



## Effect of International Financial Reporting Standards on Profitability of Nigerian Banks: A Case Study of Uba Plc

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### Abstract

The broad objective of this study is to investigate the effect of international financial reporting standards on profitability of Nigerian banks. The study is hinged on the efficient market theory which emphasizes accounting information as a major determinant in an efficient market, and obtains support from the agency theory which stipulated an agency relationship between the bank owners and the bank managers who communicate to users of financial accounting reports. The study used descriptive statistics to make comparative trend analysis of the profit before tax under GAAP and IFRS of United Bank for Africa. The study deployed clustered column bar chart and linear bar chart to analyze the trend of profit before tax under GAAP and IFRS for United Bank for Africa. The profit before tax data were sourced from income statements of the bank for the period 2003 to 2020 which comprised of pre IFRS(2003-2009) and Post IFRS(2010-2020). Findings revealed that, overall; the IFRS adoption indicates negative insignificant effect on assets quality of deposit money banks in Nigeria. The study therefore, recommends inter-alia that Financial Reporting Council of Nigeria should partner with the CBN to provide clarity on areas of regulatory hindrance to full and effective implementation of the IFRS with regular supervisory observations.

**Keywords:** IFRS, Profitability, UBA, Pre-IFRS, Post-IFRS

### 1. Introduction

Different nations have had their own accounting standards around the world with each using their own version of Generally Accepted Accounting Principles (GAAP). The individual nation allows firms to report their financial statement in line with the GAAP that is applicable to them (Armstrong *et al.*, 2010). However, when firms are involved in several businesses outside their domicile country, the question here is, how are financial users and investors able to handle these multiple standards, if making good investment and making appropriate decisions (Demaki, 2013). Firms financial comparability will also be affected



and a lot more. In recent times, the surge in accounting scandals that happened across the globe within the international financial community (Nigeria was not spared either) has raised serious concern about the way and manner by which financial information is reported (Barth *et al.*, 2014). This concern has weakened the confidence of financial information users to publish financial reports. Hence, the international accounting standard board (IASB) for the sake of public interest and to safeguard the financial world economy that globally develop a single set of accounting standards known as International Financial Reporting Standards (IFRS) that is more principle- based rather than rule based and has higher quality when compared to local GAAP. IFRS is also expected to be more transparent, understandable and comparable for financial information among firms and nations (Barth *et al.*, 2014). IFRS is a principle-based standard with a more rigorous principle which enables investors to have easy access to quality financial information and company's performance level (Cascino and Gassen, 2012; Christensen *et al.*, 2015; Zakari, 2014).

In the Nigeria context, Nigerian Accounting Standard Board (NASB) which was formed in 1982 and was formally enacted in 2003 has now been replaced by the Financial Reporting Council of Nigeria (FRCN) which was signed into law in 2011. However, the transformation of the Nigeria Accounting Standard Board (NASB) to Financial Reporting Council of Nigeria (FRCN) is a key step towards the eventual adoption of IFRS and its implantation in Nigeria on January 1, 2012. Majority of studies reviewed in this study concentrated on the effect of IFRS adoption on asset quality, loan volume, book value, cash flow, earnings per share of deposit money banks and consumer firms sector that were listed in Nigeria stock exchange. While neglecting the profitability level of deposit money banks, which this study seeks to address. Also, the banking sector has become a cynosure of all eyes in Nigeria due to multiple bank failures. It becomes necessary to carry out investigation in the sector as to whether IFRS has any influence on profitability of banks in that sector. Therefore, this study investigates the relevance of IFRS on the profitability of banks in Nigeria using United Bank for Africa

## **2. Literature Review**

### *Rationale behind Adoption of IFRS*

The main rationale behind the development of IFRS is to harmonize reporting practices of published financial statements, so as to have one set of global accounting standard (Forst, 2014). Harmonization becomes necessary due to the fact that modern factors such as cross boarder business investments, increased intricacy of business, recent worldwide financial crises, global financial meltdown and capital mobility and institutional bodies around the globe have greatly influenced the world economy (Sercemeli, 2016). The following are some additional rationale behind it; to create one global accounting standard of financial reporting, especially with the increase in global business or international trade; to provide a sound global business environment, which will enable investors across the world To have the relevant and reliable information they need for investment purposes; to also ensure that entities present fair and reliable financial statement publication (Ogundaya *et al.*, 2017). This is also to foster



high transparency in financial statement reporting and easy capital mobilization among entities across the globe.

