

**INTERNATIONAL FINANCIAL REPORTING STANDARDS ADOPTION AND  
EARNINGS MANAGEMENT IN NIGERIAN NON-FINANCAL QUOTED COMPANIES**

**BY**

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**BEING A DISSERTATION SUBMITTED TO THE SCHOOL OF POSTGRADUATE  
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## **DECLARATION**

I hereby declare that the work titled: INTERNATIONAL FINANCIAL REPORTING STANDARDS ADOPTION AND EARNINGS MANAGEMENT IN NIGERIAN NON-FINANCIAL QUOTED COMPANIES” has been done by me under the supervision of Dr. A. Bello and Dr. Salisu Abubakar of the Department of Accounting, Ahmadu Bello University Zaria. The information gathered from literatures has been duly acknowledged in the text and a list of references provided. No part of this thesis was presented elsewhere for award of any certificate. I take the sole responsibility of all errors therein.

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## CERTIFICATION

This is to certify that the dissertation titled “INTERNATIONAL FINANCIAL REPORTING STANDARD ADOPTION AND EARNINGS MANAGEMENT IN NIGERIAN NON-FINANCIAL QUOTED COMPANIES” by Tesleem, ADEYEMI (M.sc/admin/20958/2012-2013) meets the regulations governing the award of the degree of Masters of Science (M.sc) in Accounting and Finance in Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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## **DEDICATION**

This thesis is dedicated to my wonderful mother Mrs. Hafsat Adeyemi, my lovely wife, Mrs. Rashida Tesleem Adeyemi, and my beautiful daughter, Miss Humaira Tesleem Adeyemi.

## **ACKNOWLEDGMENT**

All praises and thanks due to Allah, the one, all powerful, the uncreated creator of all creations, who offered me the opportunity, wisdom, courage and determination to aspire and to attain this enviable height in life. My gratitude knows no bounds to my parents Mr. Abdulrauf Adeyemi and Mrs. Hafsat Adeyemi for their discipline, good parental care, training, support and prayers without which I wouldn't have been what I am; my lovely wife, Mrs Rashida Tesleem Adeyemi, your support has been the pillar which I lean on. Thank you for being there.

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## **ABSTRACT**

*This study investigated the effects of IFRS adoption on earnings management of non-financial quoted companies in Nigeria. I used a sample of 75 non-financial quoted companies in Nigeria that has consistently published their audited annual financial report between 2010 and 2014. In analyzing the collected data, I adopted descriptive statistics, correlation analysis and a panel multiple regression data analysis to identify the possible effects of IFRS adoption on general earnings management of Nigerian non-financial quoted companies. I find that IFRS adoption in Nigeria does not significantly affects the tendency of Nigerian companies to manipulate earnings. I also find that higher audit quality and large firm size does not created a situation where IFRS adoption affects earnings management. Therefore, it is recommended that roadmap to the convergent with IFRS in Nigeria which required all the significant public interest entities to comply with IFRS starting from 1<sup>st</sup> December, 2012 should be reviewed and allow certain companies without significant customers or operations outside Nigeria to continue the application of NGAAP because they may not have the capability and a market incentive to prepare IFRS financial statements and it has been established that IFRS does not always lead to an improvement in financial reporting quality. The study further recommended that regulatory authorities such as Security Exchange Commission (SEC) and Financial Reporting Council of Nigeria (FRCN), should device means of encouraging quoted companies in Nigeria to employ the service of Big4 audit firm so as to enhance high audit quality. The results indicate that high audit quality work as a constraint on earnings manipulation and consequently, reducing the level of earnings management practices.*

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## **CHAPTER ONE INTRODUCTION**

### **1.1 Background to the study**

Researches in finance and accounting get greater momentum since the universal declaration of IFRS. Approximately more than 120 countries have required or permitted the use of IFRS standards by publicly quoted companies (IASB, 2012). IFRS is a globally-accepted set of accounting Standards and Interpretations established by International Accounting Standards Board (IASB) and International Financial Reporting Interpretation Committee (IFRIC) which was actually created as a common global language for accountants all around the world and it was expected to become the key financial reporting standards for all business entities. The fundamental objective of IFRS is to develop, in the public interest, a single set of high quality, globally accepted financial accounting standards based upon clearly articulated principles (IASB, 2012).

Prior to the adoption of IFRS in Nigeria, all companies in Nigeria have been complying with Standards issued by The Nigerian Accounting Standards Board (“NASB”) which has now metamorphosed to Financial Reporting Council of Nigeria (FRCN). The NASB announced its Roadmap to convergence with IFRS in September 2010. The Roadmap requires publicly Listed Companies and significant public interest entities to comply with IFRS commencing from 1<sup>st</sup> January, 2012. While other public interest entities have been required to comply starting from 1<sup>st</sup> January, 2013 and small and medium sized entities expected to comply for period ending after 1<sup>st</sup> January, 2014. Despite the belief by some of the inevitability of the global acceptance of IFRS, it is has been argued that Nigerian GAAP is still the better standard, and that a certain level of quality will be lost with full adoption of IFRS (Barth, 2007). In addition, certain companies

without significant customers or operations outside their home countries may resist IFRS because they may not have the capability and a market incentive to prepare IFRS financial statements (Tanko, 2012).

The implementation of IFRS in Nigeria was motivated by the need to develop high quality financial reporting in order to enhance sound financial and healthy economy and in the wave of globalization; multi-national companies and investment are on the increase. Therefore, the adoption of IFRS in Nigeria is expected to advance the compilation of meaningful data of reporting entities' performance for comparability and reliability, facilitate and enhance effective decision making, attract foreign investment, enhance easy access to external capital and low cost of doing trans-border businesses (Madawaki, 2014). The decision to adopt IFRS in a wide and important economic area such as Nigeria cannot be over - emphasis, However, to achieve that the government need to consider several factors that may affect the adoption of IFRS in developing countries (Zeghal & Mhedbi, 2006), in which Nigeria is among.

IFRS Standards which are usually regarded as principle-based system was established to ensure a high degree of transparency of financial statements, to get better corporate transparency and to enhance the usefulness of financial reporting (Budrina, 2014; Chen, Tang, Jiang & Lin 2010; IASB 2012). The central focus is to meet the needs of the wide range of users in economic decisions and contribute positively to a healthy financial market. However, the major concern about the conversion to IFRS is that it is more principle-based and there is a fear that the companies may apply the same rules differently thereby causing varying results. Furthermore, principle-based standards give managers more flexibility to engage in earnings management and consequently resulting in high level of earnings manipulation (Callao, 2010).

IFRS comes with a lot of changes in way and manner the information contained in the company's financial statement are reported. For instance, the introduction of fair value principle, which is regarded as the most important implication of IFRS, motivates more debate on the adoption of the standards. More clearly, IFRS required the usage of fair value contrary to the book value as used by Nigerian GAAP. It is believed that fair value provides up-to-date information about assets as it reflects their real value. However, impairment test is carried on goodwill under IFRS, while it expected to be amortized under NGAAP. This implies that managers have more flexibility under IFRS and may intend to use their accounting decisions to manipulate impairment test of goodwill which could affect the quality of reported earnings.

Furthermore, NGAAP allows convertible debt to be recorded as long-term debt, while the IFRS records convertible bonds separately into the equity component and the debt components. IFRS which is a principle-based accounting method give managers significant flexibility and discretion and leave more room for earnings manipulation than rule-based accounting standards NGAAP.

Earnings management has been an issue of continuous concern for several years for regulatory bodies and accounting practitioners. For example, Hadani, Goranova and Khan (2011) argue that earnings management increases information asymmetry and negatively impacts the quality of financial reports. Earnings management is said to be the reasons for low quality of reported information. It is the choice of a manager among accounting policies which allow achieving some specific objectives (Scott, 2003). Managers use flexibilities within the accounting standard to choose accounting methods, policies and estimates in reporting process to reflect firm's future prospect (Shehu, 2013). Thus the very nature of accounting accruals gives managers a great deal of discretion in determining the earnings in any given period. Managers

can apply legal and permitted accounting methods or practices which inevitably impacting negatively on earnings quality.

Presently, many countries have replaced national accounting Standards by IFRS in order to make local accounting system more transparent, reliable, relevant, understandable and more importantly to enhance financial reporting quality. However, the process of IFRS implementation varies significantly from country to country due to political, cultural, economic, legal and institutional factors. Nigeria and many developing countries are characterized by weak institutions and volatile economic and political environment which are not very conducive for effective implementation of IFRS (Tanko, 2012). In spite of several arguments and divergence views, many countries, both developed and developing, have fully adopted IFRS as their national accounting standards.

## **1.2 Statement of the Problem**

The effects of IFRS adoption on earnings management has been a subject of concern in the accounting and financial literatures. Empirical accounting researches have been conducted to examine the effects of IFRS adoption and determine the extent to which IFRS provide additional relevant information and improve the information content of financial statement prepared in line with these standards. Prior studies have so far presented mixed results as some studies found an improvement in financial reporting quality after IFRS adoption and widely support the hypothesis that earnings management declined considerably after IFRS adoption (Cai, Courtesney & Rahman, 2008; Aussenegg, Inwinkl & Schneider, 2008).

However, this view has not been fully supported by all academicians, regulators and the business communities as their evidence fail to support the hypothesis that IFRS reduce the level

of earnings manipulation. For instance, Barth, Landsman and Lang (2008) describe IFRS standards as been of lower quality than the local GAAP. Similarly, Xu (2014) posits that IFRS adoption does not reduce the level of earnings management but rather, earnings manipulation intensified after the adoption of new accounting standards among the UK private firms. IFRS been a principle-based reporting standard are not sufficient condition to reduce the level of earnings manipulation (Stolowy, 2008). IFRS only represent pure accounting changes and are not sufficient to provide the expected benefits (Mara, 2011). It is obviously a fundamental fact that IFRS comes with a lot of changes in way and manner the information contained in the company's financial statement are reported and the prior literature have provided mixed evidence on the impact of IFRS adoption. However, the fundamental question that is yet to be resolved in the literatures is: whether the IFRS adoption has significant impact earnings management of non-financial quoted companies in Nigeria.

In spite the fact that empirical researches concerning the effects of IFRS on earnings management had gained momentum and international relevance, however, to the best of our knowledge no study has examine the effects of IFRS adoption on earnings management in Nigeria. Furthermore, the impact of big-4 audit firm and large firm size on earnings management under IFRS has not been empirically tested. Therefore, the study attempts to examine the impact of IFRS adoption on earnings management in Nigerian non-financial quoted companies.

### **1.3 Objectives of the Study**

The broad objective of this study is to examine the impact of IFRS adoption on earnings management of Nigerian non-financial quoted companies. The specific objectives are to:

- i. investigate the effect of IFRS adoption on earnings management of Nigerian non-financial quoted companies.
- ii. test whether the effect of IFRS adoption on earnings management is influenced by audit quality of Nigerian non-financial quoted companies.
- iii. test whether the effect of IFRS adoption on earnings management is influenced by firm size of Nigerian non-financial quoted companies.

### **1.4 Hypotheses of the Study**

On the bases of the above objectives, the study formulates the following null hypotheses:

- H<sub>01</sub>: IFRS adoption has no significant effects on earnings management of Nigerian non-financial quoted companies.
- H<sub>02</sub>: IFRS adoption effects on earnings management is not significantly influenced by audit quality of Nigerian non-financial quoted companies.
- H<sub>03</sub>: IFRS adoption effects on earnings management is not significantly influenced by firm size of Nigerian non-financial quoted companies.

## **1.5 Scope of the Study**

The study aims at examining the impact of IFRS adoption on earnings managements of Nigerian non-financial quoted companies. As all the listed firms in Nigeria are mandated to comply with IFRS starting from 1<sup>st</sup> January, 2012, the study covers the 2010-2014. The choice of 2010 to 2014 is based on the ground that we could assign a dummy value of “1” to companies that adopt IFRS between 2010 to 2014 and “0” otherwise. The use of this approach is supported by previous studies (Xu,2014) and also allows us to correctly assign the value of “0” to companies in Nigeria that did not comply to the mandatory IFRS adoption policy even as at 2012. The study focuses on the public interest entities in Nigeria that were expected to comply with IFRS starting from 1<sup>st</sup> January, 2012. Following prior studies (Xu, 2014; Barth, Landsman & Lang, 2008; Houqe, Zijl&Karim 2012; Chua, Cheong & Gould, 2012) we exclude financial institutions. Financial firms are subject to particular financial reporting rules that can influence the earnings management in a different manner.

