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Comparative Extensiveness of Malaysian and Nigerian Banks Earnings Management under Different Accounting Standards

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Abstract

Malaysia and Nigeria simultaneously adopted IFRS with 1January 2012 as the effective date. Different accounting standards are associated with different magnitude and extensiveness of earnings management. This paper evaluates the extensiveness of Malaysian and Nigerian banks earnings management in relation to different accounting standards. Precisely, this study is set to provide answers to the question "do Malaysian banks engage more in earnings management under both GAAP and IFRS reporting regimes than Nigerian banks? The population of this study consist of listed Malaysian and Nigeria banks. The data period is further divided into pre-adoption period (2008-2010) and post-adoption period (2011-2013). In order to provide answers to the research question, for Malaysian and Nigerian banks respective pre and post adoption periods, this study specifically investigated aggregated discretionary accruals, discretionary loan loss provisions, earnings smoothing, loan loss provisions earnings management pattern, loan quality and earnings management goals as measures of overall earnings management. E-views was used to analyse collected data. Regardless of reporting standards, findings established that Nigerian banks extensiveness in earnings management is far reaching compared to Malaysian banks. By implication, though IFRS reduces earnings management of Malaysian and Nigerian banks, IFRS adoption alone is not adequate in minimizing or eliminating earnings management of corporate firms. Since integrity of financial reporting depends largely on parties in the reporting ecosystem, this study recommends that Nigerian banks borrow a leaf from Malaysian banks by embracing the best corporate governance practices.

Keywords: Earnings management, Accounting standards, IFRS, GAAPs, Aggregate discretionary accruals, Discretionary loan loss provisions, Loan quality, Earnings smoothing.

Contribution of Study

This study is one of very few studies which have investigated comparatively the extensiveness of banks earnings management given consideration to different accounting standards.

1. Introduction

According to Azarian (2011) comparative study is a mode of scientific analysis that sets out to investigate systematically two or more cases with respect to their similarities and differences, in order to arrive at understanding, explanation and further conclusions regarding a specific phenomenon, like revolution, state formation processes, particular policies or types of organisation, etc. Giving the awesome advantages associated with comparative analysis as an old mode of research, Azarian (2011) established that results from contemporary comparative research can be found in nearly all disciplines and applied to the study of almost any topic. However, though comparative analysis is widely used within many fields of scientific inquiry, it is barely used in studies on financial reporting quality in the context of accounting standards. In other words, despite this broad and inter-disciplinary use, there is typically not much attention paid to this method in the setting of changes in accounting standards/IFRS adoption, earnings management and value relevance of accounting information. More often than not, the major purpose and goal of studies on IFRS adoption, earnings management and value relevance is to better understand singular cases rather than a typology based on the observed differences and similarities among cases which constitute many comparative studies (George, 2010; Nabil, 2012; Arum, 2013).

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Chen *et al.* (2010); Ahmed *et al.* (2013); (Paglietti, 2009); Zeghal *et al.* (2012) and Palea (2013) are few comparative studies on accounting standards including IFRS adoption's potency to limiting earnings management. Yet, these studies basically focused on manufacturing/sales-based European/industrialized countries firms. However, this study conjecture that since banks financial reporting is held to a high esteem by standard setters as evidenced in the setting of banks unique standards, the impact of accounting standards including IFRS adoption on accounting quality in terms of earnings management should be more for banks compared to other non-bank firms. IASB (2014) and Agostino *et al.* (2011) established that IFRS adoption would significantly impact on banks reporting outcomes. Thus, while few prior studies comparatively examine the potency of IFRS in reducing earnings management of manufacturing/sales-based European/industrialized countries firms (Chen *et al.*, 2010; Ahmed *et al.*, 2013) this study present fresh and distinctive empirical setting to comparatively evaluate the extensiveness of earnings management of Malaysian and Nigerian banks under different accounting standards – GAAPs and IFRS. Apart from the introductory section, the rest of this paper is divided into three sections. Section II presents the study methodology while Section III discusses empirical results of the study. Finally, Section IV concludes and provides possible recommendation.

2. Methodology

2.1. Population of the Study

The population of this study consist of all Malaysian (8) and Nigerian banks (20).

2.2. Data Source, Period and Instrument of Analyses

Panel data from banks audited financial statements for periods 2008-2013 were used for this study. Eviews special regression and forecasting capabilities were employed to perform panel data analyses.

