
Determinants of Compliance with Disclosure Requirements of IFRS 4: Evidence from Quoted Insurance Companies in Nigeria

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Abstract

This study examined the determinants of compliance with disclosure requirements of International Financial Reporting Standard (IFRS 4 - Insurance contracts) among quoted insurance companies in Nigeria. The study population comprised of the 30 listed insurance companies in Nigeria with 19 companies randomly selected as the sample for the study. With the aid of a self-constructed compliance checklist, an index was derived to quantify the level of compliance with disclosure requirement of IFRS 4; after applying the checklist to the 2012-2017 annual reports of sample companies. The study used regression technique to examine the influence of the four company attributes on the extent of compliance. The results showed an aggregate mean compliance of 80.38% to IFRS 4 disclosure requirements. A significant positive relationship was found between the level of compliance and company liquidity, and profitability (both at 5% level of significance), while a significant negative relationship was found between company leverage and extent of compliance (at 10% significance level). The study recommended among others that; regulators' compliance enforcement and monitoring mechanism be improved upon, as well as exercising great caution and put in more attention while assessing the disclosure compliance of highly leveraged companies.

Keywords: Determinants, Disclosure Requirements, IFRS 4, Quoted Insurance Companies in Nigeria

Introduction

The primary objective of insurance is to provide economic protection from identifiable risks that may occur during a specified period. The industry has continued to play a significant role, both in private and public sectors of any economy. It is in recognition of the increasing role of the industry to the development of global economy that International Accounting Standards Board (IASB) issued International Financial Reporting Standard 4 (IFRS 4): Insurance Contracts, with the aim of specifying financial reporting guidelines for companies issuing insurance and reinsurance contracts, so as to globally harmonise accounting and financial reporting practices within the industry.

More so, globalisation and development in business world have made financial statements of companies become very vital; not only to shareholders but also to several other stakeholders such as potential investors, creditors, tax authorities, financial institutions, financial analysts, and many more. The statements therefore, need to satisfy the individual requirements of users, but this was often difficult, due to variations in the methods, manner, process, and forms of the preparation

and presentation of financial reports. Sometimes, even the reporting preferences varied from company to company. Consequently, the reports instead of showing what is expected ended up showing what the chairmen/directors of companies wanted to be shown. This was observed by Brigham (1996); who criticised some reports for lacking uniformity and authenticity.

Accounting information is expected to provide a wide range of users with useful information to help them make informed economic decisions. The IASB's framework for the preparation and presentation of financial statements states that; the objective of financial statements is to 'provide information about financial position, performance, and changes in financial position of an entity that is useful to a wide range of users in making informed economic decisions' (IASB, 2001). Hence, any event that is likely to affect a company's current financial position or future performance should be reflected in its financial statements.

In addition, corporate image can be measured and enhanced by the quality and quantity as well as timeliness of information it discloses in its financial report. Compliance with relevant financial reporting standards guarantees

accurate, relevant and reliable disclosures, which are seen as means of enhancing corporate image, reducing cost of capital, and magnifying market value of the reporting entity's shares. High-quality accounting information facilitates the acquisition of short and long term fund and also enables management to properly account for the resources put in their care. Thus, it acts as a significant spur to the growth and development of money and capital markets, which are fundamental to the smooth running of any economy. The quality, usefulness and reliability of financial reports are guaranteed by strict adherence to relevant accounting and financial reporting standards in the preparation and format of presentation of such financial reports (Saidu&Dauda, 2014). These financial reporting standards are aimed at ensuring disclosure of information that would be needed by varying categories of users for the purpose of making informed decisions. This is only achievable if companies are fully complying with the requirements of these standards, and disclosing the required information to users. Conversely, rather than complying with the requirements of the standards to produce neutral and reliable financial statements, companies violated these standards and resorted to dubious or distorted accounting practices, such as income smoothening, recognition of unearned incomes, window dressing, etc. which are departures from accounting standards (Kantudu, 2006), and therefore an issue of non- or partial compliance to accounting standards. The negative consequences of violating the accounting standards resulted in accounting scandals which involve the use of complex methods for misusing or misdirecting funds, overstating revenues, understating expenses, overstating the value of corporate assets or underreporting the existence of liabilities, sometimes with the cooperation of officials in other corporations or affiliates. Accounting scandals mostly arise when financial reporting standards are violated. Series of corporate scandals like the case of Enron and that of Worldcom on international level, and the national level (such as the case Cadbury Nig. Plc). Other notable accounting scandals around the world include that of NuganHand Bank, Bank of Credit and Commerce International, Cendant, Freddie Mac, and Parmalat and these cases are related to non-compliance with accounting standards; thus triggering studies to

test compliance with accounting standards (Rehman, 2014).