## **1.6 Significance of the Study**

This study contributes to the large debate concerning the role of accounting standards in financial reporting quality. More specifically, the study contributes to the growing literatures on the effects of IFRS adoption on earnings management.

Investors and analysts would find this study of particular interest in order to discover whether IFRS application affects the tendency of Nigeria companies to manipulate earnings generally.



The study would be of immense benefit to the policy makers as it provides them with empirical answers which may support future decisions regarding financial statement reforms.

The researchers and academicians would also find this study of particular interest as it would encourage more empirical researches on IFRS in Nigeria.

The research work will also be a guide to students wishing to make further research in the field.

## **CHAPTER TWO LITERATURE REVIEW AND THEORETICAL FRAMEWORK**

### **2.1 Introduction**

This section reviewed related and relevant literatures of the study. The items to be discussed are as follows: Concepts of earning management, earnings management measure, Concept and General Overview of International Financial Reporting Standard, Historical Background of IFRS Development, Benefits and Challenges of IFRS adoption, Empirical Review of Literatures on IFRS and Earnings management, firm size, IFRS and earnings management, audit quality(big4), IFRS and earnings management and Theoretical Framework.

### **2.2 Concepts of earnings management**

Earning in accounting is generally referred to as the excess of income over expenditure. Income is the basic instrument to measure management's effectiveness in utilizing the resources belonging to the external users. It is also regarded as the net benefit of a firm's operation. Thus income is an important instrument of evaluating firm's performance.

The term earnings management can be referred to as window dressing accounting; cosmetic accounting, creative accounting, financial engineering, accounting hocus-pecus. However, the preferred term in most of the literatures is earnings management.

According to Copeland (1968) "earnings management involves the repetitive selection of accounting measurement or reporting rules in a particular pattern, the effect of which is to report a stream of income with a smaller variation from trend than would otherwise have appeared". Earnings management is a strategy employed by management of a company to deliberately manipulate the company's earnings so that the figures match a predetermined target.

Merchant and Rockness (1994) defined earnings management ‘as any action on the part of management which affects reported income and which provides no true economic advantage to the organization and may in fact, in the long-term, be detrimental’

Healy and Wahlen (1999) states that “earnings management occurs when managers use their own judgments in financial reporting and in structuring transactions to alter financial reports to either mislead stakeholders about the underlying economic performance of the company, or influence the contractual outcomes that depend on reported accounting numbers”. Stakeholders have a strong believe in the inevitability of earnings manipulation and opportunistic behavior by managers since they are in the possession of confidential information which is of course available only for insiders. Consequently the reported earnings will reflect the desires of management rather than the underlying performance of the firm. According to this definition, misleading stakeholders and influencing contractual outcomes is the key to earnings management. DeAngelo (1988), stated that stakeholders may be misled in order to influence the firm’s stock price in short run, in a way of making them appear more valuable than their actual value, or due to tax tariff incentive (Watts & Zimmerman,1978), or meeting analyst expectation or maintaining a firm’s competitive position in the market (Rifi, 2010).

In accordance with Healy & Wahlen (1999), Dechow et al. (2000) pointed out three practices on this definition and argued that earnings management is no synonymous to fraud. More succinctly, there are fraudulent accounting practice, earnings management, and legitimate exercise of accounting discretion. While the first is fraudulent and illegal, the last two are allowed by the regulators and the major difference between the second and the third is largely based on the intention of management (Xu, 2014). If the intention of the management is to deceive the interested parties, then the practice is regarded as earnings management, however, if

the practice is not in any way negatively affected the interested parties, then it is a legitimate exercise of accounting discretion. For the purpose of this study, earnings management practice is assumed to be unethical and illegitimate practices.

Belkaoui (2002) stated that managers engaged in earnings management to smooth the internal and external earnings forecast and expectations of the organization. A large number of companies are using earnings management either to maintain steady earnings growth or ensure that predetermined target is achieved. Maintaining steady growth and achieving desired targets are the key to earnings management according to this definition. Management can decide to adopt an accounting policy which allows achieving specific target.

Scott (2003), states that earnings management is the choice of a manager among accounting policies which allow achieving some specific objectives.

Similarly, Bloom (2009) argued that earnings management is a planned syndicate by managers to influence financial reporting quality in order to take advantage of the shareholders. The managers usually engaged in earnings smoothing and unethical accounting practices in order to opportunistically window dress the financial statement to suit their desires.

Bello (2010), in line with Bloom (2009) viewed earnings management as an attempt to cooked or doctored financial accounting reports to a given desires. According to him, earnings management is ethical misconduct of accountants and relates it to the recent times corporate failures and loss of investors' confidence on both financial reports and auditors.

Earnings management has been regarded as the practice of using different accounting techniques and principles in order to produce desired financial statement Budrina (2014). It is a

practice whereby managers choose particular accounting policies which allow achieving some specific objectives.

For the purpose of this study we will adopt the definition given by Healy and Wahlen (1999) which is considered the most appropriate for the research work.

### **2.3 Earnings Management Measure**

There are many measures of earnings management which may be used to proxy the extent of earnings manipulation by management of corporation. However, most of the measures used relied heavily on the existing literatures on earnings management and earnings quality. Earnings management arises from accruals accounting practices. Accruals accounting recognized revenue and expenses in the year to which they are related, with cash probably receive and paid in other periods. This creates opportunity for managers to engage in earnings manipulation.

Total accruals of a company can be divided into discretionary (abnormal) accruals and non-discretionary (normal) accruals. The non-discretionary accruals are meant to capture adjustment that reflects fundamental performance and discretionary accruals is used to capture manipulations of accounting concept and convention using earnings management. In other words, normal accruals represent real business activity records, while abnormal accruals represent managers' discretion to manipulate earnings to suit their desires. Scott (2003) argued that discretionary accruals are more flexible for the usage by managers and cannot be observed by investors. Jones (1991), model accruals as a function of revenue growth and depreciation as a function of property, plants and equipments. All variables are scaled by total asset. The Jones model suggests that change in revenues are non-discretionary and free from manipulation and the model removes a part of managed earnings from the discretionary accruals proxy if earnings are

managed through discretionary revenues. However, Jones Model has been severely criticized for not having power to capture the impact of sales-based manipulation. Therefore, Dechow, Sloan & Sweeney (1995) modified the Jones model to exclude growth in credit sales in years identified as manipulation year. The modified Jones model assumes that all changes in revenue in the event year are produced by earnings management. To measure earnings management, this study applied Modified Jones Model by Dechow et al. (1995).

## **2.4 Concept and General Overview of International Financial Reporting Standard**

International Financial Reporting Standards (IFRS) are a set of accounting standards issued by the International Accounting Standards Board (IASB) which was established to achieve the objective of developing a single set of high quality globally accepted accounting standards based upon clearly articulated principles. IFRS provide understandable, reliable, relevant and comparable accounting rules which can be implemented across international boundaries. IFRS are principle-based accounting standards which are set to achieve the objective of harmonization of all the accounting standards of different countries in order to enhance comparability and improve quality of accounting information in general. They are a consequence of growing multi-national companies and are progressively replacing the many different national accounting standards.

### **2.4.1 Historical Background of IFRS Development**

Despite the fact IFRS has just been introduced it has its origin dated back 1973 when different professional bodies from Australia, Germany, Netherlands, United Kingdom, Canada, Mexico, USA, Japan and France agreed to form an International Accounting Standard Committee (IASC) in order to harmonize national GAAPs of different countries. In the wave of globalization,

multinational companies and investment grows. Companies, investors and policy makers are very concerned with the implications of inconsistent accounting standards among countries. Consequently, demands for developing a set of global accounting standards increase which lead to the development International Accounting Standards (IAS) to harmonize all the national standards and reduce inconsistencies in international accounting principle and reporting standards. For several years the efforts was actually focused on harmonization which means reducing differences among accounting principles and reporting standards across the major countries around the world. By the 1990s, the notion of harmonization was replaced by the concept of convergence, the development of a single set high-quality international reporting standards that will be acceptable all over the world.

At the start of 2001 the International Accounting Standards committee (IASC) was restructured into the International Accounting Standards Board (IASB) in order to accomplish the objectives of developing a single set of high quality global accounting standards and bring convergence of international accounting standards and IFRS to high quality solution. This restructuring became imperative since the world is becoming a global village and there is need to have common standards that would be understandable and acceptable by all countries across the world.

The globalization of the world's economy and markets lead companies and nations to become world global players and more investments take place at global level. In 2005 European Union Commission Issued legislation that all firms listed Stock Exchange are required to comply with IFRS when preparing their financial statement. Prior to the EU announcement, other countries such as Germany, France, Italy and many others allowed early adoption. Consequently, over 120 countries including Nigeria have adopted IFRS.

## **2.4.2 Implementation of IFRS in Nigeria**

There is growing evidence that the world economies are more interconnected and symbolic than anyone can really imagine and it is obviously a fundamental fact that Nigeria is indeed part of this globalization. Following the changes in accounting standards around the world, Nigeria companies have been mandated to comply with IFRS starting from 2012. IFRS implementation Nigeria started on 28 July 2010, when the Nigerian Federal Executive Council (FEC) approved January 2012 as the effective date for the convergence of Nigeria Generally Accepted Accounting Practices (NGAAPs) to International Financial Reporting Standards (IFRS). In addition, the FEC ordered the Nigerian Accounting Standard Board (NASB) to take further necessary action to give effect to councils' decision.

The decision of Federal Executive Council to fully adopt IFRS in Nigeria was followed by the enactment of the Financial Reporting Council of Nigeria Act in 2011, which led to the transformation of the Nigerian Accounting Standard Board (NASB) to the Financial Reporting Council of Nigeria (FRCN). The NABS announced its Roadmap to convergence with IFRS in September 2010. Based on this Roadmap Nigerian Listed Companies and significant public interest entities have been mandated to comply with IFRS commencing from 1<sup>st</sup> January, 2012. While other public interest entities have been required to comply starting from 1<sup>st</sup> January, 2013 and small and medium sized entities expected to comply for period ending after 1<sup>st</sup> January, 2014. The report sought the amendment of relevant laws and regulations that had one provision or the other impacting on financial reporting in Nigeria to ensure uniformity and removal of conflicts and ambiguity. Specifically; Companies and Allied Matters Act (CAMA) 1990, Banks and Other Financial Institution Act (BOFIA) 1991, Investment and Security Act (ISA) 2007, etc. Furthermore, the report recommends for an early countrywide intensive capacity building



programs to facilitate the process of adoption and the establishment of IFRS Academy an institutional platform for capacity building.

### **2.4.3 Benefits of IFRS adoption**

The benefit of IFRS adoption cannot be over-emphasized despite numerous challenges associated with its implementation. IFRS which are principle-based accounting standards is considered to have significant benefits. It has been observed that the single set of high quality global accounting standard will simplify accounting procedures by allowing the use of a common reporting language (Deloitte 2013). Similarly, Madawaki (2014) stated that Nigeria's adoption of IFRS will advance the compilation of meaning data of reporting entities' performance for comparability and reliability, facilitate and enhance informed decision making of investors and go a long ways in attracting foreign direct investments. In addition, there will be easy access to external capital for local companies, low cost of trans-border businesses, easy consolidation of financial statements of multi-national companies as well as enhancing easy regulation. Kunle, Omoruyi and Hamed (2011) argued that IFRS is a systematic approach that promotes understandability, reliability, relevance and comparability. In the same vein Adekoya (2011) stated that IFRS adoption will improve security value and achieve higher market liquidity.

According to Herbert, Tsegba, Ohanele & Anyahara (2013) IFRS have the capacity of improving the comparability of financial statements, strengthen corporate transparency, and enhance the quality of financial reporting. Adoption of IFRS has generally been viewed as a change of norms and standards. Pricewater house cooper (2008) for example, describes the adoption of the standards as a move that will affect companies in the way they compute their taxable income.

Street, Gray & Bryant (1999) stated that the use of a single global accounting standard will bring the following benefits:

- a. It can reduce people's investment risk and save firm's cost of capital by allowing investors to make more efficient decisions.
- b. Multinational firms can lower the accounting standards compliance cost around the world.
- c. It promotes international investment opportunities.
- d. It ensures efficient cross-border capital allocation.

