

AN EMPIRICAL STUDY ON THE INFLUENCE OF IFRS AND REGULATIONS ON THE QUALITY OF FINANCIAL REPORTING OF LISTED COMPANIES IN A DEVELOPING COUNTRY

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Abstract

This research sought to establish if International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and regulations in Zimbabwe have been associated with increased financial reporting quality for listed companies. The study adopted mixed research approach. Questionnaires and unstructured interviews were used as research instruments to collect primary data. Content analysis was also adopted to triangulate the results. Target population was the listed companies in Zimbabwe. The study found a significant negative relationship between voluntary adoption of IFRS and earnings management of listed companies in Zimbabwe. The negative relationship may indicate that IFRS does not promote earnings management for voluntary adopters, thereby implying an increased financial reporting quality. It is recommended that top management, external auditors and regulators being the key players in standards, should work together and tighten compliance so that impact of IFRS could be felt more.

Keywords: Compliance, IAS, IFRS, IASB, Reporting

1. INTRODUCTION

The International Accounting Standards (IAS)/IFRS and regulations have been a subject of great interest to policy makers and researchers because of their importance to quality financial reporting. Following the mandatory adoption of IFRS in many regions of the world, much attention is being given to the association between accounting standards and accounting quality (Daske et al, 2009; Bath et al, 2008; Li, 2010). Jeanjean and Stolowy (2008) found that the pervasiveness of earnings management did not decline after the introduction of International Financial Reporting Standards (IFRS) in the UK and Australia and in fact increased in France suggesting that the adoption of IFRSs does not lead to improved information quality. Soderstrom & Sun (2007) concur with Jeanjean arguing that a single set of standards may not be suitable for all settings and thus may not uniformly improve the quality of financial reporting due to differences among countries. While most literature has focused on the impact of the adoption of IFRS, few researchers have examined other factors that relate to the nature of financial regulation processes that also directly and indirectly impact quality of financial reporting. Horton, Sarafeim & Sarafeim (2012) assert that financial regulations improve quality of financial reporting and will continue in the key capital markets. Sun et al (2011) also assert that enforcement of accounting regulations is expected to be associated with the quality of financial reporting because strong

regulations reduce instances of financial reporting and related fraud which in turn increase the reliability of financial reports (Ball, 2001).

Unlike previous studies, this study sought to tie up the two independent variables (accounting standards and regulations) on quality of financial reporting of listed companies specifically in Zimbabwe as Chinamo, chief executive officer of SECZ has expressed a concern that financial statements of listed companies do not do any good because they don't contain sufficient information investors need to know (Financial gazette 29/08/13).

While the number of public companies announcing financial restatements from 2010 through September 2014 rose from 3.7 percent to 6.8 percent, restatement announcements identified grew about 67 percent over this period (financial gazette 2014 29/10/). Industry observers noted that increased restatements were an expected byproduct of the greater focus on the quality of financial reporting by company management, audit committees, external auditors, and regulators. SECZ (2013) also highlighted that poor financial reporting quality is deterring both foreign and local investments. In its 2013 June report to investors, SECZ reported a decrease in investment from 47% in December 2012 to about 40% in March 2013 due to poor financial reporting which fail to restore investors' confidence. The ZSE has also engaged a panel of experts, chaired by Simon Hammond, who is also the managing director of Old Mutual Shared Services, to review the level of disclosure by listed

companies. Hammond told The Financial Gazette (2013) that listed companies would be required to submit their results to the review committee, which would go through the financial reports before they are made available to the public. In 2011, SECZ has also engaged South African and other local experts to look into the status of the half year and full year financial results.

The theme of this research was to identify whether there was less earnings management, as a result of the adoption of International Accounting Standards and perceived compliance to regulatory framework by listed companies in Zimbabwe.

