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THE IMPACT OF FIRM CHARACTERISTICS ON IFRS 8 DISCLOSURE IN THE TRANSITION PERIOD IN NIGERIA

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Abstract:

Following the adoption of International Financial Reporting Standard (IFRS) in Nigeria, companies listed under Nigerian Stock Exchange (NSE) are mandated to comply with the provisions of IFRS within the transition period effective 1st January 2012 and ending 2014. The aim of this paper is to share more lights in the transition process to IFRS with regards to segment reporting in mandatory regime. Based on sample of 97 listed companies using a disclosure index, the study document that the quantity of disclosure was positively related to some aspects of firm characteristics such as industry type, auditor type, firm size, and company's listing age, albeit these variables provide a significant impact on compliance with IFRS 8 (Operating segments) disclosure. The study Further document that majority of the sample companies identify Board of Directors (BOD) as their Chief Operating Decision Maker (CODM).

Keywords:

Operating segments; Firm Characteristics; Disclosure

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1. Introduction

Nigeria recently pioneer into the world of International Financial Reporting Standard (IFRS) for reporting periods beginning 2012 to 2014 as a transition process which has already began to full convergence with globally accepted accounting language. Financial Reporting Council of Nigeria (FRCN) as an independent oversight body supervises the adoption process. The initial process applies to all entities listed on the Nigerian stock Exchange (NSE) as well as other significant entities. However transition from national standard to international standard would face many challenges such as cultural issues, mental models, legal impediments, educational needs and political influence (Obazee 2007) this is because it is argued that developing countries and emerging economies, in pursuing the global economic benefits offered by the adoption of IFRS, face challenges in adapting their regulatory infrastructure and culture to western-oriented accounting standards (Soderstrom and Sun 2007)

Prior to IFRS implementation, accounting reports of Nigerian companies have been found to be deficient (Nzekwe 2009) that they lack explicit information that will allow users to make decision. Similarly in the last two decades Wallace (1988) found that financial reporting lack material substances to aid informed decision, which resulted to loss of credibility and investor confidence in firm. This is an indication that Nigerian financial reporting environment suffered material weaknesses (Ibrahim and Jaafar 2014) Empirical evidence on mandatory and voluntary regime and factors influencing them impact the quality and quantity of disclosure particularly in segment reporting.

The objective of the study is to empirically investigate the impact of selected firm's characteristics on IFRS 8 disclosure practice in a mandatory regime in Nigeria. The notion is that IFRS adopters expect benefits such as increase in comparability and decrease in information asymmetry as described by agency theory. Therefore, disclosing segregated information is expected to enable users of information to understand the risks that management face each day and to assess how well those risk are managed. This study is based on the premise of agency theory that is developed in order to mitigated conflicting interest that exist between managers and shareholders as agent does not always want to act in the best interest of the principal (Jensen and Meckling, 1976).

1.1 *An overview of IFRS 8*

IFRS are principle based standard rather than rule based standards established by IASB in 2006. These standards were developed by the International Accounting Standards Committee (IASC). The IASC was formed in 1973. Prior to 2005 EU countries were apply national standards before the establishment of IASC by Sir Henry Benson in 1973 which was later incorporated to the formation of International Accounting Standards Boards (IASB) in the year 2001 (Epstein and Jermakowicz 2009) There was agreement between

the United States Financial Accounting Standard Board (FASB) and the International Accounting Standard Board (IASB), towards the convergence of US GAAP and the IFRS in 2002. In the Norwalk Agreement, both the FASB and IASB pledged their joint commitment towards the development of high quality, compatible accounting standards for both domestic and cross border financial reporting.

In an effort to achieved harmonization the project to develop IFRS 8 was added to the IASB's agenda in September 2002 as a short term convergence project, conducted jointly with the US standard-setter, the (FASB). In 2006 IFRS 8 emerged as the first standard to be subject to Post Implementation Review (PIR) of all standards issued by the International Accounting standards Board (IASB). Operating segment allow management discretion in the capacity of CODM regarding the level of disclosure. Under management approach for information to be disclosed threshold level must be realized to permit segment reporting (Prencipe 2004) Therefore segmental information helps investors better understand an entity's performance by allowing them to estimate future cash flows more accurately (Ettredge et al. 2005).