More specifically, the following benefits have been documented in the roadmap for IFRS adoption in Nigeria:

- a. Improve comparability of reported financial information by entities
- b. Easier access to foreign capital funding and cross-border stock exchange listing.
- c. More effective management of enterprises and efficient processes since IFRS reporting is performance based.
- d. More transparent financial information to all stakeholders.
- e. Optimisation of tax planning.

In line with the benefit enumerated in the roadmap, Deloitte (2009) stated the following as general benefits of IFRS:

- a. Improve the comparability of entities and provide more consistent financial information
- b. Enable companies to have a clear understanding of the global marketplace, access world capital market and promote new business.

- c. Allow investors and others to compare the company's performance with competitors globally.
- d. Improve quality and consistency of information that management needs.
- e. Help companies to have a competitive advantage in negotiations with credit institutions and accordingly cost of borrowing are reduced.
- f. Allow a company to benchmark itself against its peers throughout the world.
- g. Considered as an opportunity to make some strategic improvements to your finance systems and processes.
- h. Help companies to make advantage of alternative forms of finance.
- i. Result in more accurate risk evaluations by lenders and to a lower risk.

It is however interesting to note that IFRS have unique benefits which have been generally attested to. These are: better quality, enhanced comparability, easy access to foreign investments and financial reporting transparency. Thus IFRS assist companies to produce and present high quality, transparent and comparable financial statements.

#### **2.4.4 The Challenges of IFRS Adoption**

Despite the stated benefits of IFRS there are numerous challenges which tend to limit the workability of IFRS in different countries. For instance, Armstrong et al. (2007) stated that the single set of global reporting standards cannot reflect the differences in national business practices arising from differences in economies, institutions, political and cultural factors. Further, the characteristics of local business environments and institutional framework to a large extent determine the form, structure and content of accounting standards (Iyoha and Jimoh 2011). In a country where there is good and effective governance structure, IFRS adoption is

likely to be less attractive as good governance represent high quality and the cost of switching to IFRS may not be justifiable. However, many developing countries suffer from weak institution, hence are important determinants of the decision to adopt IFRS (Leuz et al.2003).

According to Rong- Ruey Duh (2006), the challenges of IFRS adoption include: timely interpretation of standards, continuous amendment to IFRS, accounting knowledge and expertise possessed by financial statement users, preparers, auditors and regulators and as well as managerial incentive . Furthermore, the historical differences in thought, context, cultures, institutions and practice in the broad divides: Anglo-Saxon, Continental Europe and Southern American (Ball,1995) make harmonization and moving from one tradition to another difficulty.

It is obviously a fundamental fact that IFRS has the potentials to facilitate cross-border comparability, increase reporting transparency, decrease information costs, reduce information asymmetry and thereby increase the liquidity, competition and efficiency of markets (Choi, Carol & Meck 2005). Armstrong et al. (2007) opined that cultural, political and business differences may also continue to impose difficulties in the progress towards a single global financial reporting standard because a single set of accounting standards cannot reflect the differences in national business practices arising from differences in institutions and cultures. There are numerous challenges which limit the effective implementation of IFRS. For instance, Odi and Ogedu (2013) outline the following as some of the serious challenges to IFRS adoption:

1. IASB funding, staffing and governance structure, consistent adoption: This implies that the country adopting IFRS need assurance of IASB true independence as well as stable funding, expert staffing, appropriate governance to ensure standards setting process is free from undue influence and politicization maneuvers.

2. Another major challenge is the issue of consistency in adoption, application and regulatory review. For instance, Ball (2006) argues that most IFRS adoptions are in labels and with various versions which are inconsistent with IASB's prescription. However, there must a coordinated regulatory review and enforcement mechanism to facilitate consistent application.

3. Compliance issues and enforcement mechanisms are another serious challenge facing IFRS implementation process. It is argued that there have been varying levels of compliance with IFRS despite claims by companies that their financial statements complying with IFRS. A major challenge is enforcement mechanisms of IFRS especially in jurisdictions with weak institutions and enforcement agencies.

4. The challenges face in adopting IFRS in terms of changing culture and developing systems of regulation and accountability are quite enormous. There are cultural, language, regulatory and accounting profession challenges as well as demands for greater accountability and wider political participation and embracing of necessary political reforms faced by countries in adopting IFRS.

Furthermore, Gyasi (2010) states the following as the challenges of IFRS adoption:

- a. Cost of adoption: the cost of implementation of IFRS has been one of the most serious impediments for most countries adopting IFRS. This include the cost of restructuring accounting system, staff training, consultancy fees etc.
- b. Implementation Difficulty: it has been observed that the preparation of IFRS was done base on developed economy thereby posing difficulty of implementation. Some of the standards do not meet the local accounting needs of some countries. IFRS are developed with the developed economies as bases and as a result it would not actually fit perfectly the economies of developing countries.

- c. Internal control: there would be a need to change the entire internal control system to ensure compliance with the new standards.
- d. External auditors: the services of reputable audit firms (especially Big-4 audit firms) would be required because most the local audit firms cannot be relied upon with the new standards.
- e. Staff training and adaption: the complexity of IFRS would require extensive training of staff of which it will cost organization a great deal of time and money before staff can acquire and be able to practice and adapt to IFRS..
- f. Local regulation: some local regulation demands certain reports that are not in accordance to the IFRS and hence poses a problem to companies complying with these standards.

## **2.5 Empirical Review of Literatures on IFRS and Earnings Management**

The use of International Financial Reporting Standards (IFRS) in preparing financial statement is mandatory for companies listed in the Nigerian Stock Exchange. IFRS was established to achieve the objective of developing a single set of high quality financial accounting information in order to improve investors' confidence on the financial statements and to make efficient investments' decision. The significant of IFRS adoption has led to current research field in accounting in which several literatures in both developed and emerging economies, have examined the effects of IFRS adoption on the earnings management. However, prior literatures have so far presented mixed results as some studies found an improvement in financial reporting quality after IFRS adoption and widely support the hypothesis that earnings management declined considerably after IFRS adoption (Hayfa, Nadia and Sarra, 2013; Iatridis, 2010; Nina, Bernhard, Christoph, & Ann-Kristin, 2009; Paglietti, 2009; Cai, Courtesney &

Rahman, 2008; Aussenegg, Inwinkl & Schneider, 2008, Christensen, Lee & Walker, 2008, Barth, Landsman & Lang, 2008, Jaggi & Li, 2004,).

For instance, Hayfa, Nadia and Sarra (2013) examine the effect of IFRS on earnings quality in European Stock Market using the sample of 250 French companies listed on Euronext Paris from 2002-2007, the study found that IFRS adoption resulted in a significant improvement of value relevance of earnings. This implies that market valuation is less associated with earnings prepared in line with IFRS than those prepared under IFRS. The explanatory power of earnings improved significantly after the transition to international standards. Another study conducted by Iatridis (2010) explores the effects of switching UK GAAP to IFRS in the UK. Secondary data from audited reports were obtained from the sample. The result indicates that implementation of IFRS generally improves the accounting quality and lead to more value relevance and measures. Nina, Bernhard, Christoph, & Ann-Kristin (2009), while analyzing a large sample of German firms in the period from 1998 to 2008 find that voluntary and mandatory adopters differ distinctively in terms of essential firm characteristics. Result from their findings indicates that earnings management in the post-adoption period are mixed. While income smoothing decreases for voluntary but not for mandatory adopters, discretionary accruals only decrease for mandatory but not for voluntary adopters. Also, Armstrong (2009) argues that IFRS with a high-quality set of standards would improve the quality of financial reporting and consequently mitigate the level of earnings management.

In a similar study by Paglietti (2009) who specifically focused on Italian market, observed that the book value and earnings are more relevant under IFRS than those prepared in accordance with local GAAP. Cai et al (2008), examine the effect of IFRS on earnings management using the data of 32 countries from the year 2000 to 2006. The result from the finding indicates

declining earnings management after both mandatory and voluntary IFRS adoption. This implies that countries with stronger enforcement generally have less earnings management. Barth et al. (2008) examines the implication of IFRS adoption on earnings quality using a sample of 21 countries that adopted IAS between 1994 and 2003. Authors use three determinants of accounting quality: earnings management, timely loss recognition and value relevance metrics. The authors found that firms switching to IFRS have higher accounting quality than those not applying it and provide evidence that the application of IAS results in less earnings management, more timely loss recognition and higher value relevance. Thus IFRS standards are more informative than other accounting standards since they help in reducing information asymmetry and managerial discretion to manipulate earnings thereby improves financial reporting quality.

Aussenegg et al. (2008), examine earnings management practice in 17 European public firms. They found that the extent of earnings management is largely depending on specific country factors such institutional factors, legal origin and tax system. Christensen et al. (2008) state that earnings management decreases and timely loss recognition increases after the adoption of IFRS in Germany and Sweden. In the same vein, Jaggi and Li (2004) used a broad sample of firms in many countries adopting IFRS and found that the transition to IFRS results in better and improved financial reporting quality.

However, several studies have provide contrary evidence that adoption of IFRS does not always result to an improvement in the quality of accounting information or declining earnings management (Xu, 2014; Stolowy, 2008; Ahmed, Neel and Wang 2013; Mara, 2011; Kaserer and Klingler 2008; Christensen, Lee and Walker,2008; Daske & Gephardt 2008 Lin and Chen 2005;Leuz et al. 2003;). For instance, Xu (2014) posits that IFRS adoption does not reduce the level of earnings management but rather, earnings manipulation intensified after the adoption of



new accounting standards among the UK private firms. Ahmed et al. (2013) explore how mandatory IFRS adoption influences earnings quality and argue that the implication of IFRS adoption significantly depends on whether IFRS provide higher or lower quality than local GAAPs, thus it is expected that higher quality standards will increase the quality of earnings. Conversely, low quality standards are expected to reduce the quality of accounting information. The authors conclude that mandatory IFRS adoption has a negative impact on the quality of accounting information. IFRS only represent pure accounting changes and not sufficient to provide the expected benefits (Mara, 2011).

Furthermore, Hail, Leuz and Wysocky (2010) explore the global Accounting Convergence and the Potential Adoption of IFRS by the U.S. The authors asserted that, the general believes that IFRS adoption will ensure reliability and comparability in accounting reports is misleading and insufficient because accounting standard are not the only variable affecting the quality of accounting reports, other variables such as culture, institutional structure and legal system may have significant impact on the quality of reported earnings. Christensen et al. (2009) equally noted that the IFRS adoption does not improve the earnings quality. The authors conclude that the mandatory IFRS adoption does not benefit all firms in a uniform way but results in relative winners and losers. IFRS which has been regarded as a principle-based reporting standard are not sufficient condition to reduce the level of earnings manipulation (Stolowy, 2008). The adoption of IFRS gives manager more and less opportunity to manipulate earnings and this is evidenced through the application of fair value principle that is based on the estimation made by managers who can use their discretion to opportunistically manipulate earnings to suit their desires (Kaserer and Klingler, 2008).

Lin and Chen (2005) focus on the value relevance of International Accounting Standards harmonization in China. The results from the study indicate that accounting numbers prepared in accordance with IFRS are less relevant than those prepared in line with Chinese standards. In a related study by Leuz et al. (2003), the authors posit that the adoption of IFRS provides less implementation guidance and allows for more flexibility and discretion for managers to manipulate earnings and consequently result in lower earnings quality. Therefore, consequent upon the mixed findings from the prior studies, it is difficult to conclude whether IFRS implementation lead to a declining earnings management. Thus, this study predicts that IFRS adoption has no effect on earnings management in Nigeria.

Prior studies indicate that incentives to manipulate earnings differ considerably. Company usually manipulate earnings upward (income-increasing earnings management) so as to escape reporting losses when they apply for loans (Goncharov & Zimmerman,2006). This implies that companies manipulate earnings around the lending process in order to report favourable earnings. The research by Healey and Wahlen (1999) indicate that the main incentive to manipulate earnings upward are capital market expectation, contract based on reported financial statement and government regulation. Nelson (2003) carried out research on the behavioural evidence on the effects of principle and rule based standards and point out that managers tend to manipulate earnings upwards in order to enjoy more earnings-based incentives or bonuses.