2. STATEMENT OF THE PROBLEM

International Accounting Standards were meant to improve the quality of financial reporting. However, despite the uptake of the accounting standards and perceived compliance to regulations by the listed companies on the Zimbabwe stock exchange, over 10 companies have been delisted from the ZSE in the past five years due to failure to make appropriate disclosure in terms of financial reporting. Chinamo, chief executive officer of SECZ has expressed a concern that financial statements of listed companies do not do any good because they don't contain sufficient information investors need to know (Financial gazette 29 August 2013). Therefore, it is a concern that little has been done to understand the causes of persistent poor reporting quality by listed companies.

3. OBJECTIVES

- To analyze the relationship between accounting standards and financial reporting quality
- To examine the relationship between regulations and financial reporting quality
- To analyze the relationship between accounting standards, regulations and financial reporting quality

4. RESEARCH METHODOLOGY

4.1. Research Design

Research designs are systematic plans and procedures for research that span the decisions from broad assumptions to detailed methods of data collections and analysis. In this study correlational case study was adopted.

Research Approach

Mixed approach was adopted and found ideal for this study since it filters out external factors such as incentives that may trigger the relationship between IAS/IFRS and financial reporting. More importantly the use of standard measures like earnings management ensures reliability and validity. Harri (2011) asserts that mixed approach research ensures greater objectivity, accuracy and eliminates bias and the weakness of each is worked out by the other.

Study Population and Sampling

The Zimbabwe Stock Exchange (ZSE)'s 60 companies constitute the universe of the study. In this context,

population refers to Zimbabwe listed firms with annual financial and stock information available on Zimbabwe Stock Exchange (ZSE) for 2012-2014 periods. More importantly the study shall concentrate on only Zimbabwe Stock Exchange excluding other stock exchange where the companies are listed.

Sample Size

The study shall focus on a single country Zimbabwe and this allows the researchers to control institutional, socio-economic and political factors that may affect the firm's financial reporting and capital market participants' investigating behavior and that are thorny to control for international comparative study. A convenient sample of 10 companies constituted the study out of a total population of 60 companies. The companies that constituted the sample were chosen because of their proximity since the study had to be completed within a specified period of time. The companies varied in size; therefore, small companies received 1 questionnaire whilst big companies received 4 questionnaires. There was no formula used to determine the number of questionnaires to be distributed per each company. Initially each company was supposed to receive one questionnaire but however the researchers found that some of the companies were very big hence decided to increase to four the number of questionnaires to be distributed to such big companies.

5. SOURCES OF DATA

Primary data

In this research the primary data was gathered through questionnaires and personal interviews. This study utilised primary data collection sources as these sources provide information reliable to the study and the information that met the needs and objectives of the researchers.

Secondary data

Secondary data used comprised of membership documents and reports, budgets, chambers of commerce reports and journals and other documents which were published on capital market. Secondary data was used as it avoids confrontational bias encountered in interviews. It is also cost saving, less time consuming and it is convenient.

6. PRESENTATION OF RESULTS

This section of the study set out to deal with data presentation, analysis, interpretation and discussion of the findings collected from the field in an attempt to determine how IAS/IFRS and regulations impact the financial reporting quality of listed companies in Zimbabwe. Data presentation shall be in the form of charts, tables and percentages. STATA 12 was used to compute the coefficient of variation between variables.

Response rate

In a narrower context response rate is defined as the percentage rate of the number of participants who managed to complete research instruments as compared to the number of participants who were

asked (Armstrong et al, 2011). According to (Atwood et al, 2011), response rate is rated as follows: 50% rated adequate, 60% good, 70% very good and 80% and above being excellent. Questionnaires and unstructured interviews were employed in the data

gathering of primary data for this study. The questionnaires were administered to Accounting department personnel and internal audit departments.