#### *Benefits of IFRS*

It will be reasonable to have a cautious preliminary appraisal and benefits/cost scrutiny as to whether the mandatory adoption of IFRS by Nigeria is beneficial. A number of studies carried out by scholars such as (Bushman and Landsmann, 2010; Onale *et al.*, 2014; Oseni, 2013; Young and Guenther, 2015; Adekoya, 2011 and Ahmed, 2012; Cox, 2014) have pointed out some wide range of benefits rather than cost which Nigeria stands to gain as a result of the IFRS adoption. These are highlighted as follows: The global harmonization of accounting standards could make cross-country's transactions comparable, less costly and more efficient. The adoption of IFRS will help to eliminate cross board barriers when trading securities across countries, and it will also ensure that published financial statements become more transparent. IFRS adoption will attract foreign direct investment to the country Stock Exchange Market, as result of the transparent financial statement publication. IFRS will make it easier for global comparability to significantly increase between entities by providing reliable financial statements information. IFRS may prove to be economically beneficial by narrowing cross-country's differences in financial statements reporting as well as promote international trading.

#### *Empirical Review*

Temile (2018) examine the effect of IFRS adoption on the quality of Published Financial Information of non-financial firms listed on the floor of the Nigeria Stock Exchange. In order to accomplish the objective of this study, a quantitative approach is applied, and secondary data was collected from (87) firms listed in Nigerian Stock Exchange for a period of five years pre IFRS adoption (2007 to 2011) and five years post IFRS adoption (2012 to 2016). A regression is run for the sample in each year of the pre and post adoption in order to determine whether the adoption of IFRS has increase or decrease the value relevance of accounting information in the sampled firms. The findings revealed that adjusted R-Square in the post IFRS adoption is higher than the pre-IFRS adoption indicating a more value relevance of published financial information after IFRS adoption. On whether there is incremental value relevance, the findings show fluctuations (in years) of adjusted R-Squared from 2007 to 2016 with more noticeable decrease in 2008, 2009, 2012 and 2016 and hence results could not ascertain if IFRS leads to incremental value relevance of financial reporting in Nigeria. To measure earnings management, the modified Jones (1995) model is used and the results revealed a significant decrease in discretionary accrual, indicating a decrease in earning management in post IFRS adoption in Nigeria. The study concluded that the adoption of IFRS in Nigeria has positively and significantly impacted on the quality of published financial information by significantly increasing the value relevance of financial information and as well as significantly reducing earnings mismanagement in Nigeria. It is recommended that Nigerian government should empower the relevant bodies/ authorities to



seek out and incorporate more measures to further improve the quality of financial reporting in order to increase the quality of published accounting information.

Okafor, et al. (2017) investigated the effect of International Financial Reporting Standards (IFRS) adoption on value relevance of accounting information in Nigeria. This study analyzed the effect of IFRS adoption on value relevance of book value, cash flow and earnings per share from operations in Nigerian consumer firms sector. Three hypotheses were formulated for this study. The ex-post facto research design was utilized. The population is made up of 25 consumer firms listed in Nigerian Stock Exchange. A sample size of 12 firms selected on the basis of availability of data among other considerations. The study covers a period of eight years (2008-2015). Secondary data collected from annual reports of firms and database of Capital Assets were used. Multiple regression analysis was used in analyzing the data with the aid of Statistical Package for Social Sciences (SPSS) Version 22. The findings revealed that IFRS adoption has an incremental effect on the value relevance of book value, earnings per share, and cash flow from operations, with earnings per share showing the highest increment. Based on the findings, the researchers recommended that investors should consider the values of earnings, book values of equity, and cash flow from operations in the annual reports of firms prepared in accordance with IFRS before making any investment decision. However, more emphasis should be laid on earning.

Lee, *et al.* (2013) conducted a research on Chinese industrial firms listed on Shanghai and Shenzhen Stock Exchange over the period from 2003 to 2009 and used pre-post analyses with 2007 as benchmark. It comprises of 10,017 firm-year observations which were split into treatment and control group based on IFRS adoption time, that is, firms in treatment group consist of firms reporting based on Chinese GAAP before 2007 and IFRS as from 2007 while the control group consists of firms that have been reporting with IFRS even before 2007. Their result showed no significant change in value relevance of accounting information for firms in the control group while firms in the treatment group experienced significant change in value relevance which can be attributed to IFRS adoption.

Nzeribe and Okey (2018) examined the effect of the adoption of international financial reporting standards (IFRS) on assets quality in the Nigerian banking sector. This study analyzed the effect of IFRS adoption on asset quality, and loan volume of deposit money banks listed on the Nigerian Stock Exchange. The causal-comparative research design was adopted for this study. Secondary data on ten out of sixteen listed deposit money banks on the Nigerian Stock Exchange by June 2018 were used. Judgmental sampling technique was used to select banks whose annual financial statements for the immediate year before IFRS adoption year were available and contained figures under Nigerian GAAP/SAS and IFRS-equivalent. The data which were analyzed using paired student t-test approach were sourced from 2011 and 2012 annual reports of the selected banks except Zenith bank for which only 2011 annual financial reports were used. The variables of interest were grouped under Nigerian GAAP (SAS) and IFRS. Findings revealed that the overall IFRS adoption indicates



negative insignificant effect on assets quality of deposit money banks in Nigeria. The study therefore, recommends inter-alia that Financial Reporting Council of Nigeria should partner with the CBN to provide clarity on areas of regulatory hindrance to full and effective implementation of the IFRS with regular. Based on this review, it is empirically proof that majority of studies analyzed the effect of IFRS adoption on asset quality and loan volume, book value, cash flow, and earnings per share of deposit money banks and consumer firms sector listed in Nigeria stock exchange. While neglecting the profitability level of deposit money banks, which this study seek to address.