2.3. Regression Model

This study adjusted the Jones (1991) model to able to investigate aggregate discretionary accruals of Malaysian and Nigerian banks as proxy of overall earnings management under GAAP and IFRS. Also, consistent with Kanagaretnam *et al.* (2003) this study investigated discretionary loan loss provisions of Malaysian and Nigerian banks giving regard to different accounting standards. Malaysian and Nigerian banks earnings smoothing calculated as the correlation between accruals and operating cash flows giving recognition to separate accounting standards were equally evaluated. Furthermore, consistent with Diantimala and Baridwan (2012) this study evaluated Malaysian and Nigerian banks earnings management pattern via loan loss provisions and overall loan quality under GAAP and IFRS. Finally, in agreement with George (2010) earnings management goals of reporting small positive profits and the speed by which losses are recognized were evaluated for Malaysian and Nigerian banks under different accounting standards.

3. Comparative Effects of IFRS on Earnings Management of Malaysian and Nigerian Banks

For both Malaysian and Nigerian banks' different reporting regimes, this study has investigated aggregate discretionary accruals, discretionary loan loss provisions, earnings smoothing, LLP earnings management pattern, loan quality and earnings management goals as proxies of earnings management.

3.1. Aggregate Discretionary Accruals – Malaysian and Nigerian Banks Comparative Findings

In specifics, aggregate discretionary accruals (DA), a measure of overall earnings management were higher for Nigerian banks than Malaysian banks regardless of the reporting period. According to Table 1, while Malaysian banks exhibited relatively low aggregate DA of 0.057891 and 0.056635 respectively for the pre and post adoption periods, Nigerian banks respective pre and post aggregate DA of 0.288685 and 0.226468 were significantly higher. This is a reflection of about 399 and 300 percent respective difference in Malaysian and Nigerian banks pre and post MFRS/IFRS adoption aggregate DA. Results associating Nigerian banks with higher aggregate DA compared to Malaysian banks regardless of the reporting periods are indicative that Nigerian banks practice far reaching earnings management compared to Malaysian banks.

Table-1. Differences in Malaysian and Nigerian Banks Pre and Post Aggregate Discretionary Accruals

	Malaysian Banks	**Nigerian Banks**	**Degree of Differential**
Pre Adoption Era Aggregate DA	0.057891	0.288685	-0.230794 = 399%
Post Adoption Era Aggregate DA	0.056635	0.226468	-0.169833 = 300%

3.2. Discretionary Loan Loss Provisions (DLLP) – Malaysian and Nigerian Banks Comparative Findings

Similarly, DLLP, a measure of specific/single accruals were higher for Nigerian banks than Malaysian banks regardless of the reporting period. Precisely, according to Table 2 while Malaysian banks exhibited moderately low DLLP of 0.004913 and 0.00256 respectively for the pre and post implementation periods, Nigerian banks respective pre and post DLLP of 0.108864 and 0.031153 were much greater. This represents about 2116 and 1117 percent respective difference in Malaysian and Nigerian banks pre and post DLLP. Results linking Nigerian banks with greater DLLP compared to Malaysian banks regardless of the reporting periods are indicative that Nigerian banks engage more in earnings management compared to Malaysian banks.

Table-2. Differences in Malaysian and Nigerian Banks Pre and Post DLLP

	Malaysian Banks	Nigerian Banks	Degree of Differential
Pre Adoption Era DLLP	0.004913	0.108864	-0.103951 = 2116%
Post Adoption Era DLLP	0.00256	0.031153	-0.028593 = 1117%

3.3. Earnings Smoothing – Malaysian and Nigerian Banks Comparative Findings

Regardless of reporting periods, earnings smoothing results established that Malaysian banks smooth earnings more intensively compared to Nigerian banks. Earnings smoothing was evaluated based on the correlation between total accruals (TA) and operating cash flows (OCFL). Earnings smoothing normally, induces a negative correlation between TA and OCFL. Comparatively, a higher negative correlation between TA and OCFL is suggestive of higher earnings smoothing and a lower negative correlation between TA and OCFL is indicative of less earnings smoothing. Table 3 presents comparatively pre and post adoption correlation between Malaysian and Nigerian banks respective TA and OCFL as a measure of earnings smoothing.