Table 1. Questionnaire Response Rate

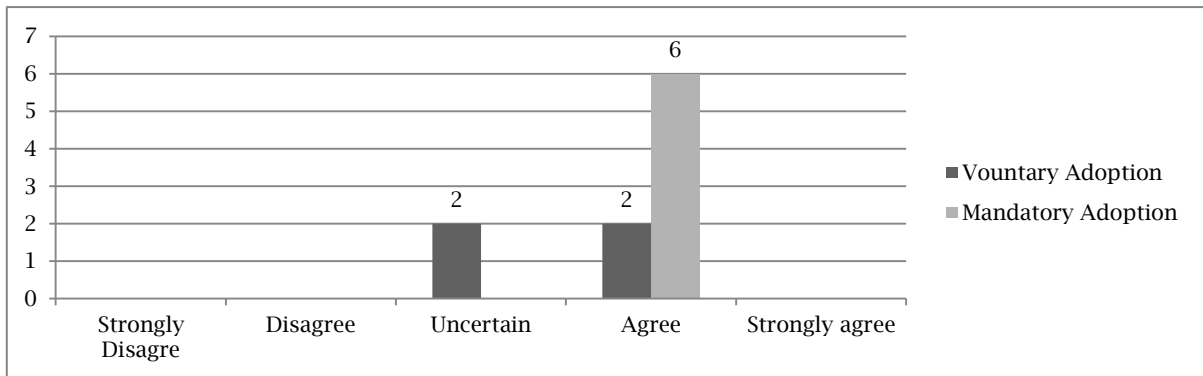
Category of participants	Questionnaire distributed	Completed &Returned	Response Rate
Agriculture	2	2	100%
Industrial Technology	1	1	100%
Conglomerates	1	0	0%
Insurance	2	2	100%
Retail	4	3	75%
Finance	4	3	75%
Hotel & Leisure	1	1	100%
Total	15	12	80%

Table 1 above shows that out of 15 questionnaires distributed, 12 were completed and returned and 3 were not completed, representing 80% response rate which is well above 67% recommended by Byard et al (2011). To concur with the above (Chen et al, 2010) also suggest that 75% or more response rate is suitable and can provide validity and reliability to the instruments used.

Respondents' views on the adoption criteria used by the listed companies

The respondents were asked to indicate which adoption criterion was used by their companies between voluntary and mandatory adoption. The respondents' answers are expressed in the following graph:

Figure 1. Respondents' view on IFRS adoption criteria used by companies



Company A agreed that mandatory adoption of IFRS was used by the company. Company B was not certain on which adoption criterion was used by the company to adopt IFRS. Company C agreed that mandatory adoption was used by his company. Company D agreed that the company used voluntary adoption of IFRS. In summary 60% agreed that mandatory adoption was used, 20% agreed that voluntary adoption was used and 20% were uncertain. The responses above point out different adoption criteria within the selected listed companies. The first explanation for these different results could be lack of effective communication on IFRS implementation within the sector. The second explanation could be lack of knowledge on IFRS among the companies. To concur with the above IFRS (2012) states that IFRS were mandatorily adopted in 1993 and legally put in place in 1996 with the publication of the statutory instrument. In the same line of thought Chamisa (2000) postulates that mandatory adoption criteria were used by Listed Companies in Zimbabwe.

Accounting Standards and Financial reporting quality

The following two hypotheses are going to be first tested using both quantitative secondary and primary data obtained from the field.

H1: Accounting standards have significant positive relationship with earnings management

H2: Accounting standards have significant negative relationship with earnings management

Quality financial reporting is measured by earnings management which is then measured using the ability of firms to meet investors' earnings expectations. Regression model that is used in this study is as follows:

$$Em = a + a(Ma) + b(VO) + c(C)$$

Where Em refers to earnings management, Ma refers to mandatory adoption, VO refers to voluntary adoption and C refers to convergence of IFRS

Respondents' views on how mandatory adoption of IFRS impact Financial Reporting Quality