There appears to be dearth of studies on determinants of compliance with IFRS 4 disclosure requirements. Majority of the few studies on IFRS compliance (such as Kantudu, 2006; Kandutu & Tanko, 2008; Paugam&Ramond, 2015; Mazzi, André, Dionysiou, & Tsalavoutas, 2015) concentrated on the extent of compliance with accounting information disclosure requirements. This study attempts to contribute to this knowledge gap. It is in this light that the current study examines the determinants of compliance with disclosure requirements of IFRS 4 among quoted insurance companies in Nigeria.

Consequently, the study hypothesised that Nigerian listed insurance companies do not fully comply with disclosure requirements of IFRS 4, and that company attributes (leverage, profitability, liquidity, and size) are not determinants of the extent of compliance with disclosure requirements of IFRS 4

Literature Review

Accounting Information and Benefits of High Quality Financial Reporting

The value of accounting information cannot be easily quantified. This is because the information assists users in making economic, social and political decisions, which involve huge amount of money. Accounting information refers to information on financial or economic activities of an organization which is identified, measured and communicated to users to enable them make an informed judgment about the business or organization (Saidu&Dauda, 2014)). Several systems such as bookkeeping, management information system and computerized accounting systems are used to capture and record economic transactions for communication to various groups interested in such information. The users can be either internal (management, employees etc.) or external (shareholders, potential investors, creditors, government agencies, trade unions, etc.) (Rehman, 2014)

High quality financial reporting reduces information asymmetry. Information asymmetry, as used in the context of this study, is a condition whereby managers (insiders) possess greater information about the firm and its operation than those external to the firm (e.g., investors, market makers, analysts). Since

investors and owners often demand information from firms then, all other things being equal, increasing the quality of information reduces information asymmetry and hence lowers the firms' cost of capital. This position was also advocated by Easley and Ohara (2003). Hence, Cohen (2003) and Saidu & Dauda, (2014) both concluded that by providing quality financial reports which helps investors in their decision making, a firm can reduce information asymmetry between itself and market participants and between informed and uninformed investors. This view was equally supported by the studies of Christopher, Rasoul, David, and Ajay (2008) and Paugam and Ramond (2015) which concluded that compliance with disclosure requirements of IFRS reduces information asymmetry. On a similar note, Dariush (2014) also concluded that disclosing financial information in a reliable and timeliness manner decreases information asymmetry in form of earning quality.

Moreover, quality financial reporting has an advantage of increasing the confidence of analysts in the accounting figures reported by companies. Cohen (2003) documented that firms choosing to report high-quality financial information enjoy a lower level of analysts forecast dispersion meaning that investors form more precise beliefs about future earnings of such companies. This finding is consistent with Christopher, Rasoul, David, and Ajay (2008) which concluded that compliance with IFRS disclosure requirements enhances the ability of financial analysts to provide more accurate forecasts.

Further still, Mazzi, André, Dionysiou, & Tsalavoutas, 2015 argued to the effect that firms providing high quality accounting information enjoy a lower cost of capital. According to him, reporting quality is an information risk factor which is priced by capital market participants, over and beyond additional risk factors priced by the market, such as beta and firm's size. Leuz and Verrechia (2004) equally established a negative correlation between disclosure and company-specific information risk and the cost of equity capital. Also, Greg (2013) concluded that where price risk cannot be avoided by investors, cost of capital is decreasing in disclosure quality.