The core principle of IFRS 8 states that "...an entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates" (AASB 2012) Allowing investors and other users of financial statements to see the company's operations through the eyes of management (management–approach perspective) would therefore enable investors to understand the risks that management face each day and to assess how well those risks are managed (AASB 2012). Under management approach discretion is given to CODM in deciding how to allocate resources and evaluating performance. Thus the second objective of the study is to investigates the identification of chief operating decision maker (CODM) among the sample companies

2. Literature review and hypotheses development

Larger firms are likely to provide more information because of investors demand for information and increasing demand for outside capital. Wallace (2004) investigates the impact of firm characteristics on disclosure in annual reports of Spanish companies using regression analysis and disclosure was found significantly positive to firm size. Also (Ibrahim 2014) investigates the association between firm size and voluntary segment reporting in Nigeria and the result indicates significant positive relationship. Suwaidan, Omari and Abed (2007) asserted that company size might have a substantial effect on the level of disclosure. Therefore huge corporation have incentives of disclosing more segmental information. However, large firms disclosed detailed information in their annual report as are expected to be more visible and accessible. Therefore, size is used as a variable in this study.

H1: There is positive association between firm size and the extent of segment disclosure in Nigeria.

According to Jensen and Meckling (1976) agency costs are higher for companies with more debt in their capital structure and disclosures are expected to increase with leverage. However, Galloway (2008) argued that firms with lower debt tend to increase their disclosure to increase market benefit. Furthermore, Ferguson et al. (2002) report a positive association between information disclosure and leverage, that leverage has an effect on the type of information disclosed. As indebted firms are prone to be pressured by creditors to increase their disclosure practice (Palmer 2008) based on this the following hypotheses is developed.

H2: The extent of segment disclosure is positively associated with firms leverage in Nigeria.

The association between industry-type and disclosure is supported by empirical evidences that compliance with IFRS disclosure can vary among industry. Ahmed (2005) finds industry-type to be a significant factor for the differences in the disclosure levels of the companies in their sample. In contrast Akhtaruddin (2005) posit that company position has no effect on disclosure. Therefore the following hypothesis is formulated.

H3: There is positive association between industry type and the extent of segment disclosure in Nigeria.

Statutory auditors have a major role in ensuring that their clients comply with accounting standards and other regulations (Kent and Stewart 2008) as they are in a position to ensure that companies have knowledge of new reporting requirements. This is also related to the fact that big auditing firms have a good knowledge of local and international standards and the costs of implementing the standards are lower than for the smaller firms (Lopes and Rodrigues 2007) larger audit firm have more resources and expertise to ensure that they familiarized themselves with the new accounting requirements. Auditor type in this study is an indicator variable for companies audited by Big 4 which are (PWC, KPMG, Deloitte, and Ernst and Young) expecting a positive impact with the level of disclosure in the transition period. It is hypothesized that.

H4: There is positive association between auditor type and the extent of segment disclosure in Nigeria.

The extent of disclosure in a firm can be attributable to how many years it has been operating (Graham et al. 2005) Principe 2004 argued that the extent of mandatory and voluntary disclosure by listed company could be associated with its listing age. Listing age can be associated with enhanced disclosure (Leuz and Wysocki 2008) Therefore company age has been employed in this study to capture the extent to which age impact the segment disclosure practice in Nigeria.

H5: The extent of segment disclosure is positively associated with firms listing status in Nigeria.

Return on Investment (ROI) has been used in prior research such as Zourarakis (2009) Companies attributable to high profitability have incentive to disclose more information (Alsaed 2006) Mahajan and Chanders (2007) found a significant positive association between profitability and the level of corporate disclosure. ROI is used as a measure of performance in this study.

H6: There is positive association between firm's profitability and the extent of segment disclosure in Nigeria.

2.1 Determination of CODM

According to IFRS 8 "an operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses and whose operating results are regularly reviewed by the entity's CODM to make decision about the segments" (IASB 2006) Up until now the specification of CODM identity is not provided by the IFRS 8 it simply states that it is not necessary a manager with specific title. It could be CEO, Chairperson, Board of directors or Management. This study identifies the CODM by reading through the annual report of the companies.

The principles behind IFRS 8 is to enable users to interpret company's financial position and performance based on internal reports that are regularly reviewed by the CODM, known as the management approach (Mardini, Crawford and Power 2012). Adopting management approach is therefore expected to improve financial reporting process in disaggregating more information, which will allow users of financial statement to review operations through the eyes of management (Schneider and Scholze 2011).

3. Research Methodology

There are varieties of approaches employed to determine compliance and to examine the factors that influence the extent of information disclosure in the annual reports of listed

firms. Some researchers determine disclosure using a survey of annual report, users, preparers, auditors and regulators (Barako 2007) in this research the used of content analyses of companies annual reports as at 2012 was used to capture the extent to which firm characteristics such as firm size, industry type, age, leverage and auditor type (independent variables) impact segment reporting items (dependent variables) in the transition period.

