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# EARNINGS QUALITY OF HEALTHCARE COMPANIES IN NIGERIA BEFORE AND AFTER IFRS ADOPTION

**BY**

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**ABSTRACT**

The major objective of this study was to examine the effect of the adoption of IFRS on the reported earnings quality of listed healthcare companies in Nigeria. It was prompted by the adoption of the IFRS where objectives include ensuring a true and fair presentation of financial statements to enable informed decision making. Using a census sampling technique, seven listed healthcare companies were selected for study. It covered a period of 18 years, 2003 to 2020, nine years each of pre and post adoption of IFRS. Earnings quality (EQ), the dependent variable, was measured by using the Gullet, Kilgore and Geddie (2018) model. Secondary data were extracted from published accounts of the companies for the pre and post IFRS adoption period. The results of the analyses showed that mean EQ scores for post IFRS adoption period were greater than that of pre adoption period. Further analyses, using paired sample t test statistics indicated that the difference in mean EQ score was statistically significant. It was therefore concluded that the adoption of IFRS has a positive significant effect on the quality of reported earnings of healthcare sector companies listed in the Nigerian Stock Exchange. It was recommended that the adoption of IFRS be encouraged and diligently enforced by regulators in Nigeria.

***Keywords***: *Earnings quality, Healthcare Compabies, IFRS, Nigeria.*

## 1 INTRODUCTION

A major reason people go into business or make financial investment is to make profit. The term earnings is used in accounting literature to describe net income or profit of a business entity. Earnings are important to investors as it is a major basis for estimating the value of a firm, assessing its profitability, and

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a key variable in decision-making process. When earnings growth is consistent, investors get a steady share of the profit and analystspredict higher value for company's share.Where analysts' predictions or targets seem difficult or impossible to achieve, management may be pressured to manipulate the earnings figure (Yadav, 2013). This manipulation could be done on financial statements where deficiencies or unanticipated drops in revenue are hidden. According to Remenaric, Mijoc, and Kenfelja (2018), the manipulations may first be achieved through questionable ethical practices and accounting treatment choices, but can later degenerate into blatant fraud. These would result in published financial statements that meet the purpose of management but completely unreliable for other stakeholders' decisions making. Furthermore, where earnings are manipulated, the quality of reported earnings drops, and thus the information in the financial statements will be deceitful to users. Also, studies have shown that managers can sometimes be under pressure to engage in this unethical practice to maximize their own interests such profit-based bonuses and rewards. This practice negatively affects the information value of earnings and has led to failures of many firms. (Farouk and Hassan, 2014).

Financial reporting is the medium in which accounting information is communicated to various users and stakeholder groups. The quality of information presented therein determines its usefulness and the extent to which they can aid investing decisions making. In order to ensure that the right quality of information (including reported earnings) is presented, accounting standards are developed to guide those who have the responsibility of preparing financial statements. Accounting standards regulate how financial transactions are to be recognized, measured and presented in annual reports and accounts. The need for standards to guide the preparers of financial statements led to the development of national accounting standards by various countries. It resulted in diversity in financial reporting. Bushman and Smith (2110) noted that diversity in accounting system has significant economic consequences for interpretation of financial reporting on an international level. As a result, international accounting bodies and other stakeholders initiated the process to promote the harmonization and or convergence of accounting standards as a means of improving financial transparency and comparability (Shima and Yang, 2012).