Table-3. Malaysian and Nigerian Banks Earnings Smoothing Results

	Malaysian Banks	Nigerian Banks	Degree of Differential
Pre Adoption Era (TA,OCFL)	-0.898426	-0.876033	-0.0224 = 2.6%
Post Adoption Era (TA,OCFL)	-0.898887	-0.856390	-0.042 = 5%

According to Table 3 and regardless of reporting regimes, Malaysian banks exhibited the highest negative correlation between total accruals (TA) and operating cash flows (OCFL), which is indicative that Malaysian banks engage more in earnings smoothing than Nigerian banks for the different reporting periods. Particularly, during the pre-adoption era, Malaysian banks TA correlation with OCFL was -0.898426 against Nigerian banks lower equivalent of -0.876033. The difference between Malaysian and Nigerian banks TA correlation with OCFL prior to MFRS/IFRS adoption is about 2.6 percent. Similarly, after MFRS/IFRS adoption by Malaysian and Nigerian banks, TA correlation with OCFL of -0.898887 for Malaysian banks was still higher compared to Nigerian banks equivalent of -0.856390, a mirror image of about 5 percent in the difference between both banks post adoption correlation between TA and OCFL.

3.4. Loan Loss Provisions (LLP) Earnings Management Pattern – Malaysian and Nigerian Banks Comparative Findings

Regarding evaluation of LLP earnings management pattern(s), results established that irrespective of reporting periods, the practice of earnings management pattern of income minimization was more intensified for Nigerian banks compared to Malaysian banks. Since loan loss provisions (LLP) affects directly profit before tax and extra ordinary items (PBTE), basically, for earnings management pattern via LLP investigation, conclusion was based on the sign and magnitude of PBTE coefficient. Table 4 presents comparatively earnings management pattern(s) using LLP findings for both Malaysian and Nigerian banks pre and post adoption periods.

Table-4. Malaysian and Nigerian Banks Comparative LLP Earnings Management Pattern Findings

	Malaysian Banks	Nigerian Banks	Degree of Differential
Pre Adoption Era	RM100 PBTE → RM-0.32 LLP	N100 PBTE → N-0.29 LLP	-0.03 = 10.3%
Post Adoption Era	RM100 PBTE → RM-0.4 LLP	N100 PBTE → N-0.069 LLP	-0.331 = 480%

According to Table 4, though for both Malaysian and Nigerian banks, the coefficient on PBTE regardless of reporting periods is negative, it is obvious that Nigerian banks pre and post adoption periods exhibited least negative coefficient on PBTE. Results associating least negative coefficient on PBTE with Nigerian banks pre and post adoption eras is indicative that Nigerian banks engaged more in the practice of earnings management pattern know as income minimization more than Malaysian banks, regardless of the reporting periods.

In precise terms, while RM0.32 of LLP reduces PBTE by RM100 prior to MFRS adoption for Malaysian banks, it takes just N0.29 LLP for PBTE to reduce by N100 during the same period for Nigerian banks. This was reflective of about 10.3 percent difference between Malaysian and Nigerian banks practice of LLP earnings management pattern of income minimization. Similarly, after, the adoption of MFRS/IFRS, while it takes RM0.4 to reduce Malaysian banks PBTE by RM100, just N0.069 LLP of Nigerian banks reduces PBTE by N100. This was a reflection of about 480 percent difference between Malaysian and Nigerian banks practice of earnings management pattern of income minimization via LLP post MFRS/IFRS adoption. With smaller amount of Nigerian banks LLP adversely affecting or reducing the same level of PBTE in comparison with Malaysian banks, results established that the practice of LLP earnings management pattern of income minimization was more pervasive for Nigerian banks against Malaysian banks.

3.5. Loan Quality – Malaysian and Nigerian Banks Comparative Findings

In the case of the evaluation of loan quality, outcomes established that while loan quality was higher for Malaysian banks compared to Nigerian banks during the pre-adoption era, loan quality for both set of banks were almost the same after the adoption of MFRS/IFRS. Essentially, conclusion on loan quality was based on the coefficient on GLOAN. Thus, higher GLOAN coefficient was indicative of higher quality of loan portfolio, and lower GLOAN coefficient was suggestive of lower quality of loan. Table 5 presents comparatively loan quality findings for both Malaysian and Nigerian banks pre and post adoption periods.

