Adoption of International Financial Reporting Standard for Small and Medium Enterprises in North Central Nigeria: Implications for Financial Reporting Quality

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Abstract

Previous studies have paid little attention to the adoption of International Financial Reporting Standard (IFRS) for SMEs in North-Central geo-political zone of Nigeria. This study investigates level of awareness, challenges and willingness for the adoption of IFRS for Small and Medium Enterprises (SMEs) in North-Central Nigeria, with a view to highlighting the implications of the adoption for financial reporting quality among the SMEs. The outcome variable in the study is financial reporting quality measured by qualitative reporting attributes namely reliability, comparability and understandability. The explanatory and control variables are IFRS awareness, challenges and willingness for the adoption, while others are taxation, entities' size and ownership structure. From the population of 556 registered SMEs in three randomly selected States in the zone, a sample of 307 SMEs was selected for the study. Data were collected through a self-administered questionnaire. Multiple regression analysis was applied to test the study hypotheses. Results show that the financial reporting practice of SMEs in North-Central Nigeria is not only poor, but also majority of the business entities do not prepare financial reports in line with the guidelines of the IFRS for SMEs.

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The study concludes that awareness, challenges and willingness to adopt IFRS are major influential factors on financial reporting quality among the SMEs. It is hereby recommended that SMEs in the North-central Nigeria and the relevant regulatory agencies on their activities should see the adoption of IFRS for SMEs as a top priority in view of the many benefits that are attached to the adoption (especially the World Bank credit availability to SMEs that comply with the provisions of the Standard as they prepare their financial statements).

*Keywords***:** IFRS; SMEs; financial reporting; North central Nigeria.

1. Introduction

International Financial Reporting Standard (IFRS) refers to a set of accounting standards developed by the International Accounting Standards Board (IASB) to be applied when preparing the financial statement and balance sheet of a company [4]. IFRS was developed in 2001 by the IASB in the public interest to provide a single set of high quality, understandable and uniform accounting standards. With the globalization of finance, the adoption of IFRS will enable investors to exchange financial information in a meaningful and trustworthy manner. Adoption of IFRS would facilitate decision-making, there by leading to better accountability and compliance with tax legislation [11].

Recently, the IASB has focused its efforts in attempting to harmonize the financial reporting of non-listed firms by introducing the IFRS for Small and Medium Enterprises (SMEs) as an alternative framework that can be applied by eligible entities in place of the full set of IFRSs. This is a self-contained standard, incorporating accounting principles based on existing IFRSs that were simplified to suit the entities that fall within its scope [5]. Adoption of IFRS for SMEs will help in enhancing the quality and comparability of SMEs financial statement around the world and assist SMEs in gaining access to finance which will not benefit only the SMEs, but also their customers, client and all other users of SMEs financial statement and this brings about growth in every business [8]. The IFRS for SMEs will facilitate the further growth of the SMEs and business sector globally [15]. As observed by [11], the adoption of IFRS for SMEs will not only facilitate decision-making, it will also results into better accountability and compliance with tax legislation.

One significant contribution of the adoption of IFRS for SMEs is improvement in the quality of financial reporting among SMEs. Financial reporting quality refers to quality information about an entity's financial performance and position during a period. Investors and creditors often use information about the past in assessing the prospects of entities [1]. If quality of financial reporting is poor, it will be difficult to determine correctly the net profit of the business. In the absence of financial reporting, entities cannot ascertain whether they are making profit or loss [6].

Studies focusing on the accounting practices of SMEs have provided evidence that majority of the SMEs do not have records of financial statements or the financial position of their business [13,2,3,12]. However, none of the existing studies specifically link the adoption of IFRS and financial reporting quality in North-Central Nigeria. This study addresses the limitation. This study will not only provide additional information required to boosting financial reporting quality in North-Central Nigeria, it will also boost awareness of the importance of adopting

IFRS for SMEs. The study thus intends to provide answer to the question on the extent of awareness; adoption and challenges of IFRS for SMEs with the view of improving financial reporting quality among SMEs in North-Central Nigeria.