Similarly, Xu (2014), examines the effects of IFRS adoption on earnings management of UK private firms using a sample of 6,859 firms and 48,480 firm-year observation from the period 2003 to 2010. The results indicate that larger firm size intensifies earnings management for IFRS adopters with income-increasing earnings management. Goncharov & Zimmerman

(2006) examine the role of tax accounting and its impact on earnings management in Russia. The findings indicate that Russia public companies use tax management less aggressively in order to report higher quality earnings. In the same vein, Budrina (2014), conducted a study on the impact of IFRS adoption on accrual-based earnings management which is based on the sample of Russian firms during the years 2006-2012. The results demonstrate that Russian companies manipulate earnings downward (income-decreasing earnings management) in order to avoid high tax. The results also indicate that the IFRS adoption increases accruals-based earnings management in Russian companies, and, as a result, decreases earnings quality. However, caution must be made while generalizing the findings of this study because the study adopted Jones model instead of Modified Jones Model. The Jones Model does not control sale-based manipulations, which are addressed in the Modified Jones Model.

Furthermore, Van Tendeloo (2007), examined the impact of audit quality on tax-induced earnings management in UK private firms. The finding from the study indicates that managers tend to manage earnings downwards for tax deduction purpose. Xu (2014), examines the effects of IFRS adoption on earnings management of UK private firms in the period from 2003 to 2010 and find that IFRS adoption have the same impact on income-increasing and income-decreasing earnings management but not sufficient enough to reduce the level of earnings management and improve accounting quality.

### **2.5.1 Firm size, IFRS and Earnings management**

Big-size companies are expected to present more information than smaller ones because their activities are often subject to more scrutiny and attentive examination by financial analysts and other stakeholders. The ownership structure of big companies is often being much diversified and widely spread across many investors. Therefore, they supply detailed and understandable accounting information for a large number of investors which include institutional investors and other small group of shareholders. Size has been identified to be one of the factors influencing company's international accounting standard choices, big-size companies may have more tendencies to comply with the IFRS because of their exposure to international financial market and cross-border investment. Prior researches present contracting results regarding the effects of mandatory IFRS adoption on company size, for example, Gassen and Sellhorn (2006) while analyzing the determinants and consequences of applying IFRS in German observed positive evidence that the propensity to adopt/comply with IFRS increases with company size. In the same vein Dumontier and Raffournier (1998) find a positive and significant influence of size on the voluntary adoption of IFRS. However, Leuz and Verrecchia (2000) did not validate the hypothesis of size in the German context.

Watts and Zimmerman (1986), in revising the positive accounting theory, stated that large firms are more likely engage in earnings management to minimize current earnings for the purpose of lowering their public visibility and minimizing their political costs. In a related study by Hashem, Bahman and sam (2012) while analyzing the empirical motives for earnings management of listed firms in Tehran found a positive and significant relationship between size and earnings management which means that the reported quality is low.

Xu (2014) provides further evidence on the conditional effect of firm size on earnings management in UK private firm. The result from the finding indicates that firm size do not affect

IFRS adopters' earnings manipulation, neither. Thus, this study predicts that IFRS adoption effects on earnings management is not significantly influenced by firm size.

### **2.5.2 Audit Quality, IFRS adoption and Earnings Management**

Auditors are independent specialists who review the account of companies and organizations so as to ensure the validity and legality of their financial statements. Prior literature on auditing suggests that auditors are one of the key determinants of earnings quality because of the role they play in mitigating intentional and unintentional misstatements (DeAngelo, 1981). Therefore, the ability of the auditor to mitigate misstatements is a function of the quality of the auditor.

It is generally acknowledged that audit market is segmented into at least two categories: large and small auditors, Big 4 firms and non-Big 4 firms and the most common researched and documented indicator of audit quality is whether an audit firm is one of the Big-4. Empirical evidence suggest that auditor size are correlated with accrual quality, thus firm which employed the service of Big-4 auditors (PwC, Deloitte, EY and KPMG) have significantly lower discretionary accruals than firms with non-Big 4 auditors. (Defond and Subramanyam, 1998; Kim et al. 2003; Francis et al. 2005). In other words, firms audited by Big-4 firms have lower earnings management and consequently higher earnings quality. This is because Big 4 auditors are more competent and independent than non-Big 4. It is generally believed that when an audit failure occurs, Big 4 audit firms have more to lose like brand name and reputation (Vander and Willekens, 2004).

However, Tate 2001; Lam and Chang, 1994, provide contrary views that there may not be positive association between size and audit quality and that Big audit firms may not always

provide higher quality audits than the small audit firms. Sometimes, clients solicit for the service of audit to get tax advisory services and Big 4 audit firms could provide more professional services than non-Big 4 firms. Consequently, Big 4 audit firm may help the client on tax planning which lead to tax-induced earnings management.

In a similar study, Xu (2014) examines the moderating role of audit quality's effect of IFRS adoption on earnings management in UK private firm. The result from finding indicates that audit quality has a stronger effect in constraining earnings management but no stronger effect of IFRS reporting on firms audited by Big 4 audit firms than firms audited by non-Big 4 auditors. Thus, this study predicts that IFRS adoption effects on earnings management is not significantly influenced by audit quality (Big 4 audit firms).

## **2.6 Theoretical framework**

Generally, there are many theories which underpin the study under consideration and they include among others: the agency theory, political cost theory, the stakeholder and the stewardship theory. Any of the four theories stated above can be used to explain the impact of accounting system on earning management. Therefore, we shall discuss each of the theory and relate it to the study under consideration and subsequently adopt the one which explain the study better.

Stakeholder theory suggests that the purpose of a business is to create as much as possible for all stakeholders such as shareholders, customers, suppliers, employees, and the general public. The advocate of stakeholders theory believe that agency theory is narrow by identified shareholder as the only interest group of companies and fail to consider other interests groups as mentioned above. It is argued that the companies have the responsibility of being accountable for their stewardship to all entire stakeholders in the environment in which

they operate. In an attempt to solve the problem of agency conflicts, Chang (1999) argue that, the stakeholders theory is more concerned about resolving problems that may occur as a result of divergent of interest between the managers and the stakeholders so that each constituency receive some degree of satisfaction.

Stewardship theory holds that managers are good stewards of their firms and as such they should perform their fiducially duty towards shareholders of the company (Chang, 1999).The advocate of stewardship theory stressed that managerial opportunism is relevant, thus criticizing the agency theory perspectives (Donaldson, 1995; Esienhardt, 1989). In the same vein, Davis, Schoorman and Donaldson (1997) state that Stewardship theory are basically designed for researchers to examine the situation in which executives as stewards are only motivated to act in the best interest of their shareholders.

Political cost theory state that if a company records high profits this might be used as a ground reason for trade unions or lobby groups to take action for an increase in a share of that profit i.e higher wages, therefore companies may adopt income-decreasing accounting methods (Watts and Zimmerman, 1978.).The theory emphases that large companies should publish more information than smaller ones because they are subject to more attentive examination by financial analysts and greater demands from the public (Schipper, 1991).Furthermore, Jones (1991) provides empirical evidence that companies have higher negative discretionary accruals in the period of relieve investigation than the period without investigation. It proves that managers use discretionary accruals in order to report lower earnings when some political investigations occur.

Agency theory explains the relationship between the shareholders and the directors. The theory view directors as the agent of the shareholders and as such they must act in the best

interest of the shareholders. Sometimes, the directors are motivated to act in their own best interest and create a conflict between the interest of shareholders and that of the directors. These conflicts usually arise when directors and shareholders have different interest and information asymmetry (i.e. the directors having more information). Therefore, the agency theory raises a fundamental problem in organizations-self interest behavior and thus stresses the separation of ownership (principal) and directors (agent) in an organization. The shareholders delegated authority of the management of the company to the directors, therefore, it is expected that the directors act in the best interest of the shareholders. However, it is believe that directors may sometimes take decisions which may conflict with the interest of the shareholders. It is argued that agency theory offers unique insight into information systems, outcome uncertainty, incentives and risk (Kathleen, 1989).

The proponents of agency theory believe that managers are in the best position to minimize the conflicts by strictly pursuing the interest of the shareholders (Fama and Jessen 1988). This holds that managers will not act to maximise the returns to shareholders unless appropriate governance structures are implemented in the large corporation to safeguard the interests of shareholders (Jensen and Meckling 1976). In essence, managers tend to engage in unethical accounting practices through earnings management which negatively impacting on the quality of reported earnings. This study therefore, adopted agency theory and political cost theory to underpin the study.

## **2.7 Summary**



In this chapter, a review of existing literatures relating to the research topic is conducted. The effect of IFRS adoption on earnings management has been a subject of concern in financial accounting literatures. The research became imperative due the fact that the study on the effects of IFRS adoption on earnings management is scanty at the global stage and virtually non-existent in Nigeria. Also, in this chapter a review of theoretical bases of IFRS adoption and earnings management is conducted. Four important theories (agency theory, political cost theory, the stakeholder and the stewardship theory) mostly discussed in the literature are given attention.

However, agency theory and political cost theory have been used to underpin the study under consideration. Political cost theory focuses on the fact that if a company records high profits this might be used as a ground reason for trade unions or lobby groups to take action for an increase in a share of that profit i.e higher wages, therefore companies may adopt income-decreasing accounting methods.

### **CHAPTER THREE METHODOLOGY**

### **3.1 Introduction**

This chapter presents the methods, the procedures, the modalities and the sequential steps the researcher adopted in the research work to ensure that the results of the investigation are dependable, accurate and valid. It also presents a careful description of the research design, target population, sample and sampling technique, sources and methods of data collection, techniques of data analysis as well as the variable measurement and model specification.

### **3.2 Research Design**

The study adopted Correlation and the Ex-post factor Design. The design is considered most appropriate because it describes the statistical relationship between two or more variables. Also the Ex-post factor Design help to investigate possible cause and effect relationship by first identifying some existing consequence and searching back by analyzing causal factors.

### **3.3 Population and Sample Size**

The population consists of all companies quoted on the Nigerian Stock Exchange as at December 31, 2014. There are 165 quoted active companies (NSE, Factbook 2014) but after excluding 56 financial companies we had 109. A total of 75 non-financial companies were drawn from the population based on the availability of data and the period of IFRS adoption which represent the sample size for this study. It should be noted that each company in the sampled population must have finished its obligation in delivering annual report for the year ended 2010 to 2014.

### **3.4 Sources and Methods of Data Collection**

Annual reports and audited financial documents served as the research instrument for this study. The nature of this study necessitated the use of secondary data. In other to ensure accuracy and standardization of data collection, the data used in this study were extracted from

“MachameSTAT®” which is financial ratio database of over 1,000 major companies in Nigeria. The database is owned and managed by TalkData Associates. MachameStat® database contains over 160 company financial ratios, with the earliest ratio data available in the year 2008. A review of the database contents shows that the IFRS reporting status of each company in the database was reported since 2011 and all the data needed for computing earnings management was also contained in the database. In this study we therefore sourced all our data from MachameSTAT®.

### **3.5 Data Analysis Techniques and Justification**

A panel data multiple regression techniques was used as our tools of analysis. The use of panel data regression methodology in this study is based on the fact that the data to be collected is subject to time and cross sectional attributes, secondly, it minimizes the bias that might result from aggregation of individual units into broad aggregates. This is due to the fact that data are made available for several units in a panel data setting, and thirdly, it helps to take care of heterogeneity in the estimation process because it allows for individual/specific variable assessment.

The estimation results would be evaluated based on individual statistical significance test (t-test) and overall statistical significance test (F-test). In this study, descriptive statistics and correlation analysis were conducted to properly describe the nature of our data.

### **3.6 Variables Measurement**

### 3.6.1 Earnings Management Measurement

To measure earnings management, this study applied Modified Jones Model by Dechow, Sloan and Sweeney (1995) given that it is the most used measure of discretionary accruals (Xu, 2014).

In line with Callao (2010) as cited in Xu (2014), the study use the following expression to calculate total accruals( $TA_{i,t}$ ):

$$TA_{i,t} = \Delta REC_{i,t} + \Delta Inventories_{i,t} - \Delta Payables_{i,t} - DEP_{i,t}$$

Where:

$\Delta REC_{i,t}$  = Change in accounts receivables for firm i in year t compared to year t-1,

$\Delta Inventories_{i,t}$  = Change in stocks for firm i in year t compared to year t-1,

$\Delta Payables_{i,t}$  = Change in accounts payable for firm i in year t compared to year t-1,

$DEP_{i,t}$  = Depreciation and amortization expenses for firm i in year t.

