioning, IFRS(IAS 39) significantly reduces earnings management and enhances earnings quality. This result based on the descriptive statistics on the Table 4 (reproduced below) contradicts the t-test's result on Table 8 which confirms that based on average industry performance, IFRS adoption leads to a rise in earnings management. However, this effect is statistically insignificant.

Reproduced Table-4. Average ratio of loan loss provisions to total loans and advances (ALLP/TL)-of the Banks.

Bank	SAS -a	IFRS-b	Change(a-b)	%Change
Access	2.95	3.90	-0.95	-32.20%
Ecobank	0.02	3.72	- 3.70	-28,500%
FCMB	12.70	6.70	6.00	47.24%
Fidelity	1.70	5.80	-4.10	241.17%
FBN	2.50	2.80	-0.30	12.00%
GTB	2.80	2.80	0.00	0.00%
StanbicIBTC	1.60	1.30	0.30	-18.75%
UBA	3.00	1.50	1.50	50.00%
Zenith	3.50	1.90	1.60	-45.71%
Average	3.42	3.38	0.04	1.16%

6. CONCLUSION AND RECOMMENDATIONS

The main objective of this Study is to examine the effect of IFRS adoption on earnings management and earnings quality in banks using fundamental effect framework.

6.1. Conclusion

Based on the findings with respect to the average industry performance as it affects Profit After Tax and Ratio of Loan Loss Provision, IFRS adoption in Nigeria results in increase earnings management and thus low earnings quality. However, when the average net interest income is considered, the IFRS adoption leads to reduced earnings management and thus improved earnings quality in the Nigerian banking sector. In the two cases the effect is not significant fundamentally. It is therefore, concluded that though some individual banks recorded significant reduction in earnings management under IFRS, fundamentally, the IFRS adoption in Nigeria has no significant effect on earnings management and earnings quality in the banking sector based on the reported average industry performance as at the date of the mandatory adoption in Nigeria.

6.2. Recommendations

(i) IFRS Foundation and the national reporting authorities in all the jurisdictions that adopt IFRS such as the Financial Reporting Council of Nigeria (FRCN) should engage in a critical review of the procedures required to be followed in first-time adoption as set out in IFRS 1. This is to identify possible areas of amendment to ensure that the IFRS 1 is consistent with the objectives of other applicable IFRSs for the banks. This recommendation is based on the finding that average industry ratio of loan loss provisioning is lower with higher profitability under IFRS and again a bank like FCMB recorded a much more lower ratio- from 12.7% under NGAAP to 6.7% under IFRS. Specifically, FCMB reported profit after tax of N11billion from a loss of N11.6billion under IFRS while ECObank's profit jumped to N19billion from a loss of N2.3billion.

(ii) The IFRS Foundation and all the relevant reporting authorities as in (i) above should review all the IASs still in force for amendments and possible replacement as IFRS proper. This recommendation is based on the finding that IAS 39 increases earnings management and lower earnings quality. Therefore, its review and replacement with IFRS 9 is justified. Other IASs still in force should be also be reviewed for improvement.

(iii) There is need for IFRS Foundation and the national reporting authorities in all the jurisdictions that adopt IFRS to monitor the implementation and application of IFRS 9 which is a replacement for IAS39. This is because of the "forward-looking expected- credit loss" model of the IFRS 9 which inevitably involves a manager's discretion. Monitoring its implementation and subsequent application is to ensure that the manger's discretion is fairly objective.

(iv) The Financial Reporting Council of Nigeria (FRC) should engage the banks and Central Bank of Nigeria in order to provide specific directives on areas of conflict between IFRS other existing regulations and laws in order to ensure coherence in the regulatory framework and promote effective implementation of the IFRS.

(v) Training and retraining of banks' staff particularly the accounting and internal control staff on the proper application of the IFRS requirements in order to reap the gains of the adoption.

(vi) The individual banks whose performances in specific indicators result in significant earnings management and lower earnings quality under IFRS need to sincerely review their polices and procedures on the IFRS adoption. The review is to ensure that objective considerations are followed where manager's discretion is required in the application of the IFRS specifications.

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