



# International financial reporting standards adoption and financial disclosures of SMEs: Evidence from Port-Harcourt Metropolis in Nigeria

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## ABSTRACT

This study examined the implications of International Financial Reporting Standards (IFRS for Small and medium-sized enterprises, SMEs) on financial disclosures by SMEs in Nigeria. The population consisted of users of financial statements of small and medium-sized enterprises, including auditors, analysts, managers, owners, and regulators in Port-Harcourt, South-south Nigeria. Primary data were collected using structured questionnaires and interviews. Descriptive statistics were used to summarize their responses. Formulated hypotheses were tested using the Pearson Product Moment Correlation Analysis. The findings obtained show that the adoption of IFRS for SMEs has significant positive relationship with financial disclosures and inflows of external capital in SMEs. The researchers therefore recommend that SMEs should be encouraged to adopt the IFRS for SMEs; due to the attendant benefits, derivable from such adoption by the SMEs in particular, and the economy of Nigeria at large. It is also recommended that SMEs should be educated on the benefits associated with such move; while compliance should be made mandatory for all enterprises in this category.

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## INTRODUCTION

Small and medium-sized enterprises (SMEs) constitute the core of the overall economy in most countries; both developed and developing countries. They contribute significantly to Gross Domestic Product (GDP) through employment generation and production of goods/services. They represent more than 99% of the operating entities in most countries and provide from 40 to 80% of employment and are responsible for about more than half of the GDP in the world (Aamir and Farooq, 2010). However, despite the great importance of the SMEs sector, they suffer from a great deficiency manifested in their accounting and financial practices.

SMEs, like other large corporate businesses, are mandated by law to prepare financial statements.

Accordingly, they are expected to disclose their financial status fairly through their financial statements; to enable the users make informed financial and related decisions. This is only possible if SMEs follow standard accounting practices (such as those enshrined in the International Financial Reporting Standards, IFRS for SMEs) in the preparation of their financial reports. Hence, this accounts for one of the reasons why the government of Nigeria directed all SMEs to adopt the IFRS for SMEs.

SMEs by nature are peculiar in their mode of operation. In Nigeria, like other developing countries, they (SMEs) are usually characterized by inadequate infrastructure, inefficient administration, lack of accountability and transparency, poor funding, etc.; yet their dominance and contributions to the economic activities of the country cannot be underestimated.

Knowing the importance of this critical sector to the economy of the country, the Federal Government of

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Nigeria had responded consistently and variously, by putting in place several measures to stimulate their growth. One of the measures was through the establishment of Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), an agency charged with the responsibility of overseeing the activities of SMEs in Nigeria. Another measure taken by the government to boost the activities of SMEs was the 2010 directive by the Federal Executive Council's (FEC) approving the adoption of IFRS by all SMEs; effective 2014 in Nigeria. To make effective its plan, the Financial Reporting Council Act was passed by the National Assembly replacing the defunct Nigeria Accounting Standards Board (NASB) with the Financial Reporting Council of Nigeria charged with the responsibility of supervising financial reporting in Nigeria (SMEs inclusive). Proponents of IFRS adoption for SMEs had given reasons of: greater transparency of financial reporting by entities, enhanced accountability and reliability, comparability and better decision making, tendency of attracting Foreign Direct Investments, Compliance with global best practices as some of the benefits derivable from such exercise. Bath (2008) argued that firms applying IAS/IFRS experienced an improvement in accounting quality between the pre-adoption and the post-adoption period. Meeks and Swann (2009) further opined that adopting IFRS had exhibited higher accounting quality in the post-adoption period than they did in the pre-adoption period. According to Adekoye (2011) "globalization of capital markets is an irreversible process, and there are many potential benefits to be gained from mutually recognized and respected international accounting standards. The adoption of uniform standards cut the cost of doing business across borders by reducing the need for supplementary information. They make information more comparable, thereby enhancing and analysis by users of financial statements". Users become more confident of the information they are provided with and presumably, this reduces uncertainty, promotes an efficient allocation of resources, and reduces costs (Ahmed, 2011). For globalization reasons, and that of the successes experienced recently by countries in Asia, Europe, Southern Africa, and South America due to adoption of IFRS; Nigerian enterprises cannot afford to be left behind in the scheme of global best practices in accounting and reporting.