Theoretical Background

The study is rooted in signalling theory. The theory tries to explain disclosure of accounting information by reporting entities. The argument of the theory is that companies disclose information in financial statements to signal superior performance to shareholders, potential investors and other market participants (Hughes, 1986 in Barde 2009). The theory suggested that managers of more profitable companies wish to signal their success and strength to outsiders, companies with larger profits are more likely to disclose more information. Moreover, in order to justify their position and compensation package, managers of more profitable companies are expected to disclose more information thereby complying with information disclosure requirements. However, economic theory equally discusses the determinants of disclosures as it provides theoretical explanation for voluntary and mandatory disclosures. The advocates of the theory suggest that asymmetric information leads to agency conflict, and increase company's cost of capital. More disclosures bring about increased level of precision and the likelihood for a reduced information asymmetry; and therefore reduce the information asymmetry component of firm's cost of capital ((Leuz & Wysocki, 2016)

Empirical Discussion

Sani and Umar (2014) assessed the extent to which Nigerian banking industry complied with procedures to be followed by entities adopting IFRS, as captured in IFRS 1: First Time Adoption of IFRS. The study employed qualitative grading system to determine the degree of compliance, while multivariate regression and chi-square were used in measuring the effect of factors responsible for compliance. They conclude that Nigerian banking industry complied (semi-strongly) with the requirements of IFRS framework, and established lack of in-depth IFRS knowledge, as a major challenge affecting the exercise. The study also found amenability, globalisation, and response to user's needs, as factors significantly influencing the level compliance by Nigerian banks.

Volkan and Oguzhan (2014) investigated the extent of compliance with IFRS by listed companies in Turkey. The study employed self-disclosure compliance index and multivariate

regression to examine the degree of compliance and relationship between the level of compliance and five firms attributes respectively. The study reported a 79% compliance level. Also, the extent of disclosure is associated with company leverage, and audit firm size, while profitability, company size, and company age were not significant in explaining the level of disclosure compliance with IFRS. However, leverage was significant but in the opposite direction. The study suggested that national monitoring and enforcement mechanisms in Turkey need to be improved.

BudarajandSarea (2015) examined the association between five firms' specific characteristics and the level of compliance with International Accounting Standards (IAS 18) by listed firms in Bahrain Bourse. A self-constructed compliance checklist was developed and the compliance index was derived to represent the level of compliance to IAS 18 disclosure requirements among publically traded firms in Bahrain Bourse for the year 2013. The study reported an aggregate mean compliance of 63% to IAS 18 disclosure requirements. A significant positive relation was found between the level of IAS 18 disclosure and a company's size and auditor type, and could not establish a significant relationship between the level of disclosure and a company's profit or age.

Bearing these in mind, assessment of compliance with disclosure requirement of IFRS 4 lacks sufficient attention in the literature, hence, the major focus of this study. This will enable policy makers to measure the adequacy of their compliance enforcement mechanisms for better results

Methodology

Model Specification

The model used for the study is built on the work of Budaraj and Sarea (2015) which was modified as follows;

$$DCI = \beta_0 + \beta_1 CSize_{it} + \beta_2 CProfit_{it} + \beta_3 CLevrg_{it} + \beta_4 CLiqdity_{it} + \epsilon_{it}$$

Where:

DCI = Disclosure Compliance Index

β_0 = Intercept

CSize = Company Size

CProfit = Company Profitability

CLevrg = Company Leverage

CLiqdity = Company Liquidity

$B_1, \beta_2, \dots, \beta_4$ are parameters being estimated

ϵ_{it} = Component Error Term given as $\mu_i + V_{it}$

A priori: $B_1, \beta_2, \dots, \beta_4 > 0$

The population of the study comprised of all the 30 insurance companies that are quoted on the Nigerian Stock Exchange (NSE) as at the time of conducting this study. A total of 19 companies (constituting over 60% of the population) emerged as sample for the study out of the quoted insurance companies on the Nigeria Stock Exchange. Secondary data was obtained through a content analysis of annual reports and accounts of the sample companies to establish compliance with disclosure requirements of IFRS 4, as well obtaining information on company attributes (leverage, profitability, liquidity, and size). In analysing the data collected for the study, both descriptive and inferential (panel least square regression analysis) statistical methods were used.