#### *Theoretical Framework*

Agency theory was propounded by Stephen Ross and Barry Mitnick in the year 1973 to explain and resolve issues in the relationship between business principals and their agents (Beaver, 1968). Agency theory has to do with the association stuck between “agents” and “principals” i.e. companies’ managers and shareholders (ICAN, 2014; Morris, 1987). The company’s owners expect the managers (agents) to run the activities of the company in the paramount interest of the owners. Thus, an agency relationship does exist between the business owners and the company’s managers who communicate to users of financial accounting reports. (Bushman and Landsmnani, 2010; Onale *et al.*, 2014; Oseni, 2013; Young and Guenther, 2015; Adekoya, 2011 and Ahmed, 2012; Cox, 2014). It is a known assumption that owners always seek to maximize profit or wealth. Managers may have interests such as good compensations, preference for the expense, building empire etc. Thomsen & Pedersen say that during diversification strategy, top managers usually have personal interests in products as well as geographical diversification at the corporate level as a result of employment risk aversion, preference in expense etc. Consequently, when ownership gets concentrated, it might lead to counteracting corporate diversification thereby increasing shareholders value. Also, ownership concentration is one of the requirements needed to influence the manager's activities. From the studies of Cascino and Gassen (2012) managers do not always make decisions that maximize shareholders value.

The Efficient Market Theory Was developed by Paul Samuelson In 1964. The theory is concerned with the way published information is processed and absorbed by the market participants, as well as how current prices reflect all the publicly available information about stock dealings (Oseni, 2013).It is expected that in an efficient market, when information is made publicly available, it should quickly reflect on the value of stocks prices. When a financial assets price is able to reflect or replicate all the relevant information made available about an assets intrinsic value, the market can be termed as an efficient market. This is because informational efficiency of share prices assists financial statements users such as investors to determine their investments options in order to beat the market or earn excess returns (Menike, 2013; Mohammed 2015). Given, the impact accounting information has on share prices, the relevance of accounting information disclosed becomes a major factor. This study is hinged on the efficient market theory. This is because the theory According to the work of Horton *et al.* (2013); Herbert and Tsegba (2013) emphasizes that accounting



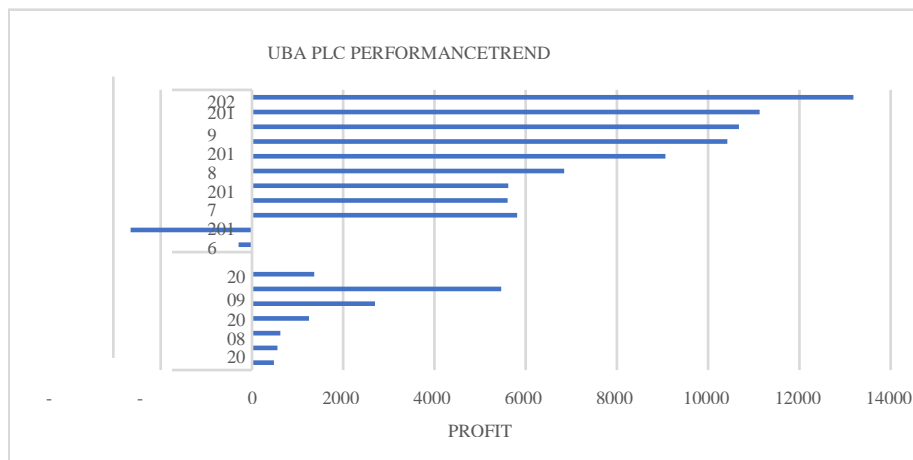
information is a major determinant in an efficient market and that value relevant is the ability of published financial statement information to be able to capture and summaries a company's value or performance.

### 3. Methodology

The study used descriptive statistics to make comparative trend analysis of the profit before tax under GAAP and IFRS of United Bank for Africa. The study deployed clustered column bar chart and linear bar chart to analyze the trend of profit before tax under GAAP and IFRS for United Bank for Africa. The profit before tax data were sourced from income statement of financial statement of the bank for the period 2003 to 2020 which comprised of pre IFRS(2003-2009) and Post IFRS(2010-2020). United bank for Africa was used for this study because it is one of First generation bank and with one of the highest gross earnings in Nigeria.