3.1 Disclosure Index

Un-weighted disclosure index approach was used to extract information about the quantity of segmental items disclosed by sample companies. The disclosure index allowed calculation of a total disclosure score for each company under study which treats all reported items equally important thus avoiding subjectivity in the analysis. This approach has been employed by many researchers such as (Mardini 2012, Cooke and Wallace 1989) therefore regarded as reliable model. However, Items are identified and measured by counting the total number of items each company disclosed divided by the total items in the study disclosure check list. Each firm's aggregate score is then divided by the total number of items relevant to that firm.

To assess the segmental information disclosed by the sample companies a score of one is given for each item disclosed and zero is assigned for each non disclosed item. Similar approach is employed to capture the identity of the CODM; the identity is further repined to understand who the CODM of each individual company is. Therefore 1, is assigned if CEO, 2 Chairman, 3, Board of Directors 4, Management.

3.2 Sample and data

The sample of the study was initially selected among top 100 publicly listed companies by market capitalization out of the total population of 205 companies from all industrial sectors listed on Nigerian Stock Exchange website (NSE) as at 2012. Some companies did not appear to provide sufficient information regarding segment reporting. As a result the population of the study was increased to 120 companies in order to increase the number of the sample companies. A sample of 97 Nigerian listed companies is used in this research using disclosure index checklist. The checklist collected information about the number of segments items reported and the identity of the chief operating decision maker (CODM) of the sample companies.

The NSE features 11 sectors Agriculture, Conglomerates, Construction/Real estate, Consumer goods, Financial services, Healthcare, ICT, Industrial Goods, natural resources, Oil and gas, and services (NSE 2013). Larger firms are considered in this

study because the cost of accumulating detailed information is less for larger firms and management of larger firms is likely to realize the possible benefits of disclosure.

3.3 Sample Selection

The NSE web site and library was used to determine the number of companies listed on Nigerian stock exchange. The total 97 of the sample companies includes all sectors both financial and non financial companies, 13 companies were removed out of 120 as they are reporting based on single line and 10 companies did not provide sufficient information regarding segment disclosure. Given a final sample of 97 companies considered in running the relevant analysis.

4. Findings

The dependent variables used in this study refers to the extent of segment reporting, as measured by items a company disclosed in their 2012 annual reports. An index expected to be reported is considered using un-weighted method. Independent variables are also examined which include industry type (INDTYPE), auditor type (ATYPE), firm size (FSIZE), leverage (LVRG) leverage, number of years company in existence since listed on the NSE (AGE) and return on investment (ROI) measured as operating income. These are most tested variables (Prencipe 2004).

Description and measurement of variables in the model are described in table 1.

4.1. Tables

Table 1. Description and measurement of variables included in the regression model

| Variables | Prediction | Proxy code | Sign |
|------------------------|---|------------|------|
| 1 Mandatory disclosure | Measured as an index that indicates the level of company's compliance. | DSCL | |
| 2 Industry type | Measured as dichotomous if financial company is assign 1, others scored as 0. | INDTYPE | + |
| 3 Auditor type | Measured as dichotomous if big four is given 1, others scored as 0. | ATYPE | + |

| | | | | |
|---|----------------------|---|-------|-----|
| 4 | Firm size | Measured using natural logarithm of total assets. | FSIZE | + |
| 5 | Leverage | Total debt to total book value of equity. | LVRG | +/- |
| 6 | Age | Natural logarithm of the number of years since listed on NSE. | AGE | + |
| 7 | Return on investment | Operating income to total assets. | ROI | +/- |

4.1.1. Equation. 1

$$VDSCl = \beta_0 + \beta_1 INDTYPE + \beta_2 ATYPE + \beta_3 FSIZE + \beta_4 LVRG + \beta_5 AGE + \beta_6 ROI + \varepsilon_0$$

4.1.2 Description statistics

Table 2 present descriptive statistics for the segment disclosure of the sample companies. The table shows that the mean disclosure of a sample of Nigerian Listed companies in 2012 was 0.67, with a minimum score of 0.25 and maximum of 0.95. This indicates that the disclosure level is on the increase in the mandatory regime among the Nigerian listed companies.

