International Financial Reporting Standards (IFRS) Adoption and Short-Term Liquidity of Firms in Nigeria

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Abstract: **- The study has the primary aim of examining the impact of IFRS adoption on the liquidity position of firms quoted on the floor of the Nigerian Stock Exchange. Short-term liquidity is measured by current ratio and the paired sample t-test measures the statistical difference between the mean of liquidity in pre-IFRS and mean of liquidity in post-IFRS periods. Using descriptive statistics to measure the mean of both periods, the results show that the mean of liquidity is lower in post-IFRS adoption period indicating a negative impact of International Financial Reporting Standards adoption in Nigeria. Furthermore, the paired sample t-test shows that there is difference between the mean of both periods and the difference is significant at 1% level. Thus, the study concludes that the adoption of IFRS has had a significant but negative impact on the short-term liquidity position measured by current ratio of firms. The study, therefore, recommends that managers should find a way to improve the liquidity position of firms and as adoption should have led to more transparency, openness and greater flexibility, there should be a new study to examine whether the reduction in liquidity is solely caused by adoption of IFRS or the economic recession which hampered the Nigerian economy in the year 2015.**

I. INTRODUCTION

Business survival especially in the short term depends on the liquidity position of the firm. To be able to meet the day to day business activities of the firm, a reasonable part of the assets of a firm is expected to be held in liquid form. This is because firms facing liquidity problems are likely heading towards crises. Aljifri, Alzarouni, Ng and Tahir (2014) argue that liquidity is not only important to lenders and investors but to regulators and that firm facing liquidity challenges may be heading towards bankruptcy. They asserted that one of the key measures of a firm's ability to survive and remain solvent is liquidity. This further emphasizes the important of liquidity in the management of firms and hence, firms' managers are usually careful when presenting liquidity information to investors, lenders, regulators and other stakeholders especially a firm with weak liquidity position. In the case of firms with weak liquidity position and in an attempt to present desired information to investors, lenders, regulators and other stakeholders, earnings manipulation is inevitable.

Lin, Jiang, Tang, and He (2015) posited that a highly qualitative financial statement reports usually provides accurate report about the performance of firms and that a higher operative performance (liquidity position) is expected to motivate managements to provide higher quality earnings information. Thus, Wallace & Naser (1995) explained that highly liquid firms are willing to disclose more information to stakeholders to alleviate the fear of bankruptcy usually associated with liquidity problems. Authors such as Belkaoui & Kahl, (1978), Cooke (1989a), (1989b), Wallace, Naser & Mora(1994) added that a firm with strong liquidity position is perceived to be strong financially and as such with be associated with more disclosure in order to attract more capital at cheaper cost. In addition, Agyei-Mensah (2015) argued that a firm with good liquidity is better positioned to pay its debt in the short run and assured of good operation while firm with low liquidity raises a red flag signally that the firm will have difficulties financing its operations. This might results to cooking the books in order not to send a red signals to investors and lenders of fund. The research work of Amr (2016), Shehata, Dahawy & Ismail (2014) summarise the discussion in a captivating way. They argued that firms with quality and impressive performance indices such as liquidity will likely provide information of higher quality to investors and other stakeholders. International Financial Reporting Standards (IFRS) adoption denotes that managers should disclose in detail all activities which they undertake on behalf of the shareholders. Hence, the disclosure is expected to impact on liquidity of firms in post IFRS adoption periods. From the foregoing, better disclosure brought about by the adoption of IFRS in Nigeria may have two-fold effects on liquidity positions of firms. First, if firms manipulate liquidity position prior to adoption, the greater disclosure associated with IFRS may mean that adoption would affect liquidity position negatively. On the other side, liquidity position is expected to be stronger for firms which disclose their true state without any manipulation. In this case, IFRS adoption is expected to have a positive effect on the liquidity of firms if other factors are held constant.

II. LITERATURE REVIEW

Shareholders, investors and potential investors are usually concerned about the firm's ability to meet its short and long term obligations as they fall due. Liquidity of firms measures the ability of the company to respond to debt obligations and assures investors that the firm is standing on a solid financial ground. This section examines some empirical evidences on liquidity in relation to IFRS adoption in Nigeria.

