

Effect of IFRS 13 Adoption on the Value Relevance of Accounting Information of Listed Deposit Money Banks in Nigeria

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Abstract

Fair value is generally considered to be one of the most controversial areas in accounting. This study examined the effect of IFRS 13 adoption on the value relevance of accounting information of listed deposit money banks in Nigeria. The sample comprised of ten (10) listed deposit money banks in Nigeria for a period of seven (7) years (2012-2018). Secondary data were obtained from the annual reports and accounts of the listed deposit money banks. The explanatory variable of the study is IFRS 13 adoption and the explained variable is share price. Descriptive statistics, correlation analysis and multiple panel regression analysis were employed for analysis. Results from the regression analysis revealed that fair value hierarchy has a positive and significant effect on the value relevance of accounting information of deposit money banks. Based on the findings, it is recommended that investors should rely on information prepared using the fair value hierarchy approach in their decision making.

Keywords: Fair value, Value relevance, Fair value hierarchy, Deposit money banks.

Introduction

Financial statements are the means of communicating the affairs of companies to stakeholders. It carries vital information relied upon for decision making by creditors, shareholders, external auditors and other interest groups such as the government. The importance of financial statements is that it, among others, provides useful information about the financial position, changes in financial position and performance of an economic entity (Nirmala & Florence, 2011). This importance of accounting information is expressed in the literature by the term “value relevance”. Value relevance measures the ability of accounting figures from the viewpoint of equity valuation. It reveals one of the main functions of accounting, which relates to the provision of useful information that enables relevant stakeholders to value a firm and make rational decisions (Kimouche, 2016).

According to IASB, the use of fair value approach in contrast to historical costs in valuing firms’ net worth provides users of financial information with more timely, relevant,

transparent and accurate information about the economic condition of companies (Posti, 2016). Fair value requires the use of both observable and unobservable inputs as such creating a fair value hierarchy, which ranks higher than the input into the fair value measurement process. Fair value measurements are classified into fair value hierarchy, built on the type of input to the valuation techniques used. There are three levels of hierarchy of the information to be used to arrive at the fair value of an asset. These are Level 1, Level 2 and Level 3 hierarchy.

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

The level 2 hierarchy is the observable assets or liabilities that could be directly or indirectly implemented, except inputs other than the market quotes involved in level 1 (IFRS 13). The second level input is the quoted price of comparable assets or liabilities in the dynamic market, and the quoted price of the same or similar assets or liabilities in the inactive market. Level 2 inputs are inputs except that of observable quotes for assets or liabilities, including inputs that are mainly obtained or confirmed by association or other means through observable market data. Du, Li, and Xu (2014), believe that level 2 fair value estimation is also applicable to increase value relevance.

Level 3 hierarchy, which this work is concerned with; measures the fair value of either an asset or liability when there is no readily available market price or the transaction in the type of the asset or liability is very rare as such unobservable inputs for the asset or liability is used (IFRS 13). In this case, an entity advances and uses unobservable inputs using the paramount information available in the circumstances, which might include the organizations own data, taking into consideration all information about market participant assumptions that is expected to be reasonably available. Alfreda and Sergej (2017) opined that when hierarchy 1 and 2 inputs are not available, then, hierarchy 3 plays an important role in increasing the relevance of fair value estimates. Barron, Chung, and Yong (2016), also opined that Level 3 measurements convey suitable information about a business to the information users.

Notwithstanding, some scholars opine that fair value might not reflect firms' financial condition, therefore, not promote the relevance of accounting information. In particular, the 2008 global financial crisis has led to a major debate about fair value accounting valuation

paradigm among accounting and banking regulators, researchers and many others (Khan, 2010). Critics have faulted the approach for increasing the crisis and creating a circle of falling prices. The fair value valuation method is considered to be volatile, unreliable and a subject of managerial decision and discretion, especially when markets are illiquid. Prior study finds that managers manipulate fair value measurement and as such making it not to be of value relevance (Song, Thomas & Yi, 2010). Alfreda and Sergej (2017) postulated that investors in making their equity pricing decisions, are likely to value mark-to-model estimates less, possibly because of information asymmetry, thereby, implying that information containing fair value estimates should be used with some level of skepticism.