Measurement of Variables

The dependent variable for this study is the extent of compliance with disclosure requirements which is measured by disclosure compliance index while the independent variables are leverage, profitability, liquidity, and size. Their respective proxies are discussed as follows;

Disclosure Compliance Index

Following the prior researches, this study adopted "dichotomous" disclosure index approach. Consistent with Kantudu (2006), Lopes and Rodrigues (2007) Barde (2009), Izzo, Luciani, & Sartori, (2013) and Koch (2018), a value of ten (10) was assigned if the company completely complied with a disclosure requirement (R) and zero otherwise, when a disclosure is deemed irrelevant for a specific company, then the item is ignored in the computation of the index for that company. To determine the degree of application or compliance with disclosure requirements of IFRS 4, the aggregate score per requirements (R_1 to R_{13}) was taken and weighted against the expected degree of application, then the result was expressed on a scale of 100 to enhance its comprehensibility. Hence, the following compliance grading/weighting formula was used to achieve this objective; consistent with Saidu and Dauda (2014) and Koch (2018);

$$Dc = \sum_i^n \frac{Ara}{Mra} \times 100$$

Where:

Dc = Disclosure compliance

∑ = Summation or addition

n = Number of expected requirements to be complied

Ara = Actual number of requirements complied with

Mra = Maximum number of requirements expected to be complied with

The Independent Variables

Table 1 presents the summary of independent variables and their proxies;

Table 1: Independent Variables

| Variable | Proxy |
|---------------|---|
| Company size | Natural log of Total Assets |
| Profitability | Return on Equity (ROE)= Net profit/Shareholders' equity |
| Leverage | Debts to equity ratio |
| Liquidity | Current assets to current liabilities ratio |

Source: Volkan and Oguzhan (2014) and Budaraj and Sarea (2015)

Table 3: Summary Statistics of Disclosure Compliance Index

| | Aggregate Mean Compliance | Max. | Min. |
|----------------------------------|---------------------------|------|-------|
| IFRS 4 Disclosure Compliance (%) | 87.48 | 100 | 79.43 |

Source: Author's computation, 2019

The aggregate mean of sample companies' compliance with disclosure requirements of IFRS 4 was 87.48%, and ranged from total compliance (100%) to 79.43% (moderate).

Results and Discussion

Results of Preliminary Test

The results of Hausman test conducted for the model are presented in table 3.

Table 2: Hausman Specification Test

| Correlated Random Effects | | |
|-----------------------------------|---------------|--------|
| Test cross-section random effects | | |
| Test Summary | Chi.Sq. Stat. | Prob |
| Cross-section random | 1.651691 | 0.7995 |

Source: Author's computation, 2019

The null hypothesis for the Hausman test is that random effect model (REM) is appropriate. The P-value of the test is 0.7995 which is statistically insignificant; hence the null hypothesis is hereby accepted. Therefore, fixed effect model is considered inappropriate and random effect model is preferred.

Summary Statistics of Disclosure Compliance Index

The table below presents the summary of compliance with disclosure requirements of IFRS 4 by quoted insurance companies.

Therefore, the null hypothesis that Nigerian listed insurance companies do not fully (100%) comply with disclosure requirements of IFRS 4 is hereby accepted.

Table 4: Regression Results

Dependent Variable: Disclosure Compliance Index (DCI)

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|------------|-------------|----------|
| C | 93.96446 | 11.32738 | 8.295340 | 0.0000 |
| LEVERAGE | -0.913337 | 0.458890 | -1.990318 | 0.0515** |
| ROE | 2.912368 | 1.092088 | 2.666789 | 0.0100* |
| LIQUIDITY | 2.904540 | 1.258898 | 2.307208 | 0.0248* |
| NLOGTA | -0.212368 | 1.122088 | -0.189261 | 0.8510 |
| R-Squared | 0.939579 | | | |
| Adj. R-Squared | 0.900482 | | | |
| F-statistic | 24.03245 | | | |
| Prob(F-statistic) | 0.000000 | | | |
| Durbin-Watson stat | 2.307428 | | | |

Source: Author's computation, 2019

*Significant at 5% ** Significant at 10%

The panel regression results presented in Table 4 above has an R^2 of 0.93 which suggests that a 93% explanatory ability of the independent variables (LEVERAGE, LIQUIDITY, ROE and NLOGTA) of the model for the systematic variations in the dependent variable (DCI) with an adjusted value of 0.90. The F-stat value of 24.03 and the associated P-value of 0.00 is less than 0.05, hence, the joint statistical significance of the model and that significant linear relationship exists between the dependent and independent variables can be accepted. In other words, the hypothesis of a significant linear relationship between the dependent and independent variables could not be rejected at 5% level. The Durbin-Watson statistics of 2.3 indicates that the presence of first order serial correlation is unlikely in the model.