### 4. Result

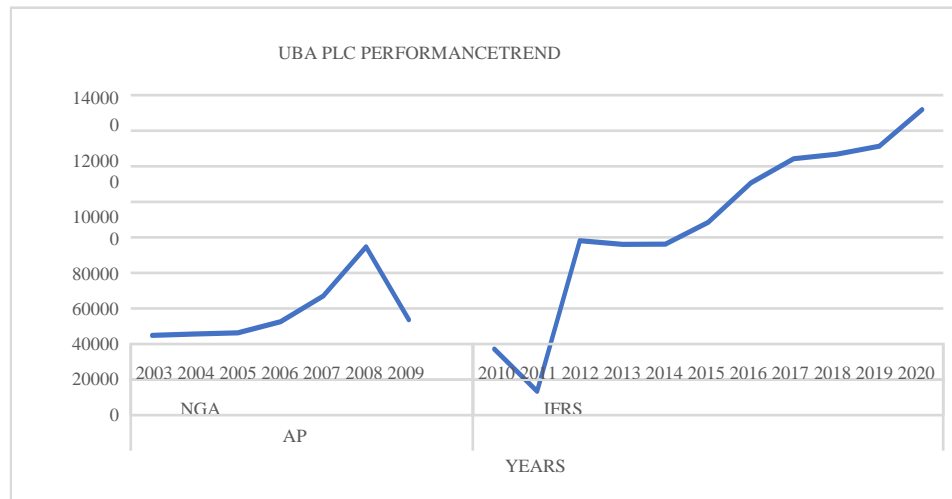
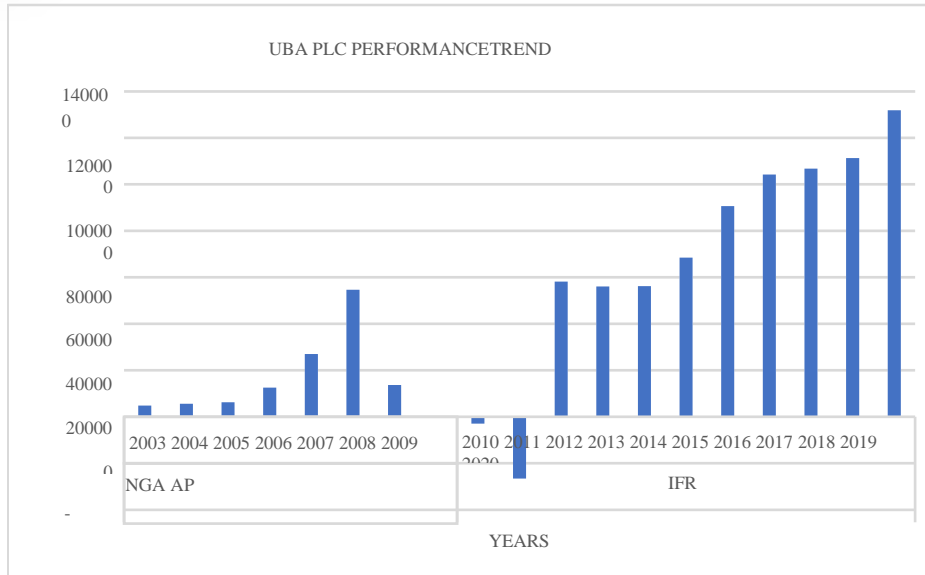
The clustered bar chart below shows that the profit before tax for united bank for Africa have increased significantly since the introduction of IFRS as a bases for financial reporting even though the year of adoption 2010 and 2011 experienced losses which may not be unconnected to the effect of a parallel system change. Under GAAP, the profit



before tax from N4,816million in 2003 to N12,514 million in 2006 and N13,662 million in 2009. On the other hand, United bank for Africa recorded a loss before tax after the introduction of IFRS in 2010 of N2925million and N26,600million in 2011 after which the performance leapfrog to a profit before tax of N58,133. Million in 2012 and has remained in that trajectory up to 2020. The profit before tax had increased from N56, 200 million in 2014 to N90, 642million in 2016 and N106,766. Million in 2018. In 2020, N131, 860million was the



reported profit before tax indicating that adoption of IFRS has had significant impact on the performance of bank operation.



## 5. Conclusion and Recommendations



The conclusion reached from this study is that the performance of United Bank for Africa as measured by profit before tax was greatly influenced by the adoption of IFRS in 2010 as indicated by a better profit values compared to pre IFRS era. The value relevance of accounting information has increased after the adoption of IFRS. It is recommended that Companies that are yet to adopt IFRS in Nigeria should do so because it will make their financial statement comparable, transparent and rich in quality thereby boosting investors' confidence to invest in their companies

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