Efforts made by worldwide accounting bodies have led to the development of International Accounting Standards (IAS) now described as International Financial Reporting Standards (IFRS). The goal was to encourage the adoption of IFRS globally therefore making international comparisons as easy as

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possible. It sought to help participants in various capital markets across the globe to better understand financial statements; and to ensure better transparency and accountability. The adoption of IFRS by various countries has increased since its first set of core standards was completed in 1998, notably by Australia and members of the European Union in 2005. It is argued that adoption of IFRS leads to increased investors confidence, reduction of reporting costs for international cross listed firms, easier access to external capital by domestic companies, facilitation of consolidation of financial statements of the same companies with offices in different countries, among others**.** (Gordon, Jorgensen and Linthicum, 2011)

On July 28, 2010, the Nigerian Federal Executive Council adopted the report of the Roadmap Committee on IFRS implementation and approved that the Nigerian standard be converged with IFRS by January 1, 2012. The advantages of adopting IFRS include the attraction offoreign direct investment, production of financial statements that are more reliable, relevant and dependable for making investment decision. Conversely, non-compliance can lead to publishing financial statements that are not free from material misstatement, and do not represent the fair view of the company's position. This can result in lawsuits if investors are misled.

Nine years (January 1, 2012 to December 31, 2020) after the IFRS adoption, it would be necessary to assess the effect of the adoption of IFRSon earnings quality of listed companies in the healthcare sector in Nigeria. This was achieved with the use of three specific objectives, which were to assess the earnings quality of healthcare companies listed in the Nigerian stock exchange before the adoption of IFRS, after the adoption of IFRS and to determine if there are any significant differences.

Hypothesis: There is no significant difference in earnings quality of healthcare companies listed in the Nigerian stock exchange before and after adoption of IFRS

## 2 CONCEPTUAL REVIEW OF RELATED LITERATURE

### Earnings

Various definitions have been used in accounting literature to explain the meaning of earnings. Net income (NI) and profit after interest and tax are some of the terms used to interchange with earnings. Earnings also represent the amount available to ordinary shareholders after holders of prior charge capital, debenture holders, providers of loans and others, have been fully settled. It is measured as revenue minus expenses. It is a measure of profitability, a very important variable, or perhaps the most important in measuring the value of a firm, according to Kothari, Leone and Wasley (2005). Crucial performance indicators such as Earning per Share (EPS), which are additional dividend to ordinary shareholders (Uford, 2017), Returns on Equity, (ROE), meaning dividend to ordinary shareholders, are denominated by the earnings figure. Where earnings are manipulated, it would no longer have the ability to predict future earnings and this would result in poor earnings quality and give misleading financial information.

## Earnings Quality

This concept embodies the idea that the investing community should find financial reports useful in making resource allocation decisions. Researchers have given several definitions of earnings quality in financial literature and they are not unified. Prat (2003) specified that earnings quality is the degree to which the profit stated in the financial statements differ from true earnings. Chan, Chan, Jegadeesh and Lakonishok (2006) describe earnings quality as the level to which earnings, as reported in a company's statements reveal the operating fundamental. According to Kirschenheiter and Melumad (2004), good quality earnings are determined when such earnings can provide the information that aids in determining more closely the worth of the firm in the long run.

Accounting or market-based measures can be used in observing earnings quality. (Francis, LaFond, Olsson and Schipper, 2007).This study adopts the EQ measure proposed by Gullet *et al.*, (2018), which is an accounting-based measure. Market based measures are not chosen because of the imperfect nature of the Nigerian stock market.Accounting-based techniques can further be subdivided into techniques of measurement that are based on time series, the smoothness of earnings, their volatility, and accrual quality.

Various formulae have been proposed in literature for the measurement of EQ. This study uses Gullet, *et.al.*, (2018) revised Q Test model modified from the Putman Q score. The model is as follows:

EQ Score= $10[CFO_t/S_t] + CFO_t/EBIT_t + COI_t/NI_t + 5[CFO_t/TL_t] + [(S_t/AR_t - S_{t-1}/AR_{t-1}) + 1]$, whre;

CFO= Cashflow from Operations, S= Sales, EBIT= Earnings before Interest and Tax, COI= Income from Continuing Operations, NI=Net Income, TL= Total Liabilities, AR= Average Receivables

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This measure is derived from five cash ratios computed from the major financial statements that appear in published accounts. These ratios are the cashflow margin, operating cash ratio, repeatable earnings ratio, leverage ratio and receivables accrual ratio.For each ratio, a Q score greater than or equal to 1 correlates with a higher EQ, and a Q score less than 1 is associated with poor EQ. Therefore, an aggregate Q score greater than or equal to 5 is good and less than 5 amounts to poor EQ. It follows that a larger increase in receivables over sales indicates a deteriorating EQ with a ratio less than 1.