Table-5. Malaysian and Nigerian Banks Comparative Loan Quality Findings

	Malaysian Banks	Nigerian Banks	Degree of Differential
Pre Adoption Era	RM100 GLOAN → RM0.012 NPL	N100 GLOAN → N0.0073 NPL	0.0047 = 64.4%
Post Adoption Era	RM100 GLOAN → RM0.019 NPL	N100 GLOAN → N0.02 NPL	0.001 = 5%

According to Table 5, for the pre adoption period, the coefficient on GLOAN was higher for Malaysian banks compared to Nigerian banks equivalent which was suggestive that loan quality was higher for Malaysian banks compared to Nigerian banks. More precisely, prior to MFRS/IFRS adoption, whereas, coefficient on Malaysian banks GLOAN was as high as 0.012, GLOAN coefficient for Nigerian banks was as low as 0.0073, a mirror image of about 64.4 percent in Malaysian and Nigerian banks respective GLOAN coefficient. However, after the adoption of MFRS/IFRS by Malaysian and Nigerian banks coefficient on GLOAN became almost the same. While the GLOAN coefficient for Malaysian banks post MFRS adoption stood at 0.019, Nigerian banks equivalent was 0.02, a reflection of about 5 percent difference in both banks GLOAN coefficient post MFRS/IFRS adoption. Therefore, results established that the effect of MFRS/IFRS on loan quality for Malaysian and Nigerian banks are similar.

3.6. Earnings Management Goals – Malaysian and Nigerian Banks Comparative Findings

For both Malaysian and Nigerian banks, earnings management goals of reporting small positive profits and the speed by which losses are recognized were investigated. Table 6 present comparatively earnings management goals findings for Malaysian and Nigerian banks. Regarding earnings management goals of reporting small positive profits, results in Table 6 established that under MFRS, Malaysian banks tend to manage their profits figures less frequently in order to report small positive profit rather than negative amounts as opposed to the Malaysia GAAP. However, for Nigerian banks, results established that under SAS banks tend to manage their profits figures less frequently in order to report small positive profit rather than negative amounts as opposed to the IFRS.

Also, with positive coefficients on Malaysian and Nigerian banks LNL results in Table 6 demonstrate that under MFRS/IFRS Malaysian and Nigerian banks tend to recognize large losses readily than under the previous Malaysia and Nigeria respective domestic GAAPS - FRS and SAS. Comparatively and in specifics, however, Malaysian banks readily recognized more of large losses under MFRS compared to Nigerian banks under IFRS. This conclusion is reflected in the higher positive coefficient on LNL for Malaysian banks compared to coefficient on LNL for Nigerian banks.

Table-6. Earnings Management Goals - Malaysian and Nigerian Banks Comparative Findings

	Malaysian Banks	Nigerian Banks	Effects
Earnings Management Goals - SPP	-1.984434	0.041137	Contradictory
Earnings Management Goals - LNL	1.374708	0.624992	Similar

In all, earnings management were more intense regardless of reporting regimes for Nigerian banks compared to Malaysian banks. Thus, consistent with Johl *et al.* (2007) Malaysian banks can be argued here to provide a setting "less transparent with low levels of public scrutiny" compared to the west and not an emerging economy such as Nigeria.

3.7. Overall Earnings Management – Malaysian and Nigerian Banks Comparative Findings

Table 7 shows overall summary of earnings management investigation results for both Malaysian and Nigerian banks.

Table-7. Summary of Earnings Management Investigation Results for Malaysian and Nigerian Banks

S/No	Earnings Management Measures	Malaysian Banks Findings	Nigerian Banks Findings
1.	Aggregate discretionary accruals	absolute value of aggregate DA reduced by 2.17% after the mandatory adoption of MFRS	Absolute amount of aggregate DA considerably reduced by 22% consequent upon the mandatory adoption of IFRS
2.	Discretionary loan loss provisions	absolute value of DLLP was considerably reduced by 47.9% after the mandatory adoption of MFRS	Absolute amount of DLLP considerably reduced by 71.4% consequent upon the mandatory adoption of IFRS
3.	Earnings smoothing	No significant difference between income smoothing habit of Malaysian banks for the FRS and MFRS reporting regimes	Earnings smoothing was more pervasive during the SAS reporting era compared to the IFRS reporting regime
4.	LLP Earnings Management Pattern	Significant practice of earnings management pattern known as income or earnings minimization for the FRS reporting age	Practice more of income or earnings minimization after the adoption of IFRS
5.	Loan quality	Loan quality increased significantly post MFRS adoption	Loan quality became significantly enhanced post IFRS adoption
6.	Earnings Management Goal - SPP	Under MFRS banks tend to manage their profits figures less frequently in order to report small positive profit rather than negative amounts as opposed to the Malaysia previous FRS	Under SAS banks tend to manage their profits figures less frequently in order to report small positive profit rather than negative amounts as opposed to the IFRS
7.	Earnings Management Goal -LNL	Under MFRS banks tend to recognize large losses readily than under FRS	Under IFRS banks tend to recognize large losses readily than under SAS
8.	Conclusions	The implementation of MFRS reduces the scope, frequency and magnitude of earnings management for Malaysian banks	IFRS significantly discourages earnings management compared to Nigeria SAS