Table 2. Description statistics for the segment disclosure index

| Dependent Variable | N | Min | Max | Mean | Std deviation |
|--------------------|----|------|------|------|---------------|
| Dscl | 97 | 0.25 | 0.95 | 0.67 | 0.16 |

Multivariate regression was employed to investigate the impact of firm characteristics on segment reporting in Nigeria during the transition period. The results on table 3 present a positive significant relationship between the industry type (INDTYPE) and the extent of

companies' segment disclosure (t-value = 2.856) supporting H1, confirming positive impact on segment disclosure in Nigeria.

Furthermore Regression analysis table indicate ATYPE (t-value = 2.004) auditor type is significant and positively impact on segment disclosure in Nigeria as hypothesized thus supporting H2. FSIZE at (t-value = 5.804) also an indicative of positive significant impact on segment disclosure. The finding is in support of H3 consistence with the findings of (Ibrahim 2014) Whereas LVRG (t-value = 1.306) does not indicate positive impact on the extent of segment disclosure among the sample companies. Furthermore, AGE (t-value = 2.203) found significantly positive to segment reporting thus contributes to the extent of segment disclosure in the country as hypothesized in H5.

The last variable in the regression ROI (t-value = 1.219) indicates no association between profitability and the extent of segment reporting in Nigeria. The study supports the findings of Ibrahim (2014) and Prencipe (2004) that company size, auditor type and industry type influence disclosure practice.

Table 3. Regression analysis based on ordinary least square (OLS)

| Variables | Estimated co-efficient | t-value |
|-----------|------------------------|----------|
| INDTYPE | .081 | 2.856*** |
| ATYPE | .075 | 2.004*** |
| FSIZE | .626 | 5.804*** |
| LVRG | .127 | 1.306** |
| AGE | .091 | 2.203*** |
| ROI | .052 | 1.219 |

N=97

ADJ R² = 0.475

Sig= .00

***Significance at 1% level

**Significance at 5% level

5. Determination of the CODM

In UK the FRRP (2010) has express concern over the preparation of financial report by prepares of financial information need to be clear of who the CODM was. The CODM is to ensure that information which is communicated to users can be understood and interpreted appropriately.

Figure 1: Represent the capture for the CODM identity of the sample companies. Large proportion of the sample, representing 38% indicates BOD as their chief decision maker followed by the management representing 22% of the sample. 11 (11%) companies did not clearly disclose who the CODM was.

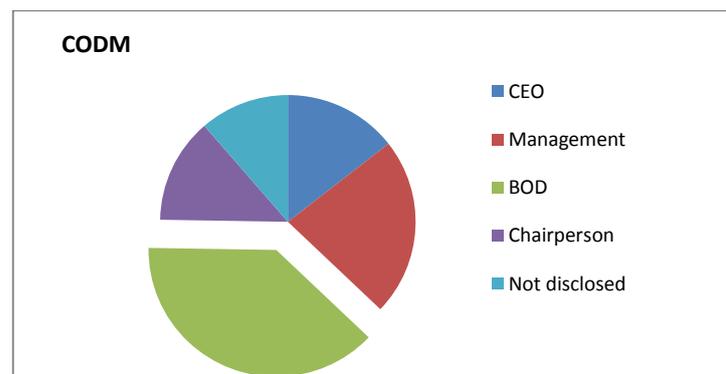


Fig. 1 Identity of the CODM

The figure shows that over 80% of the companies (86) identified the CODM in their financial statement, and majority of companies identified BOD as their CODM. Thus there is variation in the identity of CODM.

6.0. Summary and Conclusion

Result based on regression model for the mandatory disclosure measure indicate that with exception of leverage and return on investment all variables (industry type, auditor type, firm size and age) are associated with mandatory disclosure this is similar with the findings of Prencipe (2004) That firms characteristics impacts on segment disclosure. The significant association with auditor type provides evidence for increase disclosure in companies' annual report. The negative association with ROI confirms that firms with lower profitability disclosed more segment information than companies with higher profitability.

The study findings further indicate that listed companies in Nigeria adhered to international financial reporting standards that impact on the significant of uniformity and

quality financial reporting thus allowing users to develop more confidence in companies' financial statement. The study suggest that financial and economic activities will increase as the study provides insight that mandatory disclosure impact positively on the level of segment reporting in relation to various firms' characteristics as discussed.

Furthermore, the study finding shows that many Nigerian listed companies identify who the CODM was and there is variety in the identity of the CODM among the sample companies. Thus majority of the sample indicate board of director as their CODM.

Future research could usefully explore the relationship identified in the study in greater depth through industrial sector. There are limitations in the research the study focuses on corporate annual reports and further studies may consider smaller firms. There will be other factors that may affect companies' segment disclosure practice that have not been examined in this study.

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