The study brings to light the question of whether or not the adoption of IFRS will enhance the financial reporting quality of SMEs in north-central Nigeria and adds to the existing literature on the topic. It also serves as a guide to economic policy makers in making the necessary restructuring of the IFRS for SMEs in Nigeria if need be..

Extant literature on IFRS for SME opines that the distinctive standard are suitable for entities that do not have public accountability and publish general purpose financial statements for external users such as owners, current and potential creditors and credit rating agencies excluding government and tax authorities [9] [7]. IFRS for SMEs is organized in terms of evidence such as record keeping and financial accounting. Large number of studies have shown that SMEs business failure have been attributed to inadequate financial reporting. In a study by [16] a significant number of enterprises do not keep records pertaining to operations reports, financial reports, audited account, tax returns reports because most of them do not prepare a complete set of financial statements with some not preparing any financial statement.

These findings were corroborated in another study by [17] where it was found that many business owners all over the world are daunted by the mere idea of financial report and keeping records of their financial activities. Reference [2] Investigated accounting practices of SMEs in the Kumasi Metropolis of Ghana and found that the enterprises do not maintain proper books of accounts because owners do not appreciate the need to keep accounting records, lacked the necessary accounting knowledge and could not afford the cost of hiring accounting professional.

Reference [10] traced the benefits of IAS and their contribution to harmonization in management decision and influence the business growth in global scale and found that uniform management accounting standard will increase market liquidity, decrease transaction cost for investors, lower cost of capital and facilitate international capital formation and flow reduced cost will also result in more cross-listing and cross-border investigation and concluded that IFRS would create a common language for accounting. New capital market would open to companies who have been reporting in accordance with the national standards. However, in contrast to poor financial reporting practices found among SMEs by [22,18,13] examined financial practice and performance of SMEs in Sri Lanka and assessed the influence of financial practice on business performance amongst SMEs in Sri Lanka. The study ascertained that poor record keeping, inefficient use of accounting information to support financial decision-making and the low quality and reliability of financial data were part of the main problems of the SMEs. The study concluded that financial practice have a direct impact on performance of SMEs in Sri Lanka and recommended the development of proper guidelines for the preparation and presentation of financial statements of SMEs.

These conclusions were consistent with the conclusion of a study conducted in Kisii, Kenya by [6] In the study which was carried out to assessed the effect of proper book keeping practices on the financial performance of

SMEs in Kisii Municipality, it was found that: book keeping practice of the SMEs is not adequate and may negatively affect their financial performance; most of the SMEs poorly kept business receipts that result into incorrect records; about 67.9% of the SMEs created basic financial reports irregularly; and most SMEs are not effective in book keeping. The study concluded that book keeping and inadequate knowledge in book keeping were the major challenges among many SMEs in the municipality. The study recommended the design of a sensitization programme to equip SMEs with proper knowledge in book keeping.

2. Methodology

2.1 Sample size and Sampling Procedure

A multi-stage sampling procedure was adopted in the study. In the first stage, three States were randomly selected from the Six States and Federal Capital Territory that comprise the North-Central geo-political zone. The selected States are Kwara, Kogi and Niger. In the second stage, the list of registered SMEs in the selected States was obtained from the respective State Chamber of Commerce and Industry. The list of registered SMEs was adopted as the sampling frame for the study. Samples were drawn from the sampling frame. Using the Cochran (1977) sample size determination formula:

$$= \frac{Z^2 p\,(1-P)}{(D)^2}\,, \quad n = \frac{(1.96)^2 (0.7)(0.3)}{(0.05)^2} = \frac{(3.8416)(0.12)}{0.0025} = 307$$

where: n = required sample size, Z = confidence level at 95% (1.96); D = relative margin of error (5%); and P = expected prevalence of SMEs in the informal economy, a sample size of 307 was determined for the study. The proportion of 70% (0.7) was derived from literature relating to the size of the informal sector of the Nigerian economy [21,19]. Based on previous studies, it is expected that SMEs in North-Central Nigeria constitute about 70% of the informal sector in the zone. However, the analysis in the study is based on 274 completed and returned questionnaires.