Therefore, the study estimated discretionary accruals, using the following formula:

$$NDA_{i,t} = \alpha_1 [1/A_{i,t-1}] + \alpha_2 [(\Delta REV_{i,t} - \Delta REC_{i,t})/A_{i,t-1}] + \alpha_3 [PPE_{i,t}/A_{i,t-1}]$$

Where:

$NDA_{i,t}$  = Non-discretionary accruals for the firm i in year t,

$\alpha_1, \alpha_2, \alpha_3$  = Regression coefficients

Lastly, the study used the following formula to get absolute value of discretionary accruals:

$DACC_{i,t} = |TA_{i,t} - NDA_{i,t}|$  which is expanded as given below:

$$DACC_{it} = TACC_{it}/TA_{it-1} - [\alpha_1 (1/TA_{it-1}) + \alpha_2 [(\Delta REV_{it} - REC_{it} / TA_{it-1})] + \alpha_3 (PPE_{it}/TA_{it-1})] + e$$

Where  $DACC_{i,t}$  = Discretionary accruals of firm i at time t

$TACC_{it}$  = Total accruals of firm i at time t

Where  $TACC = EARN - CFO$

$TA_{it-1}$  = the book value of total asset of firm i at the end of year t-1,

$\Delta REV_{it}/TA_{it-1}$  = sales revenues of firm i in year t less revenues in year t-1 scaled by  $TA_{it-1}$

$\Delta REC_{it}/TA_{it-1}$  = sales receivables of firm i in year t less receivables in year t-1 scaled by  $TA_{it-1}$

$PPE_{it}/TA_{it-1}$  = gross property, plant and Equipment of firm I at the end of year t scaled by  $TA_{it-1}$

and  $e_{it}$  = the residual or error term.

The measurement of the dependent and explanatory variables is provided in table below:

**Table 3.1**

<b>Variables</b>	<b>Variables Definition</b>	<b>Variables measurement</b>
<b>Dependent Variable:</b>		
<b>EARM</b>	Earnings management	Absolute discretionary accruals based on Modified Jones Model by Dechow et al. (1995).
<b>Explanatory Variables:</b>		
<b>IFRS</b>	International Financial Reporting Standards	Measured as dummy variable which is equal to “1” if a company uses IFRS between 2010 to 2014, “0” otherwise.
<b>SIZE</b>	Firm Size	Log of total assets. The interaction value of firm size with IFRS is measured by a dummy variable, which equals 1 if a company is large (i.e above sample average) and “0” otherwise. This approach classifying companies size using dummy variable was adopted from the recent work of Xu(2014)
<b>BIG4</b>	Audit quality	Dummy variable which equals “1” if a company uses Big4 audit firm and “0” otherwise. The Big 4 audit firms are KPMG, Delloitte, Earnest & Young and Pricewater House Cooper (PWC).
<b>LEV</b>	Financial Leverage	Measured as the ratio of total debts to total assets
<b>REVGR</b>	Revenue Growth	Measured as percentage change in revenues
<b>ROA</b>	Return on Assets	Measured as total profit after tax divided by the total assets
<b>IFRS*SIZE</b>	Interaction effect between Firm size and IFRS adoption (Xu, 2014).	
<b>IFRS*BIG4</b>	Interaction effect between audit quality and IFRS adoption (Xu, 2014).	

**Source: Author (2015)**

### 3.7 Model Specification

In the light of the methodological knowledge gathered and empirical literature in our previous chapters, a panel data multiple regression model is specified. By the dependent variable the study used earnings management measured by discretionary accruals based on modified Jones model. For independent variable we used accounting standards (1 if company adopt IFRS, 0 otherwise), To test whether the effects of IFRS adoption on magnitude of earnings management is influenced by firm size and audit quality, the interaction variables 'IFRS\*SIZE and IFRS\*BIG-4' are included in the model 2 and 3 respectively. Firm size, Audit quality(BIG4), Financial Leverage, Growth and Return on Assets are control variables. To test the three hypotheses, panel multiple regression models with an error term ( $\varepsilon_{it}$ ) is specified in econometric form as shown below:

MODEL 1:

$$EARM_{it} = \beta_0 + \beta_1 IFRS_{it} + \beta_2 SIZE_{it} + \beta_3 BIG4_{it} + \beta_4 LEV_{it} + \beta_5 GROWTH4_{it} + \beta_6 ROA_{it} + \varepsilon_{it}$$

MODEL 2:

$$EARM_{it} = \beta_0 + \beta_1 IFRS * BIG4_{it} + \beta_2 BIG4_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 GROWTH4_{it} + \beta_6 ROA_{it} + \varepsilon_{it}$$

MODEL 3:

$$EARM_{it} = \beta_0 + \beta_1 IFRS * SIZE_{it} + \beta_2 SIZE_{it} + \beta_3 BIG4_{it} + \beta_4 LEV_{it} + \beta_5 GROWTH4_{it} + \beta_6 ROA_{it} + \varepsilon_{it}$$

**CHAPTER FOUR**  
**DATA PRESENTATION AND ANALYSIS**

**4.1 Introduction**

This chapter presents the results of the analysed data. It begins with the analysis of the samples using descriptive statistics. The descriptive analysis helps us to describe the relevant aspects of the phenomena under consideration and provide detailed information about each relevant variable. Correlation matrix was also carried out to determine the relationship between the dependent and independents variables. The panel regression analysis was used to estimate the impact of

**4.2 Descriptive Statistics**

Table 4.1 below provides the results of the descriptive statistics of variables, where the minimum, maximum, mean, standard deviations and jarque-bera of the data are fully presented. We have 369 observations from the 75 companies sampled for the period..

***Table 4. 1: Descriptive Statistics***

Variables	Mean	Max	Min	Std. Dev	Jarque-Bera
EARM	-0.00025	1.03850	-1.14874	0.16812	2132.66***
IFRS	0.71003	1	0	0.45437	72.7920***
AUDIT(BIG4)	0.72629	1	0	0.44647	77.8218***
SIZE	16.1785	19.67124	11.72637	1.66848	8.69593***
FLEV	57.4166	224.1100	-253.1500	30.0428	16942.63***
ROA	3.864959	89.54000	-101.4200	14.0781	4383.666***
REVGR	9.91019	190.4700	-85.78000	29.8016	905.2982***
Observations	369				



Source: Descriptive Statistics Results from Eviews output

Note: \*10% Level of Significance, \*\* 5% Level of Significance, \*\*\*1 % Level of Significance

The results in Table 4.1 above provide some insight into the nature of the selected Nigerian quoted companies that practiced earnings management for the period 2010 to 2014. It shows the mean (average), standard deviation (degree of dispersion), the maximum, minimum and Jarque-Bera (JB) statistics (normality test) for each of the variable. The mean of earnings management practice in our sample is -0.00025. This implies that firms with earnings management below 0.03% would be seen as highly understating their earnings. The minimum and maximum earnings management practice among sampled quoted non-financial companies in Nigeria ranges from -1.14874 to 1.03850 with a deviation of 16.8%.

The result from the descriptive statistics also reveals that audit quality accounted for 73% on the average. This implies that about 73% of the firms selected were audited by the BIG4 (KPMG, PWC, AKINTOLA WILLIAMS DELOITTE and ERNST and YOUNG) while about 71% of sampled non-financial companies complied with IFRS during the period under consideration. Firm size was measured by the natural logarithm of total assets and has a mean value of 16.1785 with a standard deviation of 1.66848. This implies significant differences across the sample of Nigerian quoted non-financial companies. This could be attributed by the variation in sizes of quoted non-financial companies in Nigeria. Financial leverage was measured with the ratio of total debt to total asset and has a mean value of 57.4166 and a standard deviation of 30.0428. This indicated a moderate significant variation among the values of financial leverages of quoted non-financial companies in Nigerian. Return on asset was measured by the ratio of net profit after tax to total assets, and has the mean value of 3.864959 and standard deviation value of 14.0781. The standard deviation of the sampled firms for return on assets was higher than the

mean and this could be justified by the losses suffered by some of the sampled firms. Revenue growth was measured by the percentage change in revenues and has the mean value of 9.91019 and ranges between -85.78000 to 190.4700 at minimum and maximum value respectively, showing the standard deviation value of 29.8016. The standard deviation of the sampled firms for revenue growth was also higher than the mean and this could be justified by the losses suffered by some of the sampled companies.

Lastly, the Jarque-Bera (JB) which test for normality or the existence of outliers or extreme values among the variables shows that all the variables are normally distributed at 1% level of significance. This means that the data collected were free from outlier bias and are reliable for drawing generalization. This also implies that a least square estimation can be used to estimate the regression models.

### **4.3. Correlation Analysis**

Following the descriptive statistics is the correlation analysis. The correlation analysis for this study was based on Pearson correlation coefficient. The correlation values between the independent variables and dependent variable as well as among independent variables themselves are presented and discussed below.

**Table 4.3 Summary of correlation results**

	EARM	IFRS	AUDIT	SIZE	FLEV	ROA	REVGR
EARM	1.0000						
IFRS	0.0639	1.0000					
AUDIT	-0.0754	0.0095	1.0000				
SIZE	-0.0167	0.0646	0.4272***	1.0000			
FLEV	-0.3306***	0.0552	0.1336**	0.1011*	1.0000		
ROA	0.4515***	-0.0365	0.0716	0.1775**	-0.4746***	1.0000	
REVGR	0.0285	0.0298	-0.0348	0.0545	0.0330	0.1172**	1.0000

**Source: Eviews output (2015)**

\*. Correlation is significant at 10% level (2-tailed)

\*\*. Correlation is significant at 5% level (2-tailed)

\*\*\*. Correlation is significant at 1% level (2-tailed)

Table 4.3 above revealed that IFRS is weakly and positively correlated with earnings management of Nigerian quoted non-financial companies up to 6%. It implied that IFRS adoption and earnings managements move in the same direction. This suggests that the adoption of IFRS reduces the tendency for companies to engage in earnings management practices. Audit type (BIG4) was weakly and negatively correlated earnings management up to 8%. This suggests that the high audit quality reduces the tendency of quoted non-financial companies in Nigeria to engage in earnings management.

Furthermore, relationship between firm size and earnings managements in Nigerian quoted non-financial companies is low to the turn of 2% and is negative and insignificant. This implies that the bigger the quoted non-financial company in our sample, the less they are likely to engage in earnings management practices. Financial leverage has 33% negative and

significant correlation with earnings management, while return on assets (ROA) is positively and significantly related with earnings management at 1% level of significant. Revenue growth is positively and weakly correlated with earnings management practices. It means that fast-growing companies have incentives to manipulate earnings, most probably to meet capital market expectation. A close look at the correlation matrix also revealed that no two explanatory variables were perfectly correlated. This means that there is the absence of multicollinearity problem in our model. Multicollinearity between explanatory variables may result to wrong signs or implausible magnitudes in the estimated model coefficients, and the bias of the standard errors of the coefficients.

### **Robustness test for dependent and independent variables**

To enhance the validity of all statistical inferences drawn in this study, it was imperative that the study carry out the recommended robustness test to validate the inferences. Included in this tests are; multicollinearity test and the test for Heteroscedasticity.

**Multicolliniarity Test:** The researcher conducted this test in a bid to ascertain the relationships which exist between the explanatory variables, which variables may result to wrong signs or implausible magnitudes in the estimated model coefficients, and the bias of the standard errors of the coefficients and ultimately detrimental to the outcome of this study. From the result presented in table 4.2 above, the relationship amongst the independent variables were observed to be insignificant except for a handful that was significantly related. This will not be a premise enough to say that there is multicollinearity except if the tolerance and Variance Inflation Factor (VIF) is above the required limit. The rule of thumb is that the VIF should be less than 10. The results indicate that variance inflation factor were consistently smaller than 10 indicating absence of multicollinearity problem among all the variables.