Since that action or directive, SMEs have been faced with difficulties with its adoption and implementation. These include problems ignorance, lack of understanding by managers/owners and accounting officers of SMEs, keeping of incomplete accounting records, inadequate infrastructure, lack of funds to ensure seamless implementation, fear of tax exposure, etc.; are some of the reasons hampering the effective take-off the scheme, by SMEs in Nigeria.

Although Madawaki (2012), Okpala (2012), Isemla and Adeyemo (2013), Adetula et al. (2014) and Oyewo (2015) have all carried out various studies on IFRS adoption in Nigeria, a lot more still need to be done in the area of IFRS adoption by SMEs, as such literature are still scanty. This study was aimed at examining the implications of IFRS adoption on financial disclosures by SMEs in Nigeria. Accordingly, the paper sought to provide answers to the following questions:

- Will adoption of IFRS by SMEs in Nigeria enhance financial information disclosures?
- Will SMEs adoption of IFRS by Nigerian SMEs lead to increased accessibility to local and foreign capital markets?

## REVIEW OF LITERATURE

The reliability of accounting information is very crucial to the success of any entity; private or public. Accurate information about the financial performance, financial position, and the certainty of cashflows of an enterprise is essential for planning and control purposes, and it is crucial to every economic decision by stakeholders. Hence, the accounting rules must be properly designed in order not to distort financial facts, which would then lead to the misallocation of resources in non-productive uses.

### SMEs defined

The term small and medium-sized entities has different definitions; depending on the jurisdiction and the defining entity. SME, in the context of the IFRS for SMEs "are entities that do not have public accountability and do not publish general purposes financial statements or follow generally accepted accounting principles (GAAP)". A small or medium-sized enterprise, or SME, as defined by the European Commission is a business or company: "that has fewer than 250 employees; and has either (a) annual turnover not exceeding €50 million (approximately £40 million) or (b) an annual balance-sheet total not exceeding €43 million (approximately £34 million); and of whose capital or voting rights, 25 per cent or more is not owned by one enterprise, or jointly by several enterprises, that fall outside this definition of an SME".

In Nigeria, there is no uniform definition of SMEs. For instance, The Central Bank of Nigeria, in its Monetary Policy Circular No. 22 of 1988, defined small-scale enterprises "as having an annual turnover not exceeding 500,000 naira". In one of its budget speeches, the Federal Government of Nigeria defined "small-scale enterprises for purposes of commercial bank loans as those with an annual turnover not exceeding 500,000 naira, and for Merchant Bank Loans, those enterprises

with capital investments not exceeding 2 million naira (excluding cost of land) or a maximum of 5 million naira.

From the above definitions, it is obvious that over 90% of enterprises in Nigeria are SMEs, meaning they contribute the bulk of the nation's GDP and employ over 70% of the populace making them not only the highest employer of labour, but major stakeholders critical to the development of the Nigerian economy.

### **IFRS for small and medium-sized entities**

After some thoughtful considerations, the IASB prepared in 2009, an independent set of accounting principles based on the full version of the IFRS, but simplified for small and medium-sized entities. The IFRS for SMEs comparable between countries are needed for these reasons:

- i. Financial institutions provide credit abroad and in most jurisdictions, even though over half of SMEs have banking credits, and banks, in turn, are based on financial statements when making decisions with regard to credit granting;
- ii. Suppliers intend to assess the financial health of buyers in other countries before selling products or services with payment term;
- iii. Credit rating agencies try to devise ratings uniformly at the international level and financial information are key to the rating process;
- iv. Many SMEs have suppliers overseas and use financial statements from one supplier to assess the prospects of a feasible long-term business relationship;
- v. Venture capital firms invest in SMEs from other countries; and
- vi. Occasional SMEs with external investors do not participate in the daily management of the entity (IASB, 2009).