In countries, especially developing ones like Nigeria, where the market is less efficient to provide the needed reliable data for fair value measurement, firms explores other alternatives. In particular, firms in these countries often resort to the use of price of similar financial instruments or use projection of future benefits, and combine it in a model with reasonable assumptions that are available in the market. This situation may result in estimated values that are less reliable and may not truly reflect reality thus adversely affecting value relevance (Hoogendoorn 2006). In developing countries like Nigeria, some assets do not have available market, therefore, fair value measurement would be more problematic, hence, reliability and relevance is questioned.

The traditional historical cost accounting method value assets at the original cost and in the presence of high inflation, this method is criticized for fair value measurement. IFRS 13 defines a framework for more accurately measuring and disclosing assets, liability and equity at fair value which should impact greater value relevance of accounting information than the hitherto historical cost accounting method adopted in valuation.

The study has made an enormous contribution in the area of value relevance literature by investigating the value relevance of accounting information in relation to fair value of listed deposit money banks in Nigeria following the adoption of IFRS 13. Accordingly, the study hypothesized that:

H₀₁: IFRS 13 adoption has no significant effect on the value relevance of accounting information of deposit money banks in Nigeria.

The rest of the paper is structured into literature review, methodology, results and discussion, and conclusion and recommendation.

Literature Review

Barth, Beaver and Landsman (2001) stated that value relevance considers the relationship between accounting numbers and equity market values. More comprehensively, Francis and

Schipper (1999) explained the concept from four interpretations. Firstly, it concerns financial statements information influence on stock prices by capturing intrinsic share values. Secondly, financial information is value relevant, if it assists in predicting share prices. Thirdly and fourthly, value relevance indicates a statistical link between financial information and prices or returns respectively. Consistent with Francis and Schipper (1999) fourth interpretation of value relevance, this study defined value relevance as the capacity of financial statement information to capture information that determines the firm's value.

The IFRS 13 provides a framework for fair value measurement. In line with the requirement of IFRS 13, fair value measurement necessitates an entity to establish the following: the asset or liability which is the subject of measurement. Further, the standard requires that in the determination of fair value estimates, an entity should consider the characteristics of the asset or liability being measured which a market participant would consider when pricing the asset or liability at measurement period, for example, the condition and position of the asset and any restraining covenant on the sale or use of the asset.

The International Accounting Standard Board (IASB) by introducing IFRS 13 seeks to improve comparability and consistency in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy classifies the valuation methods inputs used into three levels. The highest priority is given to quoted prices observable in active markets for identical assets or liabilities while unobservable inputs is given lowest priority (IFRS 13). Level 1 inputs are quoted prices in active markets for identical assets or liabilities that are observable at the measurement time (IFRS 13:76). Level 2 inputs are observable inputs rather than quoted market prices used within Level 1 for the asset or liability, directly or indirectly (IFRS 13:81). This may include quoted prices for similar assets or liabilities dealt with in an active market, similar assets or liabilities quoted values in markets that are not active, observable inputs other than current prices for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs can only be used to measure fair value when relevant observable inputs are not available.

Accounting information is essentially considered to be value relevant to investors when it truly reflects firm value. Accounting information that is not value relevant is not useful to investors for decision making. The valuation technique adopted in valuing items for reporting purposes has far reaching effect on the relevance of information disclosed in the financial statements. Over the years, the historical cost accounting method has been adopted in valuation, however, with the phenomena of inflation, this method has been criticized for producing less useful and reliable accounting information. Fair value measurement has been

increasingly advocated. It was in recognition of the importance of fair value measurement to value relevance of accounting information that the IASB developed and issued IFRS 13.

The empirical evidence on the relationship between IFRS 13 adoption and value relevance of accounting information around the world is rather mixed. For example, Ghassan and Tala (2018) investigated value relevance of IFRS 13, fair value hierarchy information in Palestinian financial institutions. The study investigated whether fair value hierarchy affects value relevance of Palestinian portfolios, especially level 3, due to unobservable inputs used for measurement. The population was Palestinian financial institutions for the period of six years (2011 to 2016). Logarithm regression was utilized and the result revealed that fair value hierarchy significantly affects the value relevance of information presented to the investors.