2.2 Research Variables

In this study the dependent variable is financial reporting quality which was measured using three qualitative characteristics of accounting information on the basis of the type of record maintained by the entities. The lists of accounting records expected to be maintained are statement of financial position, income statement, and statement of cash flow. Based on the availability of these records we applied the qualitative characteristic. Accounting information has special qualitative characteristics, among which are reliability, relevance, consistency, comparability and understandability [23]. The two fundamental qualitative characteristics are reliability and relevancy [14]. However, the three characteristics used in the study are reliability, comparability and understandability.

Reliability is used to denote high reporting quality and refers to quality of accounting information that encourages its users to depend on it with high assurance. The information is usually verifiable, representative

and free from errors and bias. In this study, the entities defined as having reliable (high) reporting quality are those entities that maintained all the accounting records and prepare regular financial report. Comparability is used in the study to denote moderate quality of financial reporting and refers to quality of accounting information that are applied and managed in similar way across the entities studied. This was defined in the study as entities that maintained some of the accounting records but do not have regular report of its financial position. Understandability is used in the study to denote low quality of accounting information. It refers to the availability of simple accounting information among the entities studied. It is defined in the study as the entities that do not maintain any of the accounting records, do not have report of its financial position, but do have some information that are used in business decision making.

2.3 Method of Data Analysis

The multiple regression analysis is used in the study to determine the influence of adoption of IFRS of SMEs and the challenges on quality of financial reporting. The multiple regression analysis is used when there is one dependent variable and at least two independent variables [20]. The multiple regression analysis is appropriate for this study because of the need to determine the extent to which adoption of IFRS could predict the quality of financial reporting. The multiple regression model constructed for the study is given as:

$$\hat{y} = b_0 + b_1 x_1 + b_2 x_2 + b_3 x_3 + b_4 x_4 + b_5 x_5 + e_i$$

where: y is quality of financial reporting, x_1 is number of entities that prepared statement of financial position only, x_2 is the number of entities that prepared statement of income only, x_3 is the number of entities that prepared statement of cash flow only, x_4 is the number of entities that prepared complete set of financial statements, x_5 is the number of entities that do not prepared any financial statement, $b_0, b_1, b_2, b_3, b_4, b_5$ and e_i are the regression parameters for which numerical values must be obtained to fit the multiple regression model. All the statistical analyses were performed using the Stata version 12 software. However, manual application of the chi-square test is also included in the report.

3. Results

Table 1 describes the state of financial reporting practice and adoption of IFRS by SMEs in the study area. As shown in the table, more than half of the SMEs (56.6%) does not prepare any aspect of financial statements for their business, though the proportion of SMEs who prepare aspects of financial statements is substantial (43.4%), but this proportion need to increase tremendously for SMEs to flourish continually in the north-central zone. Among the 119 SMEs who prepare aspects of financial statements, 26.1% reported that the financial statements were prepared by the manager of the business, 23.5% of the financial statements were prepared by the accountant. However, the owner of the business was the dominant person (39.5%) who prepares the financial statements.

Analysis of responses to reasons for preparing financial statements shows that among SMEs who prepares financial statements, majority (61.0%) prepares the financial statements for the purpose of determining the

business profit, while 24.0% reported that they prepares financial statements to maintain financial control on the business. Less than one-tenth (7.5%) of the SMEs prepares financial statements for taxation purpose, while 3.4% of them prepares financial statements for other purposes. The SMEs also responded to reasons why some enterprises do not prepare statement of financial position. As shown in the table, more than half of the enterprises (54.0%) opined that financial position are expensive to operate, while 16.8% of the enterprises believed that lack of accounting skill is responsible for the non preparing of statements of financial position.