Table 2. Regression results for mandatory adoption

<i>Meet earnings expectations</i>	<i>Coef.</i>	<i>Std. Err.</i>	<i>T</i>	<i>P>t</i>	<i>[95% Conf.</i>	<i>Interval]</i>
Mandatory adoption	0.25	0.497389	2,3	0.629	-0.89698	1.396981
_cons	2.75	2.300928	1.2	0.266	-2.55595	8.05595
			R ² =0.73			

Source: Stata 12

The above table shows the statistics results computed by STATA 12. The prime motive is to test the hypothesis that there is significant relationship between IFRS /IAS and earnings management. For the above calculation, earnings management is treated as dependent variable and voluntary adoption of IFRS is treated as independent variable. The results show that there is a significant positive relationship between mandatory adoption of IFRS and earnings management. This is indicated by a positive coefficient of variation of 0.25 which is 25% (0.25*100) and 2,3 T value in accordance to T2 rule of thumb there is significant relationship if the t value is greater than(+-2). To concur with the above results, JeanJean and Stolowy (2008) postulate that

preciseness of earnings management did not decline as a result of mandatory introduction of IFRS. In the same context, Zeghal (2011) examined the impact of mandatory adoption of IAS/IFRS on financial reporting quality in France and found that mandatory adoption of IFRS was linked with increased earnings management and therefore decreased quality of financial reporting. The R2 value is 0.73 which suggest that about 73% of the variation in earnings management is explained by the variable employed in the model which is a good fit.

Respondents' views on how voluntary adoption of IFRS impact quality of Financial Reporting

Table 3. Regression results for voluntary adoption

<i>Meet earnings expectations</i>	<i>Coef.</i>	<i>Std. Err.</i>	<i>T</i>	<i>P>t</i>	<i>[95% Conf.</i>	<i>Interval]</i>
Voluntary adoption	-0.66667	0.430332	-2.55	0.219	-2.03617	0.70284
_cons	4.333333	1.905159	2.27	0.107	-1.72973	10.3964
			R ² =	0.75		

Source: Stata 12

The above results show significant negative relationship between voluntary adoption and earnings management. Earnings management is treated as dependent variable and voluntary adoption is regarded as independent variable. To concur with above results, Christensen (2008) and Gjerde (2008) also found a decrease in earnings management for the firms that voluntarily adopted

IFRS but increase in earnings management for those firms that mandatorily adopted IFRS in Germany. In terms of the adequacy of the model, the results show that about 75% of the variation in earnings management is explained by voluntary adoption.

Respondents' views on how convergence of IFRS impact quality of Financial Reporting

Table 4. Regression results for convergence of IFRS

<i>Meet earnings expectations</i>	<i>Coef.</i>	<i>Std. Err.</i>	<i>T</i>	<i>P>t</i>	<i>[95% Conf.</i>	<i>Interval]</i>
Convergence of IFRS	0.333333	0.860663	0.39	0.724	-2.40568	3.072347
cons	2.333333	3.810317	0.61	0.584	-9.7928	14.45946
			Adjusted R ² = 0.72			

According to the above results there is a positive relationship as indicated by positive coefficient of variation of 0.33. But the relationship is not significant as indicated by 0.39 t value which is well below the threshold of the t value rule of thumb of 2. This implies that IFRS convergence cannot significantly trigger a change in earnings management. This was also indicated by Goodwin et al (2008) and Hail et al (2010) who found similarities in earnings management before and after IFRS convergence in Germany. The results also show that the model is good given that about 72% of the variation in the dependent variable is explained by the independent variable.