As observed, company leverage (LEVERAGE) had a negative coefficient of (-0.9133) and significant at 10% level ($P=0.0515<0.1$), this result implies that increase in debts to equity ratios would induce a reduction in the level of compliance with disclosure requirements of IFRS 4. Therefore, the null hypothesis which states that company leverage does not have a statistically significant influence on the level of compliance with disclosure requirements of IFRS 4 is failed to be accepted. However, company profitability (proxied as ROE) had a significant positive coefficient (2.9124) and significant at 5% ($P=0.01<0.05$). This suggests that as company's activities become more profitable, the level of compliance with disclosure requirements of IFRS 4 also increases. Consequently, the null hypothesis

which states that profitability of companies does not have a statistically significant influence on the level of compliance is hereby failed to be accepted.

Similarly, company liquidity (LIQUIDITY) had a positive coefficient (2.9045) and significant at 5% ($P=0.0248<0.05$). This also implies that an increase /improvement in the liquidity position of a company would bring about increase in the level of compliance. In the same vein, the null hypothesis which states that company liquidity does not have a statistically significant influence on the level of compliance with disclosure requirements of IFRS 4 is hereby failed to be accepted.

Finally, company size (NLOGTA) which was added as a control variable, is observe to be statistically insignificant. This implies that size of a company does not have any statistically significant influence on the level of compliance with disclosure requirements of IFRS 4

The disclosure compliance index showed an aggregate mean of 87.48%. In line with the scaling used by Rahahleh (2010), the compliance level was high. The results were better than what was reported in previous local studies (76.9%; Kantudu&Tanko, 2008, and 34.76%; Siyanbola, Musa, &Wula, 2014). Also, the compliance level were better than those reported by some foreign studies such as Al-Shammari, et al (2008), Mishari (2009), Al-Shammari (2011), and Budaraj and Sarea (2015) amongst others. The negative relationship between company leverage and the extent of compliance with disclosure requirement found in this study is in tandem

with Demir and Bahadir (2014), and Budaraj and Sarea (2015) which both found a negative relationship between leverage and compliance level. Study by Mishari (2009) produced a conflicting result, by concluding that highly leveraged firms are more likely to comply with disclosure requirements.

Furthermore, this study also found a positive relationship between company profits and the extent of compliance with disclosure requirements. This finding is in compliance with prior conclusions of Mishari (2009), and Yiadom and Wisdom (2014), where profitability was found to be positively associated with the level of compliance with IFRS. On the contrary, Sucuahi (2013), and Volkan and Oguzhan (2014) could not establish a significant influence of company profits on the extent of compliance.

In addition, the regression results showed a significant positive relationship between liquidity and the level of compliance. The results of the study validate the prediction of signalling theory which supports that profitability and liquidity influence the extent of disclosure compliance on the ground that managers of liquid and profitable companies are willing to disclose more accurate information about their financial strength to justify their positions and pay packages. Also, highly indebted companies are hesitant in complying fully with disclosure requirements because of fear of losing investors' confidence, hence some information is not shown on the face of financial statements.

CONCLUSION

Going by the result of data analysis, the study concludes that the level of disclosure compliance varied among companies; while some were fully complied, others were not, with the aggregate mean of the level of compliance being 87.48%. The results showed that there is a significant positive relationship between company liquidity, company profits and the extent of compliance, as well as a significant negative relationship between company leverage and the level of disclosure compliance. The regulator's (FRCN) nationwide monitoring and enforcement mechanisms need to be improved upon. Although, the aggregate mean compliance was not too low, mandatory disclosures are meant to be fully (100%) complied with.

The study was however conducted using a relatively small sample and within a subsector of financial services sector. Future studies may consider a larger sample size, as well as extending the investigation to other key sectors of the economy.

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