Nearly one-tenth (9.9%) of the SMEs do not prepare statements of financial position because they see it as a means of preserving their privacy. Slightly more than one-tenth (12.0%) of the SMEs do not prepare statements of financial position because they do not see the need for preparation of such statements. This may be responsible for the low prevalence of account maintenance found among the business entities. As shown in Table 1, 62.8% of the entities have low account maintenance system, 28.1% has moderate account maintenance system, while only 9.1% of them reported high account maintenance system. Among the SMEs who usually prepare statements of financial position, the sales day book is the dominant type of accounting records usually prepared by 46.0% of the entrepreneurs, 28.1% of the enterprises usually prepares the purchases day book. The operating expenses records are usually prepared by 19.3% of the enterprises. The least type of accounting records among the enterprises is the payroll record. Though, a substantial proportion of the enterprises do not prepare statements of financial position, majority of them (66.1%) believed that maintenance of accounting records by SMEs affect financial reporting, compared with the 33.9% who do not believed that maintenance of accounting records by SMEs do not affect financial reporting.

The most prominent type of financial statement among the SMEs is income statement which was attested to by 48.5% of the SMEs. Statement of financial position is the second most dominant type of financial statement usually prepared among the SMEs, while statement of cash flow is usually prepared by 16.1% of the SMEs. However, 10.2% of the SMEs prepare all the three major financial statements. Only 4.8% of the SMEs do not prepare any type of financial statements. Regardless of the type of financial statements prepared by the SMEs, the frequency of preparation of financial statements varies among the SMEs.

The highest proportion of 39.4% prepares financial statements on monthly basis, while nearly one-third of the SMEs (31.7%) prepare financial statements on annual basis. About one-fifth of the SMEs (20.1%) prepare financial statements occasionally. Despite irregular preparation of financial statements by many of the SMEs, many of them believed that non preparation of financial statements have serious consequences for the SMEs. For instance, more than two-thirds (67.2%) reported that it makes it difficult for the SMEs to determine the business entity profit. Furthermore, 27.4% were of the opinion that non preparation of financial statements hinder access to bank loan. These tend to suggest that many of the enterprises may have desire to prepare regular financial statements, but may face series of challenges in doing so.

As shown in the table, only 5.8% of the entities have high quality financial report. The financial reporting quality of the majority (78.5%) is low, while 15.7% has moderate financial reporting quality. These features depicts a dire need to improve the accounting and financial reporting practice of SMEs in the zone to which 34.7% of the SMEs believed could be achieved if the SMEs learn about accounting standard for SMEs.

Substantial proportions of the SMEs however believed that training of book-keepers as well as hiring external consultants is key steps to improving the competence of SMEs in financial reporting.

In spite of the near universal access to Information and Communication Technology (ICT), only 12.4% of the SMEs advocated the use of accounting software as a means of improving competency in financial reporting.

Table 1: Distribution of SMEs by Financial Reporting Practice

Question/Variable	Frequency	Percent (All)	Percent (Valid)
Do you prepare any aspect of financial statement for your business?			
Yes	119	43.4	43.4
No	155	56.6	56.6
Total	274	100.0	
Who Prepares the Financial Statement?			
Manager of the Business	31	11.3	26.1
Accountant of the Business	28	10.2	23.5
External Auditor	13	4.7	10.9
Owner of the Business	47	17.2	39.5
Do not prepare financial statement	155	56.6	-
Total	274	100.0	
Reasons for Preparing Financial Statements			
Profit Determination	89	32.5	61.0
Financial Control	35	12.8	24.0
Bank Loan Requirement	11	4.0	7.5
Taxation Purpose	6	2.2	4.1
Other Purposes	5	1.8	3.4
Don't Know	128	46.7	-
Total	274	100.0	
Reasons for not preparing statement of financial position			
Expensive to operate	148	54.0	54.0
Lack of accounting skill	46	16.8	16.8
Want my privacy	27	9.9	9.9
No need for preparation	33	12.0	12.0
Others	20	7.3	7.3
Total	274	100.0	
Types of Accounting Records Kept for your Business			
Sales Day Book	105	38.3	46.0
Purchases Day Book	64	23.4	28.1