### **EMPIRICAL EVIDENCE**

Beck et al. (2005) found a robust, positive relationship between the relative size of the SME sector in a country and its Economic Growth. Ciobotaru (2013) pointed that SMEs contribute in raising the living standards of the society through stimulating the economic activity, the diversity of products offered to consumers and creating new jobs. Also, as Larson (1993) had found in his study of the relationship between the adoption of the IASC's (IASB) standards and economic growth in developing countries, international accounting standards modified to suit local conditions can be instrumental in promoting economic growth. Owolabi and Onyinye (2014) opined that the major factor responsible for the adoption of IFRS by SMEs in Nigeria was that other countries around the

world are adopting it. Other scholars including Garuba and Donwa (2011), Madawaki (2012), Okoye and Adeniran (2013) and Oyewo (2015) supported the adoption of IFRS by SMEs. Okpala (2012) opined that IFRS implementation will promote foreign direct inflows and economic growth.

The United Nations in its document titled "Accounting and Financial Reporting Guidelines for Small and Medium-sized Enterprises (SMEGA) Level 3" asserted that in developing countries, compliance with IFRS for SMEs is believed to be more difficult than elsewhere possibly because the standards setter did not accommodate the peculiarities of developing countries, in terms of their uniqueness and heterogeneous nature.

Other researchers like Campbell and Morris (2006), Deaconu et al. (2007), Alp and Ustundag (2009), Cirkveni (2011) and Madawaki (2012) concluded that there is a need and a necessity for launching a special set of accounting standards specially designed for the SMEs in order to encourage the SMEs to use a set of high quality standards in preparing their financial statements; and thus this will enhance the harmonization and comparability of the information among business enterprises across the globe.

### **METHODOLOGY**

The population of the study was SME-owners and other users of their financial statements in Nigeria. For this study, samples were selected from Port-Harcourt, South-south geo-political Zone of Nigeria. The cosmopolitan nature of Port-Harcourt, the prevalence of multiple SMEs, and the closeness of the town to the researchers made them to concentrate on Port-Harcourt metropolis. The researchers employed judgmental sampling technique during the study. Questionnaires were distributed to the owners, managers, and accountants of SMEs (herein referred to as "internal users of financial statements" of SMEs) on one hand; and the auditors, tax authorities and business professionals (herein referred to as "external users of financial statements" of SMEs) on the other hand. Primary data were collected through questionnaires. A total of 231 questionnaires were received out of a total of 250 that were distributed, representing 92.4% of total questionnaires received (125 each between the internal users and the external users of financial statements). Out of that, a total of 108 were returned by the internal users while the external users returned 123 copies. All of them were analyzed using descriptive statistical tools. A 5-Likert scale survey questionnaires used to solicit for responses were structured were structured thus: Very High Extent (VHE), High Extent (HE), Small Extent (SE), Very Small Extent (VSE) and Not at All (NAT). Formulated hypotheses were tested using the Pearson Product Moment Correlation

**Table 1.** Response to questions relating to adoption global financial reporting standards by SMEs in Nigeria by stakeholders.

S/N	Variables Responses (In %)	External users of financial statement					Internal users of financial statement				
		VHE	HE	SE	VSE	NAT	VHE	HE	SE	VSE	NAT
1	Adoption of global accounting standards increases financial disclosures amongst SMEs	52 0.48	48 0.44	4 0.04	4 0.04	0 -	57 0.46	38 0.31	24 0.20	3 0.02	1 0.01
2	It enhances credibility and transparency	49 0.45	37 0.34	16 0.15	4 0.04	2 0.02	51 0.41	53 0.43	16 0.13	2 0.02	1 0.01
3	Boosts uniformity and comparability of financial statements of SMEs	41 0.38	43 0.40	17 0.16	6 0.06	1 0.01	49 0.40	47 0.38	19 0.15	5 0.04	5 0.04
4	Increases investors and lenders confidence in financial of SMEs	54 0.50	39 0.36	11 .10	2 0.02	2 0.02	47 0.38	52 0.42	14 0.11	9 0.07	1 0.01
5	Leads to increased access to local and foreign capital in Nigeria	43 0.40	57 0.53	7 0.06	1 0.01	0 -	45 0.37	47 0.38	25 0.20	4 0.03	2 0.02

Field survey, November 2016.

Coefficient.

**DATA PRESENTATION AND ANALYSIS**

**H0<sub>1</sub>:** There is no significant relationship between adoption of IFRS and enhanced financial disclosures by Nigerian SMEs.

