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Proactive Monitoring and Compliance with International Financial Reporting Standard in Nigeria

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ABSTRACT

The study examines how proactive monitoring by regulatory authorities and external auditors affect compliance with International Financial Reporting Standard (IFRS) in Nigeria. Data is hand collected from 154 companies that mandatorily adopted IFRS in the year 2012. The study uses the unweighted index in determining the extent of compliance with the disclosure requirements of 10 standards and uses multiple regressions in examining how proactive monitoring affects compliance with IFRS. The results show that the overall level of compliance is 61% and the regulatory bodies under insurance companies and firms audited by Big-4 auditors significantly and positively affect the level of compliance with IFRS disclosures. The study recommends an increase in vigilant in monitoring compliance with IFRS by the regulatory bodies supervising non-financial firms and by local audit firms to improve compliance.

Keywords: Proactive Monitoring, Compliance with International Financial Reporting Standard, Nigeria

JEL Classifications: C31, M41

1. INTRODUCTION

Nigeria mandated the use of International Financial Reporting Standard (IFRS) in 2012. Before the adoption of IFRS, the financial reporting and accounting practices are governed by multiple of regulatory bodies backed by multiple laws. The multiplicity in the number of regulatory bodies makes the system of enforcement and monitoring compliance with accounting regulation weak and ineffective (World Bank, 2011). Additionally, the regulatory bodies responsible for the enforcement of accounting regulation are lacking in financial and human resources to fulfil their mandate leading to high non-compliance with national standards, fraud and insider abuse (World Bank, 2011).

To overcome these challenges, the government passed the Financial Reporting Council (FRC) of Nigeria Act 2011 and mandated the adoption of IFRS for all publicly listed companies effective from January 1, 2012. The expectation of the change in regulation and the enforcement mechanisms is to achieve high-level compliance with IFRS. Prior literature, on the other hand, argues that enactments of laws mandating compliance do not necessarily improve compliance (Al-Akra et al., 2010; Bova and Pereira, 2012; Hodgson, et al., 2009; Hope, 2003). Prior literature also stressed the importance of efficient institutions in ensuring compliance with IFRS (Al-Shammari et al., 2008; Brown and Tarca, 2005; Healy and Palepu, 2001).

Many regulatory bodies under different acts review financial reports and monitors compliance with IFRS in Nigeria to ensure compliance with accounting regulation. To the authors’ knowledge, no empirical literature has examined how proactive monitoring by the regulatory authorities in Nigeria affects compliance with IFRS disclosures. Therefore, this study seeks to examine how proactive monitoring by regulatory bodies affects compliance with IFRS in Nigeria. The study contributes to the literature on IFRS enforcement, as the objective of International Accounting Standard Board is to promote the use of the standard across the world. This study serves as feedback on the enforcement of IFRS in an African country.
The remaining part of the paper is divided into four sections. Section 2 reviews relevant literature on the importance of monitoring compliance with accounting regulation and the development of hypotheses. Section 3 explains the methodology for data collection and analysis while Section 4 presents and analyse the data collected. Section 5 concludes the paper and makes recommendations.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Literature Review
The importance of regulatory bodies in enforcing compliance with accounting regulation has been emphasised in the literature. Prior literature argues that the effectiveness of monitoring mechanisms plays a significant role in ensuring compliance with accounting standard (Schipper, 2005; Al-Shammari et al., 2008; Daske et al., 2008). Other literature also stresses the importance of regulatory bodies in ensuring compliance with IFRS (Tsalavoutas, 2011; Chen and Zhang, 2010).

Prior literature also reports differences in the level of compliance with IFRS disclosures across countries with different regulatory bodies (Al-Shammari et al., 2008). In addition, Prior literature also reported a positive relationship between the regulatory intervention and disclosure (Nelson et al., 2010).

2.2. Regulatory Monitoring in Nigeria and Hypotheses Development
Financial reports in Nigeria are subjected to review by a minimum of four regulatory bodies to ensure compliance with accounting regulation. The regulatory bodies include the Corporate Affairs Commission (CAC), the Security and Exchange Commission (SEC), the Nigerian Stock Exchange (NSE), and the FRC. In addition, National Insurance Commission (NAICOM) and Central Bank of Nigeria (CBN) subject the annual reports of financial institutions (insurance companies, banks, and other financial institutions) to additional review. Thus, three groups of regulatory bodies are identified. First, a general group of all listed companies (financial and non-financial) consisting CAC, SEC, NSE, and FRC. The second group (insurance companies) consists of regulatory bodies in the first group plus NAICOM while the third group (banks and other financial institutions) consist of regulatory bodies in the first group plus CBN.

In line with the above classification and the arguments in the literature, the study raises the following hypothesis:

H1: The extent of compliance with the mandatory disclosure requirement of IFRS is associated with the category of the group of the regulators reviewing annual reports.

In addition to regulatory monitoring by authorities, the Companies Act in Nigeria requires each company to have external auditors to review their annual report and ensure compliance with accounting regulation (S.360 of CAMA, 2004). This is an additional regulatory requirement by law to ensure that financial reports are prepared in accordance with the legal requirement. The prior literature argues that auditing is a tool for monitoring the activities of management. This activity includes preparation of the annual reports, which must comply with accounting regulation. Adoption of IFRS for the first time requires expertise in international accounting. The international auditing firms (Big-4) consisting of PricewaterhouseCoopers, KPMG, Ernst and Young, and Deloitte have more of this expertise than the local auditing firms whose experience is more of local accounting standard since IFRS was first adopted in Nigeria in 2012.