Lin et al (2015), as earlier discussed, asserted that a higher operating performing firm (liquidity position) is expected to motivate managements to provide higher quality earnings information. The research work of Amr (2016), Shehata, Dahawy & Ismail (2014) summarise the discussion in a captivating way. They argued that firms with quality and impressive performance indices such as liquidity will likely provide information of higher quality to investors and other stakeholders. Since, IFRS is expected to improve the quality of financial reports, all things being equal, liquidity is expected to improve post IFRS adoption periods in Nigeria. However, the study of Omaliko, Uzodimma & Okpala (2017) found otherwise. Mean liquidity pre IFRS was 24.01 and post IFRS 23.94, indicating a fall in liquidity after the adoption of IFRS in Nigeria. Also, the difference in mean test does not show any difference statistically between the mean of both periods and hence, they concluded that IFRS did not significantly impact liquidity positions of Nigerian banks. Studies on the impact of IFRS on liquidity have been scarce in literature, especially as it pertains to adoption in Nigeria. However, there are ample studies which examined effect of liquidity on earnings quality. Amr (2016) examined what effect liquidity has on quality of financial report using 32 firms in the 2014 and 2015 financial years. They opted for quick ratio instead of current ratio as the measure of liquidity. Quick ratio has the advantage of separating inventory which might not be readily converted into cash from the equation leaving cash, cash equivalents and receivables. The results after moderating for the effect of size and profitability reveal a significantly positive relationship between liquidity and financial reporting quality measured by accounting conservatism. The major criticism of their work is that financial reporting quality was proxy with more of ratio (market to book value) than the estimated model which detects the extent of earnings manipulations.

Similarly, Bardos (2011) examined the effect of liquidity on the quality of financial information presented in the annual reports of firms over a long period of time using "*analyzing long-term trends in Amihud's 2002 illiquidity measure model*" for firms that restate financial statements. The results were intriguing as he found that income decreasing restatement (earnings manipulation) were detected several months before the announcement of illiquidity and this remains at elevated level even one year after the announcement. The results indicated the profound effect of illiquidity on firm's restatement of earnings. Hence, liquidity will results in less or none restatement and improving financial reporting quality.

On their part, Hamidzadeh & Zeinali (2015) studied asset structure and liquidity effect on financial reporting quality of listed companies in Tehran stock exchange. They used 100 listed firm for 5 years (2007 to 2011) making 1000 firm year observation to examine the causal relationship between liquidity and financial reporting quality. Other assets structure used have significant negative effect while liquidity significantly and positive impacted the reporting quality of firms indicating that liquid firms without fear of bankruptcy are more likely to disclose information to investors (potential and present) and the general public.

In Nigeria, studies seem to agree with findings from other parts of the world. Echobu, Okika, and Mailafia, (2017) studied the determinants of quality of financial reports in the Agriculture and Natural Resource Sector of the Nation. They found that liquidity measured by current ratio showed a positive and significant effect at 1% level of significant indicating that reporting quality is enhanced with increase in the liquidity position of firms while a fall in liquidity will cause increase earnings manipulation. However, their work, as with other studies, examined firms' data for 7 firms over 8 years (2008 – 2015) without examining the effect of the adoption of IFRS in 2012. Hence, the study did not make effort to show whether the adoption of IFRS could have influence quality of financial reports differently with respect to liquidity of firms. Other studies such as Hassan & Farouk (2014), Takhtaei & Mousavi (2012) agree with the findings of authors above. Studies on impact of IFRS adoption on liquidity are scarce and the dearth of knowledge is one area this research is set to fill.

III. RESEARCH METHODOLOGY

3.1 Population and Sample

The population of study comprises all firms quoted on the stock exchange (Nigeria Stock Exchange). However, the sample comprises all non-financial firms listed in different sectors and subsectors. In the end, companies whose data were not available were dropped, remaining 87 firms with complete data for ten (10) years, 2007 -2016. Thus, a total of 87 firms were selected from different non-financial sectors of the economy based on data availability.

3.2 Source of Data and Sample

The data for this study were sourced from annual reports of firms quoted on the floor of the Nigeria Stock Exchange. 87 firms were used from the non-financial sectors of the economy. These firms were selected based on data availability. I.e., firms whose liquidity data were assessed through the 10 years of the study, five (5) years pre-IFRS (2007 – 2011) and five (5) post-IFRS (2012 – 2016).