## IFRS and Principles Designed to Improve Earnings Quality

The standard is the International Financial Reporting Standard (IFRS) 15 - Revenue from Contracts with Customers and the accounting principle is the Realization Concept.IFRS 15 is a standard based on principles. It sets the principles to be followed in giving report regarding the nature; the amount; the timing; and the uncertainty of revenue and cash flows resulting from a contract with a customer.The realization concept states that an entity can only recognise revenue oncethegoods or services that gave rise to the revenue have been delivered. Therefore, revenue is realized when it has been earned.

## Theoretical Review

### Stakeholder Theory

This theory is widely understood in business today with the view that the main objective of a firm is to create value for all stakeholders such as employees, suppliers, contractors, shareholders and business. The Stakeholder Theory developed by Edward Freeman in 1984, postulates that shareholders are just one of numerous stakeholders in the organization. The managers of the organization must, therefore, work for the interest of anyone interested, involved in, or affected by the corporation. Real success therefore depends on stakeholder and not putting too much emphasis on the wealth of shareholders group but to all stakeholders.

This theory relates to this study because its principles is an encouragement to managers to be fair to all stakeholder groups. This can, in part, be achieved by avoiding financial manipulations to obtain result that advances their interest (enhances the bonuses paid to mangers, for example) but that mislead other stakeholders such as investors into making wrong investment decisions.

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**Empirical Review**

A major objective of a research conducted by Yurisandi and Puspitasari (2015) was to assess the effect of adoption of IFRS on quality of financial reporting in Indonesia. The study employed a qualitative approach developed by Nijmegen Centre for Economics (NiCE). The period represented as pre- IFRS adoption was 2009 to 2010 and the post IFRS adoption was 2012 to 2013. They employed paired sample test as the statistical tool for analysing the data that were obtained. It was concluded that IFRS adoption increased the quality of financial reporting in Indonesia. They found out that the qualitative characteristics of relevance, understandability and comparability level increased after IFRS adoption.

Mensah (2020) sought to evaluate how the adoption of IFRS in Ghana has impacted on the quality of financial reporting of manufacturing firms listed on the Ghana Stock Exchange. The period covered by the study was 2001 to 2014. Pre IFRS adoption period was 2001 to 2006 and 2007 to 2014 was the post – IFRS adoption period. Data were obtained from audited accounts of eleven companies for the 14 years covered by the study. Ccorrelation, as well as regression analyses techniques were the statistical tools of data analyses. The study also used earnings management, measured by modified Jones' discretionary accruals, as a proxy for financial reporting quality.The regression results showed a significant negative effect of IFRS adoption on earnings management, thus indicating an improvement in the financial quality. The findings of the study showed that IFRS adoption improves the quality of firms' financial reports of manufacturing firms listed in the Ghanaian Stock..

A study conducted in Nigeria by Abdullahi and Suleiman (2021) sought to obtain the opinion of users of financial statement, mostly investors, on their perception of quality of financial reporting under Nigerian Statement of Accounting Standards (SAS) compared with IFRS. on reporting quality between the Statement of Accounting Standards (SAS). The study used a Likert scale structured questionnaire as the instrument of data collection. Data obtained were analysed using T-test. It was found that all the qualitative characteristics of financial reporting which were used as reporting quality variables in the study have improved with the adoption of IFRS.

## 3 METHODOLOGY

The *ex-post-facto*research design was adopted for this study. It is an experimental study which examines how the independent variable, the adoption of IFRS affects thereported earnings quality (EQ) of seven healthcare

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companies listed in the Nigerian Stock Exchange. Data were extracted from the published accounts of the companies from 2002 to 2011, nine years pre IFRS period, and 2012 to 2020, being nine years post IFRS adoption. EQ scores were computed using the (Gullet *et. al.* 2018) model, for each of the seven companies for nine years, resulting in a total of 63 pre-observations and 63-post observations.