**Heteroscedasticity Test:** To test for heteroscedasticity, an important assumption of the classical linear regression model (Assumption 4) need to be considered. This assumption states that the disturbances  $\mu$  appearing in the population regression function are homoscedastic. That means they all have the same variance. When the probability of the chi square value is significant either at 1%, 5% or 10% level of significance, we therefore concluded that there is presence of heteroscedasticity and if otherwise, it showed that heteroscedasticity is absent which showed the presence of homoscedasticity. The Breusch-pagan-Godfrey test for heteroscedasticity carried out revealed that the probability of chi-square (0.0018) which is significant at 1% level of significance. This is an indication of heteroscedasticity of the data within the study period. Because of this, the study will not rely on the results obtained from the Pooled Ordinary Least Square (OLS) estimator and further robustness diagnosis (fixed and random effects technique) will be carried out.

#### 4.4 Presentation and interpretation of Regression Result

The results of Generalized Least Square regression (Cross-sectional fixed effects) are shown in the Tables below. The regression result of the dependent variable (Earnings management) and the explanatory variables (IFRS adoption, audit, size, leverage, return on assets and revenue growth) are captured in the model 1 of the study. In other to test whether the effects of IFRS adoption on earnings management are influenced by firm size and audit quality, we include an interaction variables IFRS\*SIZE and IFRS\*BIG4 in model 2 and 3 respectively.

Summary of Regression Results obtained from the model 1, 2 and 3 of the study:

$$EARM_{it} = \beta_0 + \beta_1 IFRS_{it} + \beta_2 SIZE_{it} + \beta_3 BIG4_{it} + \beta_4 LEV_{it} + \beta_5 GROWTH4_{it} + \beta_6 ROA_{it} + \varepsilon_{it}$$

$$EARM_{it} = \beta_0 + \beta_1 IFRS * BIG4_{it} + \beta_2 BIG4_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 GROWTH4_{it} + \beta_6 ROA_{it} + \varepsilon_{it}$$

$$EARM_{it} = \beta_0 + \beta_1 IFRS * SIZE_{it} + \beta_2 SIZE_{it} + \beta_3 BIG4_{it} + \beta_4 LEV_{it} + \beta_5 GROWTH4_{it} + \beta_6 ROA_{it} + \varepsilon_{it}$$

**Table 4.4**  
**Summary of Regression Results (Panel Fixed effects)**

	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>
C	<b>-1.6701</b> (-3.487) [0.001]***	<b>-1.7098</b> (-3.842) [0.000]***	<b>-1.7125</b> (-3.372) [0.000]***
IFRS	<b>-0.0015</b> (-0.075) [0.940]		
IFRS*BIG4		<b>-0.0075</b> (-0.341) [0.733]	
IFRS*SIZE			<b>-0.0003</b> (-0.235) [0.816]
SIZE	<b>0.1021</b> (3.329) [0.001]***	<b>0.0146</b> (3.710) [0.000]***	<b>0.1049</b> (3.372) [0.000]***
BIG4	<b>-0.0114</b> (-0.232) [0.817]	<b>-0.0082</b> (-0.165) [0.869]	<b>-0.0118</b> (-0.240) [0.810]
FLEV	<b>-7.2806</b> (-0.016) [0.987]	<b>-1.8905</b> (-0.042) [0.967]	<b>-0.1005</b> (-0.024) [0.981]
REVGR	<b>-0.0002</b> (-0.555) [0.579]	<b>-0.0002</b> (-0.559) [0.576]	<b>-0.0002</b> (-0.560) [0.576]
ROA	<b>0.0078</b> (8.439) [0.000]***	<b>0.0077</b> (8.357) [0.000]***	<b>0.0078</b> (8.414) [0.000]***
R2	0.48	0.48	0.48
Adjusted R2	0.34	0.34	0.34
F-Statistic	3.36 [0.000]	3.36 [0.000]	3.36 [0.000]
Haus test: Chi2	28.36 [0.000]	31.45 [0.000]	29.07 [0.000]

Source: Eviews output(2015)

Note: t-statistics are shown in the form ( ), while p- values are in the form [ ].

\*Significant at 10% level

\*\*Significant at 5% level

\*\*\*Significant at 1% level

From the result in table 4.4 above, it can be observed that the R-squared which is the multiple coefficient of determination was 0.48 for model 1, 2 and 3 respectively. This means that IFRS adoption, firm size, BIG4 audit firm, financial leverage, revenue growth, return on assets and interaction between IFRS adoption and BIG 4 audit firm and size (IFRS\*BIG4 and IFRS\*SIZE) jointly explained the systematic variations in earnings management practices among the sampled companies in Nigeria to the tune of 48%, while the remaining 52% was caused by factors not captured in the model. The F-Statistics value of 3.36 for model 1, 2 and 3 respectively and their p-values of 0.000 show that the model overall was statistically significant at 1%. This shows that the model is fit and the explanatory variables were carefully selected.

#### **4.5 Hypothesis Testing**

In chapter one, three principal testable hypotheses were formulated on the impact of IFRS adoption on earnings management and to test whether the impact is influenced by audit quality of firm size. In this section, we subject these propositions to empirical testing drawing from the results of our descriptive and inferential statistical analyses. Our decision rule is based on the significances of the t-statistics which are represented by the p- values flagged by the statistical packages used.

##### **Hypothesis 1**

H<sub>01</sub>: IFRS adoption has no significant effects on earnings management of Nigerian non-financial quoted companies.

IFRS adoption (IFRS) was found to be insignificant and negatively associated with earnings management practices among quoted non-financial companies in Nigeria with the value of -0.002 with p-value of 0.94. This implies that IFRS adoption is not significantly influencing the tendency of Nigerian non-financial quoted companies to engage in earnings manipulation. This

perhaps, maybe due to the fact that, IFRS being a principle based accounting standards, is not substantially different from NGAAP which is both principle and rule-based accounting standards.

The result from this finding provides evidence for failure to reject the null hypothesis  $H_{01}$  which suggests that IFRS adoption has no significant effect on earnings management practices of quoted non-financial companies in Nigeria. The finding from this study is in line with the study conducted by Xu (2014) who argued that IFRS adoption is not sufficient to reduce the level of earnings management.

For control variables, Firm Size (SIZE) appears to be positively and significantly influencing the level of earnings management practice of non-financial companies in Nigeria with the value of 0.1021 which is significant at 1% level. This implies that, the larger a firm is, the more likely that it would engage in earnings management practice probably for capital market expectation or to take advantage of low-tax payment. While Audit Quality (BIG4), was found to be insignificant and negatively associated with earnings management practices in Nigeria with a value of -0.0114 with p-value of 0.817. This implies that earnings management decreases with higher audit quality. This may be justified by the fact that Big 4 auditor can provide more professional and qualitative service than non-Big 4 auditors, hence high audit quality work as a constraint on earnings manipulation. This result is contrary to the study conducted by Xu (2014) who argued that private firms in UK audited by Big 4 audit firms mostly engage in income-decreasing earnings manipulation.

Furthermore, the results show that leverage is negatively and insignificantly influencing the level of earnings management practice among quoted non-financial companies in Nigeria with a value of -7.2806 with a p-value of 0.987. This implies that the companies with



lowleverage are less involves in earnings manipulations, than the companies with higher leverage. Revenue growth (REVGR) appears to be negatively and insignificantly impacting on the level of earnings managements. Lastly, return on asset (ROA) was found be positive and significantly influencing earnings management practice at 1% level of significant.

## **Hypothesis 2**

**H<sub>02</sub>:** IFRS adoption effects on earnings management is not significantly influenced by audit quality of Nigerian non-financial quoted companies. To test whether the effects of IFRS adoption on magnitude of earnings management is influenced by audit quality, the interaction variables 'IFRS\*BIG4' is included in the model 2.

Specifically IFRS interaction with big4 (IFRS\*BIG4) appears to be negatively and insignificantly associated with earnings management practices. This implies that the effects of IFRS adoption on earnings management are not different between companies audited by Big-4 and non-Big4 audit firms. On this premise, we fail to reject the null hypothesis H<sub>02</sub> which suggests that IFRS adoption effects on earnings management is not significantly influenced by audit quality of Nigerian non-financial quoted companies. This result is in line with the study conducted by Xu, 2014 which suggests that the effects of IFRS adoption on earnings management are not different between companies audited by Big 4 audit firms and non-Big 4 audit firms. The finding indicates that audit quality does affect the reported magnitudes of earnings management when firms adopt IFRS (after including the interaction variable IFRS\*BIG4). Although audit quality (Big 4) affects earnings management generally, it does not affect the reported magnitudes of earnings management when firms adopt IFRS (after including the interaction variable IFRS\*BIG4). Besides, Audit Quality (BIG4) was found to be statistically insignificant with a negatively associated with earnings management practices in Nigeria with a value of -0.0082. This implies

that the earnings management decreases with higher audit quality. Prior studies provide evidence that higher audit quality work as a constraint on the extent of earnings manipulation, for instance, Medhat and Kevin (2010), found that public firms show lower level of earnings management when they are audited by Big 4 audit firms. This is in line with our result and could be based on the fact that Big 4 audit firms provide higher audit quality so as to avoid losses in case audit failure occurs (DeAngelo, 1981).

### **Hypothesis 3**

**H<sub>03</sub>**:IFRS adoption effects on earnings management is not significantly influenced by firm size of Nigerian non-financial quoted companies. To test whether the effects of IFRS adoption on magnitude of earnings management is influenced by firm size, the interaction variables 'IFRS\*SIZE' is included in the model 3.

Specifically, IFRS adoption interaction with firm size (IFRS\*SIZE)was found to be statistically insignificant and was negatively associated with earnings management practices in Nigeria. This means that the effects of IFRS adoption on earnings management are not different between large companies and small companies. The result from this finding provides evidence for the failure to reject the null Hypothesis H4, which states that IFRS adoption effects on earnings management is no significantly influenced by firm size of Nigerian non-financial companies. This result is in line with the study conducted by Xu, 2014. Besides, Firm Size (SIZE)appears to be positively and significantly associated with earnings management practice among the sampled firms in Nigeria. This implies that as the firm grows in size, the tendency to engage in earnings management will increase.

#### **4.6 Findings and Policy Implication of the study**

The findings of this study will enhance a better understanding of the impact of IFRS adoption on earnings management practice of non-financial quoted firms in Nigeria. It is imperative for academia, regulatory authority, standard-setters, investors and analyst to gain insight on the effects of adoption of IFRS on the level of earnings management. For dependent variable the study focused on earnings management measured by discretionary accruals based on modified Jones model and for independent variable the study used accounting standards (1 if company adopt IFRS, 0 otherwise), and to test whether the effects of IFRS adoption on magnitude of earnings management is influenced by firm size and audit quality, the interaction variables 'IFRS\*SIZE and IFRS\*BIG-4' are included in the model. Audit quality, firm size, Financial Leverage, Growth and Return on Assets are control variables. The findings from this study have several implications which form the bases of contribution of this study to existing knowledge with respect to earnings management practices in Nigeria.

IFRS adoption showed a negative and insignificant effect on earnings management of Nigerian non-financial quoted companies. This implies that the adoption of IFRS adoption is not a significant determinant earnings management of non-financial quoted companies in Nigeria. The results from the study imply that the Nigerian companies did not significantly practice earnings management after their adoption of IFRS. This insignificant IFRS adoption effect on earnings management in a country like Nigeria may be attributed to the less pressure Nigeria companies face in maintaining existing investor's confidence.

Furthermore, this study provides empirical evidence that earnings management practices cannot be eliminated by IFRS standard alone and that the high-quality accounting standards are

not sufficient condition for high-quality financial reporting as there are other institutional, cultural, political, legal framework and macro economic factors which collectively influencing the quality of reported earnings in a given country. Therefore, the findings from this study support the empirical evidence which prove that IFRS does not always have a significant positive effect on the quality of accounting information.

Considering whether the effects of IFRS adoption on earnings management is influenced by audit quality (BIG4), the study provides evidence that big-4 auditors does not sufficiently created a situation where IFRS adoption affected earnings management. The results reveals that the interaction of IFRS\*BIG4 audit firm does not significantly affect the tendency of Nigeria companies to manipulate earnings. This implies that IFRS adoption has no effects on earnings management of companies audited by BIG4 audit firms. Audit Quality (BIG4) was found to be negatively correlated with earnings management of non-financial quoted companies in Nigeria. This implies that earnings management decreases with high audit quality.