Relationship between regulatory framework and quality of financial reporting

The following hypotheses are to be tested to determine the direction and nature of the relationship between regulations that govern listed companies in Zimbabwe and financial reporting quality:

H3: *There is significant positive relationship between regulatory framework and financial reporting quality*

H4: *There is significant negative relationship between regulatory framework and financial reporting quality.*

The following proxies are used to measure financial reporting quality:

Panel A-relevance, Panel B-reliability, Panel C-comparability and Panel D-understandability

Table 5. Regression results

	Quality of financial reporting	Significant level
Panel A		
Relevance as a measure FRQ Regulatory framework	0.69	0.12
Company Act	0.543	0.01
Security Act	0.321	0.03
PAAB	0.623	0
Audit Office	0.024	0.04
Panel B		
Reliability as a measure FRQ Regulatory framework	0.31	0.01
Company Act	-0.342	-0.88
Security Act	0.235	-0.38
PAAB	0.225	-0.05
Audit Office	0.421	0.03
Panel C		
Comparability as a measure of FRQ Regulatory framework	0.56	0.14
Company Act	0.447	1.23
Security Act	0.555	0.77
PAAB	0.547	1.23
Audit Office	0.394	0.07
Panel D		
Understandability as a measure FRQ Regulatory framework	0.157	0.27
Company Act	-0.156	0.07
Security Act	0.152	-0.73
PAAB	0.054	1.23
Audit Office	0.123	-0.88

The above regression results shown in table 5 indicate that there is positive relationship between regulations and financial reporting quality of Zimbabwe listed companies. Panel A results show that there is positive coefficient of 0.69 (69%) between perceived compliance with regulations and financial reporting quality. The significant position is determined by 1% level, therefore the 3rd hypothesis which states that there is significant positive relationship between regulations and financial reporting quality is supported. The outcomes of panel A also show that all components of regulatory framework are positively related with reliability of financial statements. The results in

panel B also show that all elements of regulations are positively related with financial reporting quality but the relationship is not significant as shown by a lower coefficient of variation of 0.31(31%). Panel C uses comparability as a proxy for financial reporting quality and the results show that there is significant positive association between regulations and financial reporting quality of 0.56 (56%).

Interview Response Rate

In this study structural interview were used and the table below shows the interview response rate:

Table 7. Interview response rate

Interviewees	Interview Scheduled	Interview conducted	Percentage response
Accountants and Accountants	15	12	80%

From the interviews conducted by the researchers, 12 out of 15 (80%) interviews were conducted which is also above recommended (Monkey 75%).

Question (a)

What challenges are faced by firms in implementing IFRS in Zimbabwe?

Amendment to existing laws

Company A asserted that amendments to existing laws are a major hindrance to the smooth implementation of country wide. This was also supported by the Financial Controller of company B as she mentioned that IFRS does not recognize the existence of the regulatory framework that govern the accounting practices in Zimbabwe, therefore it is cumbersome to fully comply with IFRS without overriding the provisions of such local laws. The same view was also forwarded by the Accountant of company C, as he highlighted that though the existing local regulations that govern financial

reporting of listed companies have the same objective with IFRS, there is need for continuous assessment as the laws are being amended. This is also supported by Hung et al (2007) who found similar challenges in their study.

Training resources

One of the companies, company A’s internal auditors postulated that in Zimbabwe, Professional Accountants (PAAB) has the mandate to ensure successful implementation of IFRS. Accordingly accountants, financial analysts, auditors, regulators, accounting lecturers, government officials and more other require training on IFRS since they are all responsible for the successful implementation of IFRS. The challenge is that in Zimbabwe there are not enough training resources. Financial Accountant at company D supported the view as he said full implantation of IFRS requires back up of the financial resources to enable all the stakeholders to be trained on how it works and it is a challenge to

developing countries to raise those training resources. Kang (2013) also found similar challenges for the listed companies in Nigeria.

Level of awareness

Company A's accountant asserts that the transition plan to IFRS and its implications for users of financial statements, regulators; preparers of financial statements, shareholders have not been effectively communicated and coordinated. The Audit Department of company E put forward a similar view as they assert that IFRS is a great move towards the improvement of quality of financial reporting, however there is need to effectively communicate to all the stakeholders. The Financial Manager of company B also mentioned the same challenge as he articulated that the level of awareness to IFRS needs to be improved to ensure full adoption.

Question (b)

Do you think IAS/IFRS helps in improving the quality of financial reporting?