Descriptive statistical analyses were used to compare the mean EQ for the pre and post IFRS adoption. Further analysis using paired samples t test was done to test whether the difference between the pre and post adoption mean EQ scores were statistically significant in line with the hypothesis that was formulated.

## 4 RESULTS AND DISCUSSION

Data obtained for the study were analysed using descriptive statistical techniques of tables and charts. Table 1 shows the pre-and post-IFRS EQ mean scores for the companies that were studied.

**Table 4.1 Pre and Post Mean EQ Scores**

| Company | Pre IFRS (2003 - 2011) | Post IFRS (2012 - 2020) |
|---|---|---|
| EkoCorp PLC | 3.89 | 5.76 |
| Fidson PLC | 5.12 | 6.07 |
| GlaxoSmithKline | 3.58 | 4.17 |
| May and Baker | 3.88 | 5.21 |
| Neimeth | 3.42 | 4.52 |
| Pharma Deko | 4.90 | 7.57 |
| Union | 4.61 | 5.54 |
| Total | **4.20** | **5.54** |

**Source: Researcher's Compilation (2022)**

Table 4.1 shows that the overall mean EQ score for the companies increased from 4.20 points during the pre IFRS years to 5.54 in the post IFRS implementation period. Whereas the quality of reported earnings was below 5, which is considered poor performance, Gullet, *et.al.* (2018)), mention that it improved in the post IFRS implementation period. Similar result is depicted in Figure 1 - a bar chart that compares the pre and post IFRS EQ scores for the

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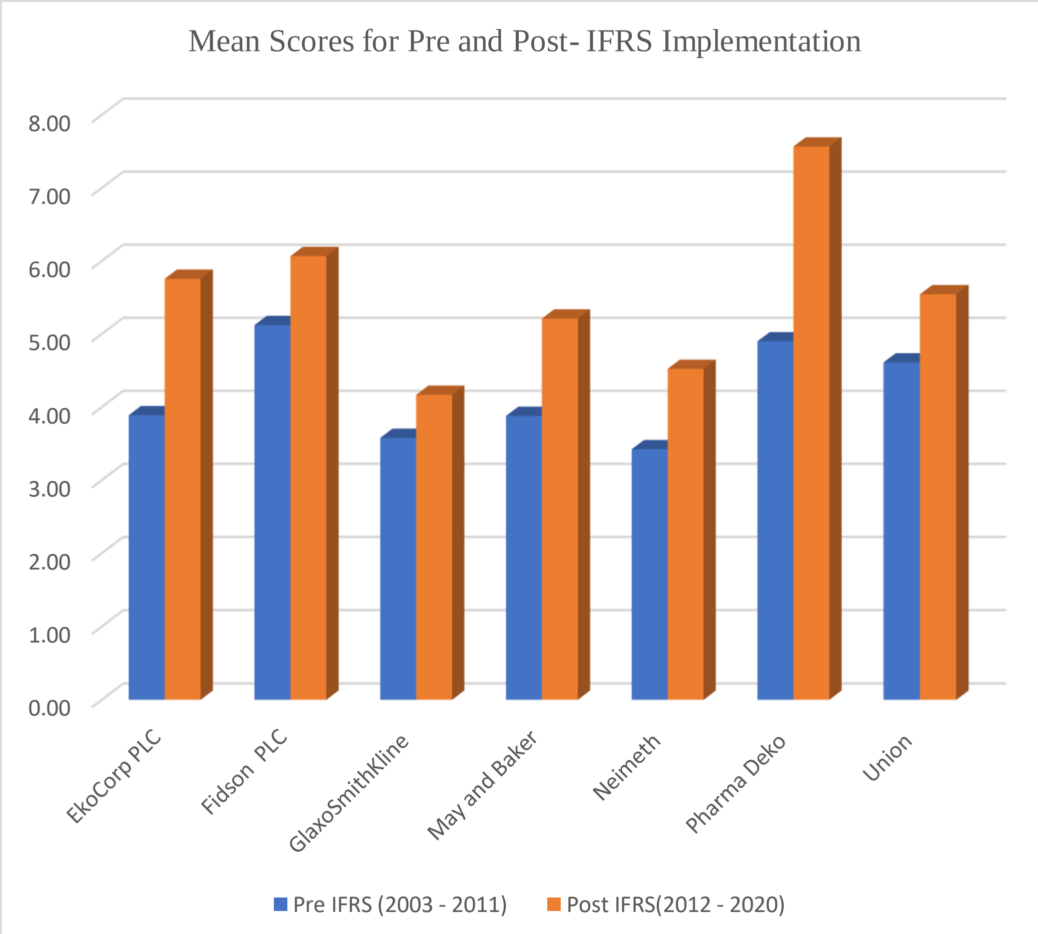
companies. All the bars for post IFRS EQ scores are taller indicating that earnings quality is enhanced after adoption of IFRS.