Haiping and Eliana (2018) conducted a study on the compensation of chief executive officers and the relevance of fair value accounting. The study covered a period of ten years between 2007 and 2016. The modified model of Ohlson (1995) was used. The result showed that Level 3 fair value inputs are less value relevant. The results shed light on the decision usefulness of fair value accounting. Mary, Taylor and Kevin (2015) investigated market pricing of fair value measurements for non-financial firms. The study covered a period of seven years (2008 to 2014). The results showed that Level 1 and 2 fair value asset measurements are value relevant and positively associated with stock prices. However, Level 3 fair value measurements are negatively associated with stock price.

Isho and Liyin (2015) empirically examined the value relevance of fair value financial assets during and after the financial crisis. This study examined value relevance of the three levels of fair value assets and of non-fair value assets during the financial crisis of 2008-2009 and compare the results to the value relevance during the normal economic period of 2012-2013 using quarterly data from the banking industry. The study reveals that although both fair value disclosure and non-fair value disclosure provide investors with decision-related information, the value relevance of fair value assets is slightly greater than value relevance of non-fair value assets, and this difference is larger during recession period. The study also reveal that the value relevance of Level 3 is lower than the value relevance of Level 1 and Level 2.

Theoretical Framework

This study is anchored on the Ohlson's clean surplus theory. The Ohlson's clean surplus theory discloses how the market value of a firm can be expressed in terms of balance sheet and income statement of profit or loss components. The market value of a firm can be expressed in terms of the net book value of the firm's assets from the statement of financial

position and the expected present value of future earnings, together these figures are used to estimate share value. The market price of firm can be signified by the net book value to the company's assets in the statement of financial position and the predictable current value of imminent earnings, both of which can be used to derive the price of the stock. The clean surplus theory helps in the measurement side because, the fairer the values the accountant incorporates into the book value, the less the need to predict abnormal earnings. The relevance of this theory to the current study hinges on the fact that IFRS 13 adoption ensures fairer values in the financial statements hence increase the value relevance of accounting information disclosed in them.

Methodology

This study adopted the correlational research design. The design was informed by the research paradigm which is positivism. The population of the study encompassed all the listed deposit money banks in Nigeria as at 31st December, 2018. Using convenient sampling, ten banks were selected as the study sample. The independent variable is Fair Value Hierarchy (FVH) and Share Price (SP) the dependent variable as a proxy for value relevance. Firm Size (FSZ) was introduced as a control variable. The data were obtained from the annual reports of the sampled banks for the period 2012-2018 and multiple panel regression using STATA 13 software was employed as technique of analysis.

To determine the value relevance of IFRS13, the model is depicted below:

$$SP_{it} = b_0 + b_1FVH_{it} + b_2FSZ_{it} + \varepsilon_{it} \dots \dots \dots (1)$$

Where: SP_{it} = Share price for Bank i in year t , FVH_{it} = Fair value hierarchy unobservable inputs for Bank i in year t , FSZ = Size for Bank i in year t , b_0 is the intercept, while b_1 , and b_2 are the coefficients/estimators, ε_{it} = the residual or error term.

Results and Discussion

Table 1 presents the descriptive statistics of the study variables.

Table 1: Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min.	Max.
SP	70	6.27	7.23	0.4	28.2
FVH	70	0.41	0.60	0.31	0.55
FSZ	70	11.41	3.59	5.57	16.43

Source: Authors computation, 2022.

Table 1 presents the descriptive statistics of the data for the variables of the study. The data comprised a total of 70 observations for 10 listed deposit money banks over the period of 7 years. The independent and control variable were measured against the dependent variable.

Table 1 shows that the sampled deposit money bank during the period of the study have on average share price of ₦6.27 with standard deviation of 7.23, minimum value of ₦0.4k and maximum value of ₦28.2k. The standard deviation of ₦7.22 signifies high variability of the share price among the sampled banks, this is also manifest from the difference between the maximum and minimum value. Also, the Table 1 reveals that the average fair value hierarchy (FVH) for the sampled banks of ₦0.41k, standard deviation of 0.60, the minimum value and maximum value of ₦0.31k and ₦0.55k respectively. The control variable which is firm size has an average of ₦11.41 million, with standard deviation of 3.59, while the minimum and maximum values were ₦5.57 million and ₦16.43 million respectively.