Company E agreed that IFRS adoption may improve the quality of financial reporting provided it is successfully implemented. The head of finance department of company F supported the same notion as he mentioned that IFRS is a better move to bring financial reporting to a better level as it enhances comparability of financial statements across countries. The accountant of company G argued that mere adoption of IFRS does not necessarily improve financial reporting. He mentioned that it takes courage and commitment to improve financial reporting. The accountant of company H also mentioned the fact that the provision of incentives is a major factor that determines the quality of reporting. The Financial Manager of company I contended that it depends on IFRS's adoption criteria, with voluntary adoption taking a lead towards the increased quality of reporting. The Financial Manager of company J was uncertain on this issue.

Question (c)

Does perceived compliance to regulatory framework improve the quality of financial reporting?

Company E's Finance member agreed with the notion that there is positive relationship between perceived compliance with regulatory framework and financial reporting quality as it limits the options available to management. Company A's financial controller mentioned the fact that not all regulations components improve the based financial quality of reporting, compliance to PAAB, Audit Office act may improve the financial reporting. Company D's representative agreed that compliance improves reporting quality. Company H's finance manager argued that compliance to regulations does not improve the financial reporting quality as management should have enough mandate to decide on any accounting discretion.

7. MAJOR RESEARCH FINDING

Accounting Standards and Financial Reporting Quality

1. Mandatory adoption of IFRS and earnings management:

The study found a significant positive relationship between mandatory adoption of IFRS and earnings management. This implies that mandatory adoption enables firms to manage earnings thereby reducing the quality of financial reporting.

2. Voluntary adoption of IFRS and earnings management:

The study found a significant negative relationship between voluntary adoption of IFRS and earnings management of listed companies in Zimbabwe. The negative relationship may mean that IFRS does not promote earnings management for voluntary adopters, thereby implying an increase on the quality of financial reporting.

3. Convergence of IFRS and earnings management

The study found a positive relationship between IFRS convergence and earnings management; however, the relationship is not significant. This implies that IFRS convergence cannot necessarily trigger a change to the quality of financial reporting.

8. REGULATIONS AND FINANCIAL REPORTING QUALITY

The study found a positive relationship between all regulatory frameworks' components and the quality of financial reporting. This implies that perceived compliance to regulatory framework is associated with increased quality of financial reporting.

9. CHALLENGES FACED BY FIRMS IN IMPLEMENTING IFRS IN ZIMBABWE

Major challenges that are faced by firms to fully implement IFRS are:

- amendment to existing laws,
- inadequacy of training resources,
- the level of awareness and tax reporting.

CONCLUSION

Conversely to the expectations, the study was unable to find systematic evidence that mere adoption of IFRS results in improved financial reporting quality for mandatory adopters over the period under study (2012-2014). The study found evidence of increased earnings management for firms that mandatorily adopted IFRS and decreased quality of financial reporting for firms that mandatorily adopted IFRS compared to firms that voluntarily adopted IFRS. The study did not find any change in meeting earnings expectations for firms that converge IFRS with local standards. The results consistently indicate decreased quality of financial reporting over time for firms that mandatorily adopted IFRS and consistent less earnings management for firms that voluntarily adopted IFRS. However it is also possible that a strong regulatory framework compensate for

higher quality of financial reporting. The study also acknowledges that IFRS may not be superior to local standards.

RECOMMENDATIONS

It is recommended that:

- Top managers, external auditors and regulators being the key players in standards, need to work together and tighten compliance so that impact of IFRS could be felt more
- Regulators and policy makers should consider revising the local regulations that govern financial reporting of listed companies in Zimbabwe in order to be in line with the IFRS.
- Policy makers should also consider communicating the objectives of IFRS to all stakeholders.
- They should also carry out the awareness campaign to ensure that the corporate world fully implement IFRS.
- Raise awareness of professionals, regulators and preparers to improve the knowledge gap.

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