Furthermore, the study provides evidence that firm size does not sufficiently created a situation where IFRS adoption affected earnings management differently. The results revealed that IFRS interaction with size (IFRS\*SIZE) was statistically insignificant and negatively correlated. This means that the effects of IFRS adoption on earnings management are not different between large companies and small companies.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary**

The impacts of IFRS adoption on the financial reporting quality have taken center stage of discussion among researchers, investors and regulators following the adoption of IFRS by many countries around the world. Since 2001, approximately more than 120 countries have required or permitted the use IFRS standards by publicly listed companies. Specifically, all the publicly listed companies in Nigeria are required to comply with the requirements of IFRS from the period ending after 1<sup>st</sup> January, 2012. Therefore, it became imperative for regulators and practitioners to gain more insight on the impact of the mandatory IFRS adoption on the level of earnings management practices in Nigeria.

In this study, an attempt was made to examine the impact of IFRS adoption on earnings management practices in Nigeria and whether the effects of IFRS adoption are conditional on audit quality and firm size. The empirical research of this study is based on the sample of 68 non-financial quoted companies in Nigerian that has consistently published their audited annual financial report between 2010 and 2014. The dependent variable in this study is earnings management measured by discretionary accruals based on modified Jones model. For independent variables, the study used accounting standards (1 if company adopt IFRS, 0 otherwise), and to test whether the effects of IFRS adoption on magnitude of earnings management is influenced by firm size and audit quality, the interaction variables 'IFRS\*SIZE and IFRS\*BIG-4' are included in the model. Audit quality, firm size, Financial Leverage, Growth and Return on Assets are control variables.

Using a panel data multiple regression model, this study provides strong evidence that IFRS adoption does not significantly affect the tendency of Nigeria companies to manipulate earnings generally. It is specifically documented that high audit quality (BIG-4) does not sufficiently create a situation where IFRS adoption affected earnings management. The results reveal that the interaction of IFRS\*BIG4 audit firm does not significantly affect the tendency of Nigeria companies to manipulate earnings. Lastly, the study documents that firm size does not sufficiently create a situation where IFRS adoption affected earnings management differently. This implies that the effects of IFRS adoption on earnings management are not different between large companies and small companies.

The findings of this research are relevant to researchers, investors, regulators and practitioners as they give an insight on the impact of IFRS adoption on the level of earnings management practices in Nigeria.

## **5.2 Conclusion**

This study is conducted in order to investigate the impact of IFRS adoption on earnings management of Nigerian non-financial quoted companies. Firstly, the study provides evidence that IFRS adoption does not significantly affect the tendency of Nigeria companies to manipulate earnings generally.

Secondly, considering whether the effects of IFRS adoption on earnings management is influenced by audit quality (BIG4), the study provides evidence that audit quality (BIG-4) does not sufficiently create a situation where IFRS adoption affected earnings management. The results revealed that IFRS adoption effects on earnings management remained insignificant even after interaction with BIG4 audit firms.

Lastly, the study documents that firm size does not sufficiently created a situation where IFRS adoption affected earnings management differently. This implies that the effects of IFRS adoption on earnings management are not different between large companies and small companies.

Despite limitation, it has been argued in the empirical literature that IFRS contribute to decreasing information costs, especially for cross-border companies which consequently bringing benefits for investors.

### **5.3 Recommendations**

Based on the findings and conclusions of this study, the following recommendations are made:

- i. The findings of this study indicate that IFRS adoption in Nigeria significantly affects the tendency of Nigeria companies to manipulate earnings generally. This implies that IFRS adoption does not lead to an improvement of reporting quality. This being stated, the quality of published accounting information is rather a complex concept, and it is difficult to improve it just by IFRS adoption alone. Therefore, it is recommended that roadmap to the convergent with IFRS in Nigeria which required all the significant public interest entities to comply with IFRS starting from 1<sup>st</sup> December, 2012 should be reviewed and allow certain companies without significant customers or operations outside Nigeria to continue the application of NGAAP because they may not have the capability and a market incentive to prepare IFRS financial statements and it has been established that IFRS does not always lead to an improvement in financial reporting quality.

- ii. It is also recommended that while implementing IFRS in Nigeria, other factors such as the institutional framework, national legal system, and good corporate governance practices should be strengthened to ensure an improvement in transparency and comparability of financial statements.
- iii. The study further recommended that regulatory authorities such as the Securities Exchange Commission (SEC) and Financial Reporting Council of Nigeria (FRCN), should devise means of encouraging quoted companies in Nigeria to employ the service of Big4 audit firms to enhance high audit quality. The results indicate that high audit quality works as a constraint on earnings manipulation and consequently, reducing the level of earnings management practices of IFRS adopters.
- iv. Lastly, the study also recommended that further research be conducted in this area to improve on the findings and to provide more empirical evidence on other variables not used in our model.

#### **5.4 Limitations of the study**

Caution must be made in utilizing the results of this work as a basis for generalization due to the following limitations:

- i. This study focused only on selected non-financial companies in Nigeria. We excluded financial firms because they are subject to particular financial reporting rules that can influence the earnings management in a different manner. This may affect the outcome of this research.
- ii. Furthermore, IFRS is mandatory for publicly listed companies in Nigeria merely from the year 2012, the time duration is not sufficient enough to conduct thorough



analyses. Nonetheless, this study gives an insight into the likely outcome of future research covering a wider scope.

- iii. Another important limitation relates to the fact that the effect of IFRS adoption would vary from country to country due to cultural, political and economic differences. This is because IFRS only represent pure accounting changes and not sufficient to provide the expected benefits.

### **5.5 Areas for further research**

The results from this study provide evidence on the effects of IFRS adoption on earnings management practices in Nigerian non-financial quoted companies. However, there are several areas that are not explored by this research that could be useful in ascertaining the effects of IFRS adoption on earnings management. These areas are suggested for further research:

- i. Further research should expand the sample size to include both financial and non-financial sectors in Nigeria. This will assist in documenting the effects of IFRS adoption on earnings management of all quoted companies in Nigeria.
- ii. Further research should also be carried out to examine the effect of IFRS adoption on earnings management among different West African countries which share common characteristics with Nigeria.

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## APPENDICES

### LISTS OF SELECTED QUOTED NON-FINANCIAL COMPANIES IN NIGERIA

1	7Up Nigeria
2	A.G.Leventis Nig
3	Academy
4	Afromedia
5	Air& Logistic Services
6	Aluminium Extrusion Ind
7	Ashaka Cement
8	Associated Bus Company
9	B.O.C Gases Nig
10	Berger Paints Nig
11	Beta Glass Company
12	Cadbury Nig
13	Capital Hotel
14	Champion Breweries
15	Chams
16	Chellarams
17	Chemical & Allied Prod
18	Conoil
19	Courtville Investment
20	Cutix
21	Dangote Flour
22	Dangote Sugar
23	Dn Meyer
24	Eternaoil
25	Etranzact Interntional
26	Fidson Healthcare
27	First Alumminium Nig
28	Flour Mills Of Nigeria
29	Forte Oil (Ap)
30	Ftn Cocoa Processors
31	Glaxosmithkline Nig

32	Greif Nig	
33	Guinness Nig	
34	Honywell Flour Mill	
35	Ihs Nig	
36	Ikeja Hotel	
37	Interlinked Technologies	
38	Ipwa	
39	Japaul Oil & Maritime	
40	John Holt	
41	Julius Berger	
42	Lafarge Cement Wapco	
43	Learn Africa (Longman) c	
44	Livestock Feeds	
45	May & Baker Nig	
46	Mobil Nig	
47	Morison Industries	
48	Mrs(Texaco Chevron)	
49	Multiverse	
	National Aviation	
50	Handling	
51	National Salt Company	
52	Ncr Nigeria	
53	Neimeth Int Pharm	
54	Nestle Nig	
55	Nigeria Breweries	
56	Nigeria Ropes	
57	Nigerian Enamelware	
	Nigerian Northen Flour	
58	Mill	
59	Okomu Oil Palm	
60	Pharma-Deko	
61	Premier Paints	
62	Presco	
63	Pz Cussons	
64	R.T Briscoe Nig	

65	Scoa Nig	<hr/>
66	Studio Press Nig	
67	Total Nigeria	<hr/>
68	Transcorp Nig	
	Trans-Nationwide	
69	Express	<hr/>
70	Uac Of Nig	
71	Uac-Propety	<hr/>
72	Unilever Nig	
73	University Press	<hr/>
74	Vitafoam Nig	
75	Vono Products	<hr/>

## Modified Jones OLS Regression for Generating Earnings Management

Dependent Variable: ACC  
 Method: Least Squares  
 Date: 02/03/16 Time: 21:51  
 Sample: 1 375  
 Included observations: 370

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.026664	0.015029	-1.774208	0.0769
1/LAGTASST	-16334.10	10810.25	-1.510983	0.1317
(DREVEN- DRECVB)/LAGTASST	0.003948	0.023308	0.169395	0.8656
FASST/LAGTASST	-0.061853	0.023804	-2.598387	0.0097
R-squared	0.028367	Mean dependent var		-0.063823
Adjusted R-squared	0.020403	S.D. dependent var		0.170404
S.E. of regression	0.168657	Akaike info criterion		-0.711151
Sum squared resid	10.41090	Schwarz criterion		-0.668843
Log likelihood	135.5629	Hannan-Quinn criter.		-0.694346
F-statistic	3.561818	Durbin-Watson stat		1.959537
Prob(F-statistic)	0.014447			

## Descriptive Statistics

	EARM	AUDIT	IFRSA	LOG(TASST)	TLBTA	RETOA	REVGR
Mean	-0.000259	0.726287	0.710027	16.17847	57.41656	3.864959	9.910190
Median	0.003680	1.000000	1.000000	16.05838	56.37000	4.410000	6.310000
Maximum	1.038502	1.000000	1.000000	19.67124	224.1100	89.54000	190.4700
Minimum	-1.148739	0.000000	0.000000	11.72637	-253.1500	-101.4200	-85.78000
Std. Dev.	0.168124	0.446469	0.454366	1.668479	30.04283	14.07813	29.80160
Skewness	-0.048160	-1.015052	-0.925740	-0.065164	-2.068395	-0.615239	1.505116
Kurtosis	14.77712	2.030331	1.856995	2.259322	35.93701	19.84050	10.05831
Jarque-Bera	2132.664	77.82182	72.79202	8.695931	16942.63	4383.666	905.2982
Probability	0.000000	0.000000	0.000000	0.012933	0.000000	0.000000	0.000000
Sum	-0.095585	268.0000	262.0000	5969.856	21186.71	1426.170	3656.860
Sum Sq. Dev.	10.40174	73.35501	75.97290	1024.446	332146.3	72935.31	326833.9
Observations	369	369	369	369	369	369	369

## Correlation Analysis

Correlation Analysis: Ordinary

Date: 02/03/16 Time: 23:24

Sample: 1 375

Included observations: 369

Balanced sample (listwise missing value deletion)

		Correlation	t-Statistic
EARM	EARM	1.000000	-----
AUDIT	EARM	-0.075435	-1.449251
AUDIT	AUDIT	1.000000	-----
IFRSA	EARM	0.063932	1.227271
IFRSA	AUDIT	0.009547	0.182910
IFRSA	IFRSA	1.000000	-----
LOG(TASST)	EARM	-0.016724	-0.320435
LOG(TASST)	AUDIT	0.427205	9.051620
LOG(TASST)	IFRSA	0.064626	1.240658
LOG(TASST)	LOG(TASST)	1.000000	-----
TLBTA	EARM	-0.330617	-6.711120
TLBTA	AUDIT	0.133581	2.582185
TLBTA	IFRSA	0.055151	1.058146
TLBTA	LOG(TASST)	0.101117	1.947104
TLBTA	TLBTA	1.000000	-----
RETOA	EARM	0.451528	9.694539
RETOA	AUDIT	0.071620	1.375580
RETOA	IFRSA	-0.036491	-0.699542
RETOA	LOG(TASST)	0.177518	3.455632
RETOA	TLBTA	-0.474596	-10.32936
RETOA	RETOA	1.000000	-----
REVGR	EARM	0.028526	0.546699
REVGR	AUDIT	-0.034846	-0.667960
REVGR	IFRSA	0.029833	0.571779
REVGR	LOG(TASST)	0.054450	1.044669
REVGR	TLBTA	0.033037	0.633240
REVGR	RETOA	0.117181	2.260441
REVGR	REVGR	1.000000	-----