Overall, according to Table 7, for both Malaysian and Nigerian banks, aggregate discretionary accruals and discretionary loan loss provisions reduced substantially after the adoption of IFRS. However, the decrease in aggregate DA and DLLP following the adoption of MFRS/IFRS differ for Malaysian and Nigerian banks. Whereas, for Malaysian banks aggregate DA and DLLP reduced respectively by 2.17 and 22 per cent following the adoption of MFRS, Nigerian banks showed greater respective decrease of about 47.9 and 71.4 percent in aggregate DA and DLLP after the implementation of IFRS. The significant difference in the effects of IFRS on Malaysian and Nigerian banks aggregate DA and DLLP is because the distance between the Nigerian previous SAS and IFRS is more than the distance between the Malaysian previous FRS and MFRS. According to Zeghal *et al.* (2012) improvement in accounting quality post-IFRS adoption is a function of the distance between the pre-existing national GAAP and IFRS. Tan *et al.* (2011) also demonstrated that firms in countries where local GAAP differ more from IFRS prior to IFRS adoption will receive greater benefits than firms from countries where local GAAP are already close to IFRS.

Also, for both Malaysian and Nigerian banks, earnings smoothing reduced and loan quality increased after the adoption of IFRS. Additionally, under IFRS, Malaysian and Nigerian banks tended to recognize large losses readily than under Malaysia and Nigeria previous GAAP. Thus, findings established that IFRS reduced earnings management of

Malaysian and Nigerian banks more than GAAP. However, findings were contradictory for LLP earnings management pattern and earnings management goals of reporting small positive profits analyses. For Malaysian banks, findings evidenced that IFRS limited the practice of earnings management pattern of income minimization and the practice of deliberate reporting of small positive profits rather than negative amounts. But, for Nigerian banks, findings from these two analyses favour Nigeria GAAP. Thus, findings showed that SAS limited the practice of earnings management pattern of income minimization and the practice of deliberate reporting of small positive profits rather than negative amounts.

4. Conclusions and Recommendations

This study investigated comparatively earnings management of Malaysian and Nigerian banks under different accounting standards- GAAPs and IFRS and by extension, this study evaluated whether the effect of IFRS adoption on earnings management is similar for Malaysian and Nigerian banks. Empirical results established that irrespective of accounting standards, Nigerian banks engaged more in earnings management against Malaysian banks.

Essentially, out of seven analyses conducted, each for Malaysian and Nigerian banks, except for two (LLP earnings management pattern and earnings management goals of reporting small positive profit for Nigerian banks), overall empirical results were in agreement with the prediction of this study and tended towards the same direction, establishing that IFRS adoption by Malaysian and Nigerian banks reduced earnings management considerably. Overall, the effects of IFRS adoption on earnings management are similar for both Malaysian and Nigerian banks. This conclusion is empirically appropriate and guaranteed given comprehensive investigation of earnings management using nearly all measures/models (manufacturing/sales-based and banks-specific measures/models) propounded by present studies. The use of both sets of models have bridged the gap between their respective weaknesses and eliminated existing studies bias. The findings of this study are consistent with conclusions from George (2010); Arum (2013) and confirm that the objective of IASB in developing IFRS to enhancing accounting quality by minimizing earnings management is being achieved.

Findings associating more extensiveness of earnings management to Nigerian banks against Malaysian banks regardless of reporting standards are indicative that accounting standards including IFRS alone does not guarantee reduction in earnings management of banks since the sincere implementation of accounting standards depend on parties in the financial reporting ecosystem (Seow and Pan, 2013; Sanusi *et al.*, 2014) a concern for corporate governance. Therefore, this study recommends that Nigerian banks embrace best corporate governance practices, particularly, they should borrow a leaf from Malaysia corporate governance code 2007. Also, with findings establishing the superiority of IFRS over GAAPs in reducing earnings management of banks, this study recommends that banks globally should adopt IFRS.

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