Table 2: Correlation matrix

	SP	FVH	FSZ
SP	1.0000		
FVH	0.2888	1.0000	
FSZ	0.0602	0.2968	1.0000

Source: Authors computation, 2022.

Table 2 reveals that FVH and FSZ are positively correlated with SP of the listed deposit money banks in Nigeria within the period of the study. The inference is that share price change in the same direction with changes in these variables. Also, Table 2 shows a possible nonexistence of multicollinearity among the independent variables since the coefficients of the relationships are all less than the threshold of 0.8 as suggested by Hair et al. (2010). However, to further check for the problem of multicollinearity in the data, the Variance Inflation Factor (VIF) was conducted. The results of the VIF indicates that values for all the variables are less than 10. The mean VIF of 1.10 in Table 3 also confirm absence of multicollinearity.

A test for residuals was performed. The results in Table 3 shows the absence of Heteroskedasticity in the data as indicated by the Breuch Pagan/Cook-Weisberg test for heteroskedasticity. The test shows a Chi2 of 2.48 and a p-value of 0.1153 which exceeds the 0.05 level of significance. Thus, the null hypothesis which states that there is no constant variation in the residuals was rejected. Additionally, Hausman specification test was conducted in order to decide the preferred model for interpretation between the fixed and random effects. The result obtained from the Hausman specification test revealed a p-value of 0.1982, meaning it is statistically none significant as such, the random effect model was considered as the most suitable estimator. Further, the Breusch and Pagan Langragian multiplier test was conducted to decide whether the random effect should be interpreted or the

pool OLS. The result of the test indicated that the random effect model was the best model that suits the study.

Table 3 presents the summary random effect regression results.

Table 3: Regression Results

Variable	Coefficient	Std. Error	Z- value	P>(Z)
FVH	35.60	14.34	2.48	0.013
FSZ	0.056	0.24	0.23	0.815
CONSTANT	20.31	5.80	3.50	0.000
R-Square	0.1593			
F-Statistics:	6.43			
Prob.:	0.0401			
Hettest:	0.1153			
Hausman:	0.1982			
L.M test:	0.0000			
VIF:	1.10			

Source: Authors computation, 2022.

The R^2 value of 0.1593 indicates that the independent variables explain the variation in the dependent variable by 15.93% with about 84.07 variation explained by variables not included in the model. However, the F- statistics of 6.43 has an associated p-value of 0.0401 which is less than the 0.05 level of significance implying that the model is fit.

The result from Table 3 shows that fair value unobservable inputs hierarchy (FVH) has a positive and significant effect on the value relevance of listed deposit money banks in Nigeria. This was inferred from the coefficient of 35.60 and p-value of 0.013 which is statistically significant. Fair value hierarchy beta coefficient of 35.60 means that a 1% increase in the use of unobservable inputs will lead to a corresponding increase in share price of ₦35.60K. Based on this, the study affirms that fair value hierarchy have significant effect on the value relevance of accounting information of listed deposit money banks in Nigeria. The result is in consonance with the study of Fadia and Mohammad (2015), Mary Taylor and Kevin (2015) but contrary to Haiping and Eliana (2018). This finding suggests that when financial statements are prepared using fair value accounting approach, it is of value relevance. This further means that with the implementation of IFRS 13, accounting information has more value relevance. This also means that investors can rely on accounting information prepared using fair value measurement when making their investment and other decisions.

Conclusion and Recommendations

This study examined the effect of IFRS 13 on the value relevance of accounting information of listed deposit money banks in Nigeria. The results demonstrated that, information contained in the financial statements prepared using fair value unobservable inputs are value relevant. Based on the finding, it is recommended that investors should rely on information prepared using the fair value hierarchy approach in their decision making. Also, the regulatory authority (SEC) should step up monitoring to ensure that the management of listed deposit money banks prepare their financial statements in strict compliance with the requirements of IFRS 13.

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