Operating Expenses Records	44	16.1	19.3
Non-current Asset Register	9	3.3	4.0
Payroll Records	6	2.2	2.6
Others	46	16.7	-
Total	274	100.0	
What type of accounting records do you often prepare?			
Statement of financial position	133	20.4	20.5
Income statement	133	48.5	48.5
Statement of cash flow	44	16.1	16.1
All of the above	28	10.2	10.2
None of the above	13	4.8	4.8
Total	274	100.0	
How often do you prepare financial statement?			
Yearly	87	31.7	31.7
Quarterly	24	8.8	8.8
Monthly	108	39.4	39.4
Occasionally	55	20.1	20.1
Total	274	100.0	
Financial Reporting Quality			
Understandability (Poor)	215	78.5	78.5
Comparability (Moderate)	43	15.7	15.7
Reliability (High)	16	5.8	5.8
Total	274	100.0	100.0

Source: Fieldwork, 2015

Table 2 presents result of Model 1used to predict understandability. Result show that IFRS awareness significantly influences the prevalence of understandability.

For instance, a unit increase in the level of IFRS awareness will result in the decline of understandability by a unit of 0.0779 (β_1=0.0779, p<0.05). Though this is an inverse relationship, it however reveals that the higher is the level of IFRS awareness, the lower is the prevalence of understandability among the SMEs. Other variables in the model did not show significant relationship with the prevalence of understandability.

For instance, taxation and ownership structure also maintains an inverse relationship with understandability. Their coefficient values are however not statistically significant (β_2=0.0228, p>0.05; β_4=0.0997, p>0.05). These results suggest that among the variables included in the model, only IFRS awareness significantly predict understandability.

Table 2: Multiple regression analysis showing the prediction of understandability

Variable	Coefficient	Std. Err.	p>|t|	95% Conf. Interval
IFRS awareness	0.0779	0.0513	0.002	0.0230-0.1789
Taxation	0.0228	0.0547	0.676	0.0848-0.1305
Size	-0.0562	0.0416	0.178	-0.1382-0.0258
Ownership structure	0.0997	0.0307	0.093	0.0391-0.1602

Table 3 presents result of Model 2 used to predict comparability. Result show that IFRS challenges significantly influences comparability. For instance, a unit increase in IFRS challenges that is an additional challenges facing the adoption of IFRS will result in the decline of comparability indicating decline in the quality of financial reporting by a unit of 0.1679 (β_1=0.1679, p<0.05). With the exclusion of size of entity, other variables in the model did not show significant relationship with the prevalence of comparability. For instance, taxation is inversely related to comparability. If taxation increases by additional unit, the prevalence of comparability, that is moderate quality of financial reporting will further reduces among the SMEs (β_2=-0.0392, p>0.05). These results suggest that IFRS challenges deter SMEs from adopting the new accounting standard.

Table 3: Multiple regression analysis showing the prediction of comparability

Variable	Coefficient	Std. Err.	p>|t|	95% Conf. Interval
IFRS challenges	0.1679	0.0611	0.001	0.0477-0.2881
Taxation	-0.0392	0.0652	0.548	-0.1676-0.0891
Size	1.1788	0.0365	0.003	1.0362-1.3214
Ownership structure	-0.0561	0.0365	0.125	-0.1281-0.1579

Table 4 presents result of Model 3 used to predict reliability. Result show that willingness to adopt IFRS significantly influences reliability that is high quality financial reporting.