**Bar Chart Depicting Pre and Post IFRS EQ scores**

**Source: Researchers Compilation (2022).**

**Test of Hypothesis**

The hypothesis that was formulated for this study was tested in this section

$HO_1$: There is no significant difference in the earnings quality of healthcare companies listed in the Nigerian stock exchange before and after adoption of IFRS

Results from descriptive analyses indicated that the mean EQ scores for post-IFRS adoption was higher, which suggesting that an enhancement in quality of reported earnings in the post IFRS implementation era. A further analysis

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using paired sample t-test was done in order to find out whether this positive difference is significant. The result is shown in Table 4.2.

**Table 4.2: Paired Samples Test**

| | | Paired Differences | | | | | T | df | Sig. (2-tailed) |
|---|---|---|---|---|---|---|---|---|---|
| | | Mean | Std. Deviation | Std. Error Mean | 95% Confidence Interval of the Difference | | | | |
| | | | | | Lower | Upper | | | |
| Pair 1 | EQPostIFRS– EQPreIFRS | 1.34762 | 2.31752 | .29198 | .76396 | 1.93128 | 4.615 | 62 | .000 |

Source: Researcher's Compilation ( **2022)**

From Table 4.2, T(62) = 4.615, which is greater than the critical value of T(62) the p value is 0.000 which is less than 0.05 being the acceptable probability of error. These results indicate that the introduction of IFRS has significantly enhanced the quality of earnings reported by healthcare companies listed in the Nigerian Stock Exchange.

Analyses of data obtained for this study showed that EQ scores improved in post-IFRS adoption period compared with pre-IFRS implementation. Its adoption has therefore improved the quality of reported earnings among healthcare companies listed in the Nigerian Stock Exchange.The result reinforces the outcome of a research undertaken in Indonesia by Yurisandi and Puspitasari (2015) where it was concluded that the adoption of IFRS had significantly improve the quality of financial reporting in that country. The result of this study also agrees with a related study conducted in Ghana by Mensah (2020) which showed that introduction of IFRS discouraged earnings management among manufacturing companies in Ghana, and has thus improved the qualitative characteristics of financial reporting.

## 5 SUMMARY AND CONCLUSION

This study was undertaken to assess the effect of IFRS adoption on earnings quality of healthcare companies listed in the Nigerian Stock Exchange. Data was extracted from published accounts of the companies for the pre-IFRS implementation period (2003 to 2011) and the post adoption period (2012 to 2020). Earnings quality scores were computed using the Gullet, *et al.*,(2018) model for the pre and post IFRS period. Description analyses of data showed an improvement in quality of reported earnings after IFRS implementation. Further analyses using paired samples T-test showed the different was significant. It was therefore concluded that earnings quality of the healthcare companies listed in the Nigerian stock exchange were better after the adoption of IFRS.

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