## Pooled OLS results

Dependent Variable: EARM  
 Method: Least Squares  
 Date: 02/03/16 Time: 23:30  
 Sample: 1 375  
 Included observations: 369

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.103672	0.079379	1.306034	0.1924
IFRSA	0.033482	0.017044	<b>1.964421</b>	0.0502
LOG(TASST)	-0.005389	0.005256	-1.025239	0.3059
AUDIT	-0.025162	0.019286	-1.304652	0.1928
TLBTA	-0.000701	0.000302	<b>-2.319947</b>	0.0209
REVGR	-9.98E-05	0.000263	-0.379943	0.7042
RETOA	0.004917	0.000652	<b>7.538055</b>	0.0000
R-squared	0.238541	Mean dependent var		-0.000259
Adjusted R-squared	0.225920	S.D. dependent var		0.168124
S.E. of regression	0.147918	Akaike info criterion		-0.965526
Sum squared resid	7.920493	Schwarz criterion		-0.891337
Log likelihood	185.1395	Hannan-Quinn criter.		-0.936054
F-statistic	18.90056	Durbin-Watson stat		2.095880
Prob(F-statistic)	0.000000			

## Test of multicollinearity

Variance Inflation Factors  
 Date: 02/03/16 Time: 23:31  
 Sample: 1 375  
 Included observations: 369

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.006301	106.2672	<b>NA</b>
IFRSA	0.000291	3.478730	<b>1.008737</b>
LOG(TASST)	2.76E-05	123.2610	<b>1.293693</b>
AUDIT	0.000372	4.555934	<b>1.247017</b>
TLBTA	9.13E-08	6.464579	<b>1.386521</b>
REVGR	6.90E-08	1.145742	<b>1.031380</b>
RETOA	4.25E-07	1.525428	<b>1.418244</b>

## Test for Heteroscedasticity

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	3.637575	Prob. F(6,362)	<b>0.0016</b>
Obs*R-squared	20.98243	Prob. Chi-Square(6)	<b>0.0018</b>
Scaled explained SS	94.48956	Prob. Chi-Square(6)	<b>0.0000</b>



### Model 1: Panel Fixed Effect without Interaction

Dependent Variable: EARM  
 Method: Panel Least Squares  
 Date: 02/03/16 Time: 23:39  
 Sample: 2010 2014  
 Periods included: 5  
 Cross-sections included: 75  
 Total panel (unbalanced) observations: 369

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.670062	0.478908	-3.487232	0.0006
IFRSA	<b>-0.001501</b>	<b>0.020061</b>	<b>-0.074833</b>	<b>0.9404</b>
LOG(TASST)	0.102054	0.030652	<b>3.329395</b>	0.0010
AUDIT	<b>-0.011412</b>	<b>0.049168</b>	<b>-0.232109</b>	<b>0.8166</b>
TLBTA	-7.28E-06	0.000454	-0.016049	0.9872
REVGR	-0.000157	0.000284	-0.554710	0.5795
RETOA	0.007776	0.000921	<b>8.439042</b>	0.0000

#### Effects Specification

##### Cross-section fixed (dummy variables)

R-squared	<b>0.482419</b>	Mean dependent var	-0.000259
Adjusted R-squared	<b>0.338646</b>	S.D. dependent var	0.168124
S.E. of regression	0.136724	Akaike info criterion	-0.950512
Sum squared resid	5.383742	Schwarz criterion	-0.092044
Log likelihood	256.3694	Hannan-Quinn criter.	-0.609486
F-statistic	<b>3.355433</b>	Durbin-Watson stat	2.601401
Prob(F-statistic)	<b>0.000000</b>		

## Model 1: Panel Random Effect without Interaction

Dependent Variable: EARM  
 Method: Panel EGLS (Cross-section random effects)  
 Date: 02/03/16 Time: 23:41  
 Sample: 2010 2014  
 Periods included: 5  
 Cross-sections included: 75  
 Total panel (unbalanced) observations: 369  
 Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.088157	0.089072	0.989733	0.3230
IFRSA	0.033522	0.016170	2.073065	0.0389
LOG(TASST)	-0.005007	0.005920	-0.845778	0.3982
AUDIT	-0.027061	0.021151	-1.279410	0.2016
TLBTA	-0.000551	0.000313	-1.759641	0.0793
REVGR	-8.21E-05	0.000254	-0.322873	0.7470
RETOA	0.005418	0.000670	8.084909	0.0000

  

Effects Specification		S.D.	Rho
Cross-section random		0.044759	0.0968
Idiosyncratic random		0.136724	0.9032

  

Weighted Statistics			
R-squared	0.234527	Mean dependent var	-0.000183
Adjusted R-squared	0.221840	S.D. dependent var	0.159635
S.E. of regression	0.140820	Sum squared resid	7.178510
F-statistic	18.48503	Durbin-Watson stat	2.233098
Prob(F-statistic)	0.000000		

  

Unweighted Statistics			
R-squared	0.237047	Mean dependent var	-0.000259
Sum squared resid	7.936040	Durbin-Watson stat	2.075201

### Hausman Test

Correlated Random Effects - Hausman Test

Equation: Untitled

Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	<b>28.360255</b>	<b>6</b>	<b>0.0001</b>

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
IFRSA	-0.001501	0.033522	0.000141	0.0032
LOG(TASST)	0.102054	-0.005007	0.000905	0.0004
AUDIT	-0.011412	-0.027061	0.001970	0.7244
TLBTA	-0.000007	-0.000551	0.000000	0.0979
REVGR	-0.000157	-0.000082	0.000000	0.5502
RETOA	0.007776	0.005418	0.000000	0.0002

## Model 2: Panel Fixed Effect with Interaction (IFRS and Big 4 auditors)

Dependent Variable: EARM

Method: Panel Least Squares

Date: 02/03/16 Time: 23:47

Sample: 2010 2014

Periods included: 5

Cross-sections included: 75

Total panel (unbalanced) observations: 369

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.709796	0.445054	-3.841773	0.0002
AUDIT	-0.008188	0.049765	-0.164538	0.8694
IFRSA*AUDIT	-0.007514	0.022029	-0.341085	0.7333
LOG(TASST)	0.104591	0.028188	3.710422	0.0002
TLBTA	-1.89E-05	0.000455	-0.041636	0.9668
REVGR	-0.000159	0.000284	-0.559848	0.5760
RETOA	0.007740	0.000926	8.356656	0.0000

### Effects Specification

#### Cross-section fixed (dummy variables)

R-squared	0.482618	Mean dependent var	-0.000259
Adjusted R-squared	0.338901	S.D. dependent var	0.168124
S.E. of regression	0.136698	Akaike info criterion	-0.950896
Sum squared resid	5.381673	Schwarz criterion	-0.092428
Log likelihood	256.4403	Hannan-Quinn criter.	-0.609870
F-statistic	3.358107	Durbin-Watson stat	2.598078
Prob(F-statistic)	0.000000		

**Model 2: Panel Random Effect with Interaction (IFRS and Big 4 auditors)**

Dependent Variable: EARM  
 Method: Panel EGLS (Cross-section random effects)  
 Date: 02/03/16 Time: 23:48  
 Sample: 2010 2014  
 Periods included: 5  
 Cross-sections included: 75  
 Total panel (unbalanced) observations: 369  
 Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.098930	0.090212	1.096636	0.2735
AUDIT	-0.037005	0.024611	-1.503630	0.1335
IFRSA*AUDIT	0.012993	0.019155	0.678327	0.4980
LOG(TASST)	-0.004249	0.005967	-0.712042	0.4769
TLBTA	-0.000529	0.000314	-1.685306	0.0928
REVGR	-7.21E-05	0.000255	-0.283279	0.7771
RETOA	0.005387	0.000672	8.014659	0.0000

Effects Specification		S.D.	Rho
Cross-section random		0.045525	0.0998
Idiosyncratic random		0.136698	0.9002

Weighted Statistics			
R-squared	0.226805	Mean dependent var	-0.000181
Adjusted R-squared	0.213990	S.D. dependent var	0.159439
S.E. of regression	0.141354	Sum squared resid	7.233117
F-statistic	17.69789	Durbin-Watson stat	2.235576
Prob(F-statistic)	0.000000		

Unweighted Statistics			
R-squared	0.229356	Mean dependent var	-0.000259
Sum squared resid	8.016042	Durbin-Watson stat	2.073916

## Hausman Test

Correlated Random Effects - Hausman Test

Equation: Untitled

Test cross-section random effects

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Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	31.451222	6	0.0000

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Cross-section random effects test comparisons:

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Variable	Fixed	Random	Var(Diff.)	Prob.
AUDIT	-0.008188	-0.037005	0.001871	0.5053
IFRSA*AUDIT	-0.007514	0.012993	0.000118	0.0594
LOG(TASST)	0.104591	-0.004249	0.000759	0.0001
TLBTA	-0.000019	-0.000529	0.000000	0.1215
REVGR	-0.000159	-0.000072	0.000000	0.4890
RETOA	0.007740	0.005387	0.000000	0.0002

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### Model 3: Panel fixed Effect with Interaction (IFRS and Firm Size)

Dependent Variable: EARM  
 Method: Panel Least Squares  
 Date: 02/03/16 Time: 23:50  
 Sample: 2010 2014  
 Periods included: 5  
 Cross-sections included: 75  
 Total panel (unbalanced) observations: 369

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.712544	0.486041	-3.523455	0.0005
LOG(TASST)	0.104858	0.031099	3.371790	0.0008
IFRSA*LOG(TASST)	-0.000292	0.001244	-0.234826	0.8145
AUDIT	-0.011809	0.049103	-0.240499	0.8101
TLBTA	-1.10E-05	0.000454	-0.024302	0.9806
REVGR	-0.000159	0.000284	-0.560280	0.5757
RETOA	0.007761	0.000922	8.414255	0.0000

#### Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.482508	Mean dependent var	-0.000259
Adjusted R-squared	0.338760	S.D. dependent var	0.168124
S.E. of regression	0.136713	Akaike info criterion	-0.950684
Sum squared resid	5.382816	Schwarz criterion	-0.092216
Log likelihood	256.4011	Hannan-Quinn criter.	-0.609658
F-statistic	3.356629	Durbin-Watson stat	2.600023
Prob(F-statistic)	0.000000		

### Model 3: Panel random Effect with Interaction (IFRS and Firm SIZE)

Dependent Variable: EARM  
 Method: Panel EGLS (Cross-section random effects)  
 Date: 02/03/16 Time: 23:51  
 Sample: 2010 2014  
 Periods included: 5  
 Cross-sections included: 75  
 Total panel (unbalanced) observations: 369  
 Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.110365	0.089545	1.232510	0.2186
LOG(TASST)	-0.006276	0.006032	-1.040402	0.2988
IFRSA*LOG(TASST)	0.001916	0.001001	1.913071	0.0565
AUDIT	-0.027520	0.021144	-1.301548	0.1939
TLBTA	-0.000545	0.000313	-1.742775	0.0822
REVGR	-7.93E-05	0.000254	-0.312009	0.7552
RETOA	0.005421	0.000670	8.087235	0.0000

  

Effects Specification		S.D.	Rho
Cross-section random		0.044752	0.0968
Idiosyncratic random		0.136713	0.9032

  

Weighted Statistics			
R-squared	0.233255	Mean dependent var	-0.000183
Adjusted R-squared	0.220546	S.D. dependent var	0.159636
S.E. of regression	0.140937	Sum squared resid	7.190498
F-statistic	18.35423	Durbin-Watson stat	2.233594
Prob(F-statistic)	0.000000		

  

Unweighted Statistics			
R-squared	0.235827	Mean dependent var	-0.000259
Sum squared resid	7.948724	Durbin-Watson stat	2.075729



## Hausman Test

Correlated Random Effects - Hausman Test

Equation: Untitled

Test cross-section random effects

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Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	29.072978	6	0.0001

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Cross-section random effects test comparisons:

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Variable	Fixed	Random	Var(Diff.)	Prob.
LOG(TASST)	0.104858	-0.006276	0.000931	0.0003
IFRSA*LOG(TASST)	-0.000292	0.001916	0.000001	0.0028
AUDIT	-0.011809	-0.027520	0.001964	0.7230
TLBTA	-0.000011	-0.000545	0.000000	0.1039
REVGR	-0.000159	-0.000079	0.000000	0.5278
RETOA	0.007761	0.005421	0.000000	0.0002

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