Most of the prior studies on the relationship between audit quality and compliance with IFRS reports positive relationship (Kent and Stewart, 2008; Mısırlıoğlu et al., 2013). In line with the prior literature argument, the study hypothesised that

H2: Audit quality is positively associated with compliance with IFRS disclosures.

Additionally, various theories could be used to explain compliance with IFRS. These theories include agency theory, information cost theory and political cost theory. Several proxies have been used in prior literature to represent these theories including firm size, and gearing (Tsalavoutas, 2011). For the purpose of this research, these proxies are used as control variables.

3. METHODOLOGY

The sample is 154 listed companies whose annual reports are available in the year IFRS became mandatory for financial reporting in Nigeria (2012). Ten standards are examine because they contained more of new disclosure introduced by IFRS. The standards include: IFRS 1; IFRS 2, IFRS 3; IFRS 4; IFRS 5; IFRS 7; IFRS 8; IAS 19; IAS 24; and IAS 36.

To determine the extent of compliance with IFRS, unweighted compliance index is used. The index is widely used by prior literature (Mısırlıoğlu et al., 2013). The index, attached equal weight to each disclosure requirement. Compliance with each applicable disclosure requirement is recorded as 1 and 0 otherwise. If it is not applicable, it is recorded as NA. The compliance index is computed as a ratio of total applicable disclosure complied with to the total applicable disclosure. It is given as:

$$DCI_i = \frac{T}{M} = \frac{\sum_i di}{\sum_i dm}$$

Where $DCI_i$ measures the extent of compliance with IFRS disclosure requirement by company $i$ and $DCI_i \leq 1$ and $\geq 0$. $T$ is the total number of items disclosed by firm $i$ where $M$ is the maximum number of disclosure applicable to firm $i$ and $di$ are the item disclosed and $dm$ applicable disclosure. To determine how
the regulatory monitoring affects compliance, a multiple cross-sectional regression is used as follows:

\[ DCI = \alpha_0 + \alpha_1 GREG2 + \alpha_2 GREG3 + \alpha_3 AUDIT + \]
\[ \alpha_4 SIZE + \alpha_5 GEARING + \epsilon \]  

(2)

From Equation 2, GREG2 is the group of regulatory bodies falling under insurance companies and is measured as a dummy variable 1 for firms under the group and 0 otherwise. GREG3 is the group of regulatory bodies under banks and other financial institutions measured as a dummy variable 1 for firms under the group and 0 otherwise. GREG1 is the group of regulatory bodies under non-financial firms, which is used as a base group. AUDIT is the audit quality for the group of companies audited by Big-4 auditors and is measured as a dummy variable 1 for firms audited by Big-4 auditors, 0 otherwise. SIZE is the size of the firm measured as the natural logarithm of the total asset for firm i, and GEARING is company’s level of using external capital measured by total debt to the total asset. DCI is as in Equation 1. The regression is estimated using OLS and all the main assumptions of OLS are tested.

### 4. EMPIRICAL ANALYSIS

#### 4.1. Descriptive Analysis

Table 1 below shows that across the three groups of regulatory bodies, the bank and other financial institutions group supervised by CBN achieve higher compliance of 77% above insurance companies supervised by NAICOM, which achieved 63%. The non-financial firms achieved 56%. Analysis of compliance by audit quality shows that those firms audited by Big-4 audits achieved 78% as against 46% by those audited by local audit firms. Overall, the mean compliance is 61%.

#### 4.2. Univariate and Multivariate Analysis

The result from Table 2 under univariate analysis shows that the correlation coefficient between the DCI and GREG3 (Banks and other financial institutions) of the regulatory bodies and the audit quality (Big-4 audit) are positive and statistically significant indicating that association exist among the variables. Additionally, multivariate analysis from Table 2 shows that jointly the regulatory bodies and audit quality explains 64.80% (adjusted R²) of the variation in the level of compliance in Nigeria. The F-statistics is significant at 1%. In addition, the result from the multivariate analysis could be relied upon because it passes the post-estimation test as reported in Table 2.

The result from Table 2 also shows that there is a significant relationship between IFRS compliance and GREG2 of the regulatory bodies (insurance companies) and firms audited by Big-4 audits both at 1% level of significance. Therefore, the result supports both hypothesis one and two.

### 5. SUMMARY AND CONCLUSION

The study examines how proactive monitoring through regulatory authorities and external auditors affect compliance with IFRS in Nigeria. The result shows that the overall level of compliance with IFRS is 61%, and there is a difference in the level of compliance with IFRS across the three categories of the regulatory bodies with insurance companies group having a significant positive result. Additionally, the level of compliance with IFRS for those firms with the Big-4 audit is positive and statistically significant indicating that the level of compliance with IFRS for those firms audited by Big-4 auditors differs significantly from the level of compliance with IFRS for those firms without Big-4 audit.
The study recommends increased vigilance by the regulatory bodies supervising non-financial firms and by local audit firms to improve compliance.

REFERENCES