3.3 Method of Data Analysis

The study uses descriptive and inferential statistics to analyse the effect of IFRS adoption on the short-term liquidity position of firms in Nigeria. First the data for current ratio were collected and analysed using descriptive statistics. This enabled us to see how widely spread the data are and to measure whether liquidity was stronger after adoption of IFRS by Nigerian firms. Once this is confirm, we use the paired sample t-test to test the difference in mean of both periods (pre and post-IFRS) in order to determine the statistical impact of IFRS adoption on short-term liquidity position of firms. Hence, the model for the paired sample t-test is as below:

$$t = \frac{\hat{x}_1 - \hat{x}_2}{\sqrt{\left(\frac{s_1^2}{n_1} + \frac{s_2^2}{n_2}\right)}}$$

Where:

$\hat{x}_1$ *and* $\hat{x}_2$ represent the sample mean of liquidity in pre and post IFRS era

s_1^2 and s_2^2 are the sample variances for both periods

$\mathbf{n}_1$ and $\mathbf{n}_2$ are the sample size for both periods

IV. RESULTS AND DISCUSSION

4.1. International Financial Reporting Standard (IFRS) and Short-Term Liquidity

Table 4.1 Descriptive Statistics of liquidity (Pre & Post-IFRS)

Statistic Pre-IFRS Adoption (2007-2011)	**Liquidity**
Mean	1.7218
Std. Dev.	2.2446
Minimum	0.0049
Maximum	29.8269
Obs	**435**
Post-IFRS Adoption (2012-2016)	
Mean	1.4142
Std. Dev.	1.3676
Minimum	0.0195
Maximum	15.5056
Obs	**435**

Source: Author's Computation

4.2 Liquidity of firms and the Effect of IFRS-Adoption in Nigeria

The liquidity position of a firm is important to its survival in the short term as cash flow is important to survival in the long run. The mean liquidity ratio of firms in pre IFRS era is 1.7218:1 indicating that current assets are able to cover current liability for up to two times. Generally, this is a fair liquidity position but would depend strongly on the components of current assets of firms. Some firms are in poor liquidity position while others have very strong liquidity position as indicated by the minimum and maximum of 0.0049:1 and 29.8269:1 respectively (*see table 4.1*). In post IFRS era, mean liquidity position dropped to 1.4142:1. The minimum of 0.0195 and maximum of 15.5056 indicates that while some firms in pre IFRS performed better in liquidity, others also performed worst. The pre IFRS standard deviation of 2.2446 compared to post IFRS of 1.3676 confirms this spread in performance in liquidity. While there is generally weaker liquidity position in post IFRS era than the pre IFRS era, the paired sample test below showed whether this difference is statistically significant or not.

Table 4.2 Two Sample t-test for the Means of Liquidity of Firms (Pre & Post-IFRS)

Variable	**Obs.**	**Mean**	**Std. Dev.**	**[95% Conf.**	**Interval]**
Liq Pre-IFRS	435	1.7218	2.2446		
Liq Post-IFRS	435	1.4142	1.3676		
Difference		0.30756	2.37237	0.08400	0.53112

Difference=mean(Liq Pre) - mean(Liq Post) t-Statistics(Sign Two Tailed)=2.704(0.007***)

Ho: diff = 0 H1: diff ≠0 Degrees of freedom = 434

Liquidity position shows a t-statistics of 2.704 with a p-value of 0.007 indicating that there is a significant difference between liquidity in pre and post IFRS adoption years. The result indicates that there is a 99% confidence that the test could explain the difference. The difference in mean is 0.30756 with a 95% confidence interval of 0.08400 to 0.53112 that the result is correct. Hence, we conclude that IFRS has a significantly impact on the liquidity position of firms measured by the current ratio. The results contradict previous work of Omaliko, Uzodimma & Okpala (2017), although Omaliko et work was carried out in the banking subsector of the economy.

V. CONCLUSION

The study aimed at examining the impact IFRS adoption has on the liquidity position of firms quoted on the floor of the NSE. To measure liquidity, the study used current ratio and examines the mean in pre and post adoption years. The results show mean liquidity is lower in periods of 2012-2016 indicating a negative impact of IFRS-adoption in Nigeria. Furthermore, the sampled t-test shows that the difference in mean of both periods, 2007 – 2011 and 2012-2016, statistically differ from each other, implying that there exist a difference in mean as confirmed by the t-test. Thus, the study concludes that the adoption of IFRS has had a negative and significant impact on the short-term liquidity position measured by current ratio of firms. We therefore, recommend that managers should find a way to improve the liquidity of firms in order to position the firm stronger both in the short and long-term. Again, since adoption should lead to more transparency, openness and less conflict of interest, there should be a new study to examine whether the reduction in liquidity is solely caused by adoption of IFRS or the economic recession which hampered the Nigerian economy in the year 2015.

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