For instance, increases in the level of willingness to adopt IFRS will lead to more quality financial reporting among the SMEs indicating that entities that show willingness to adopt IFRS are willing to prepare their financial statements based on the guidelines of IFRS (β_1=1.3327, p<0.001). As size of firm also increases, high quality financial reporting is also predictable from the regression model (β_3= 1.2825, p<0.001).

This implies that if the SMEs are assisted to grow in size either through credit facilities or government subsidies, there is the likelihood that more entities will commence the preparation of their financial statements in line with the IFRS requirements. These results suggest that IFRS challenges deter SMEs from adopting the new accounting standard.

Table 4: Multiple regression analysis showing the prediction of reliability

Variable	Coefficient	Std. Err.	p>|t|	95% Conf. Interval
IFRS adoption	1.3327	0.0611	0.000	0.0477-0.2881
Taxation	0.0812	0.0292	0.006	0.0236-0.1387
Size	1.2825	0.1414	0.000	1.0050-1.5600
Ownership structure	-0.0353	0.0164	0.033	-0.0678-0.0029

4. Discussion

Findings from the study indicated that the financial reporting quality of SMEs in North-Central Nigeria is not only low, but also that majority of the business entities do not prepare financial reports in line with the guidelines of the IFRS for SMEs. This is consistent with findings in previous studies [16,2,22,6]. The level of IFRS awareness will go a long way in facilitating its application among the SMEs. However, the challenges facing its adoption among the SMEs must be promptly addressed by fresh initiatives. The main challenge to the adoption of the IFRS among the entities in North-Central Nigeria is cost constraint. However, low attitude is the main underlying barrier to the adoption of the IFRS since majority of the entities does not wish to adopt IFRS if it is not made mandatory in the country; this is without regard to industry type among the SMEs.

5. Conclusion and Recommendations

The study concludes that awareness, challenges and willingness to adopt IFRS are major influential factors on financial reporting quality among the Nigerian SMEs. There is the need for a special public education programme to target raising the level of awareness of the IFRS for SMEs in North-Central Nigeria. Until awareness is made universal, the prospect of adopting the IFRS and implementing it to ensure quality financial reporting by small and medium entities in Nigeria, or specifically in the North-central Nigeria, is doubtful.

It is hereby recommended that SMEs in the North-central Nigeria and the relevant regulatory agencies on their activities should see the adoption of IFRS for SMEs as a top priority in view of the many benefits that are attached to the adoption (especially the World Bank credit availability to SMEs that comply with the provisions of the Standard as they prepare their financial statements). Based on findings from the study, the following recommendations are made:

SMEs in North-Central Nigeria should be encouraged to purchase for use a good financial software that can help maintain basic accounting records such as profit and loss statements, statement of financial position, actual performance to budget, cash flow generated compared to budget, and historical accounts receivable and payable analysis. The Ministries of Commerce and Industry can help provide public enlightenment in this regard by developing a Public Education Programme that emphasis the importance of preparing periodic financial report to SMEs.

There is need for an enlightenment programme to emphasize the nexus among maintenance of adequate accounting records, business profitability and financial reporting quality. Such enlightenment may be provided to SMEs at the point of business registration or payment of tax to government. There is need for a special public education programme to target raising the level of awareness of the IFRS for SMEs in North-Central Nigeria. Until awareness is almost universal, the prospect of adoption of the IFRS by small and medium entities is doubtful.There is need for the governments in the zone to collaborate with the bodies of professional accountants in the zone on how professional accountants can help to reduce the cost of preparing financial statements for SMEs. If the cost in terms of professional fees paid for preparation of financial statements is bearable, the challenges facing the SMEs will be reduced and many more entities may adopt the IFRS. There is need for a special programme to target improving financial reporting quality across all the industries within the SMEs. It should not be taken for granted that the manufacturing sector is more likely to have qualitative financial reporting than other sectors within the SMEs.

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