**H0<sub>2</sub>:** There is no significant relationship between adoption of IFRS by SMEs and increased accessibility to local and foreign capital markets.

$$r = \frac{n \sum xy - (\sum x)(\sum y)}{\sqrt{[n \sum x^2 - (\sum x)^2][n \sum y^2 - (\sum y)^2]}}$$

$$\sum X = 15, \sum Y = 115.5, \sum XY = 494, \sum X^2 = 55, \sum Y^2 = 5027.75$$

Where: n = 5, r = 0.74 or 74%.

$$r = \frac{n \sum xy - (\sum x)(\sum y)}{\sqrt{[n \sum x^2 - (\sum x)^2][n \sum y^2 - (\sum y)^2]}}$$

$$\sum X = 15, \sum Y = 115.5, \sum XY = 482, \sum X^2 = 55, \sum Y^2 = 4903.25$$

Where: n = 5, r = 0.68 or 68%.

The result of our study revealed that more than 92% of both internal and external users of SMEs' financial

reports agreed that adoption of IFRS for SMEs will ensure better financial disclosures, enhanced credibility, and transparency (Table 1, 2 and 3). 78% each of both external and external users also agreed that adoption of IFRS for SMEs will ensure uniformity and comparability of financial statements prepared by them. Both stakeholders also agreed that it will help SMEs in the areas of investors' confidence and accessibility to external funds.

**CONCLUSION AND RECOMMENDATIONS**

The research work focused on the effect on adoption of IFRS for SMEs on financial disclosures by small and medium-sized enterprises in Nigeria. The results of the hypotheses tested revealed that adoption of IFRS for SMEs will impact positively on the financial information disclosures of SMEs in Nigeria. It further reveals that such will lead to greater disclosures of financial information, will lead to greater investors' confidence and in turn enhance inflow of external capital into the activities of SMEs from banks, internal and foreign investors.

Based on the above conclusions of the study, the researchers therefore recommended that:

- SMEs should be encouraged to adopt a globally recognized and accepted accounting standard (IFRS for SMEs) due to its attendant positive effects on the firms and the economy at large.
- SMEs should be educated on the benefits associated with such move.
- Compliance should be made mandatory but should be

**Table 2.** Calculation of correlation: using responses to Question 1 of Table 1 to test H0<sub>1</sub>: Adoption of global accounting standards increases better financial disclosures by SMEs in Nigeria.

<b>Q1: Adoption of global financial standards increased financial disclosures by SMEs</b>																
<b>External users of financial statements</b>						<b>Internal users of financials</b>										
<b>Options</b>	<b>Point</b>	<b>Response</b>		<b>X<sup>2</sup></b>	<b>Y<sup>2</sup></b>	<b>Point</b>	<b>Response</b>		<b>X<sup>2</sup></b>	<b>Y<sup>2</sup></b>	<b>AA point</b>	<b>AA response</b>		<b>AA</b>	<b>AA</b>	<b>AA</b>
	<b>x</b>	<b>y</b>	<b>xy</b>			<b>x</b>	<b>y</b>	<b>xy</b>			<b>x</b>	<b>y</b>	<b>xy</b>	<b>x<sup>2</sup></b>	<b>y<sup>2</sup></b>	
VHE	5	52	260	25	2704	5	57	285	25	3249	5	54.5	272.5	25	2970.3	
HE	4	48	192	16	2304	4	38	152	16	1444	4	43	172	16	1849	
SE	3	4	12	9	16	3	24	72	9	576	3	14	42	9	196	
VSE	2	4	8	4	16	2	3	6	4	9	2	3.5	7	4	12.25	
NAT	1	0	0	1	0	1	1	1	1	1	1	0.5	0.5	1	0.25	
	15	108	472	55	5040	15	123	516	55	5270	15	115.5	494	55	5028	

Decision: The r calculated of 0.74 is greater than 0.5 level of significance. Hence, we reject the null hypothesis and accept the alternative hypothesis. There is therefore a significant relationship between adoption of International Financial Reporting standards (IFRS for SMEs) and enhanced financial disclosures by SMEs in Nigeria.  
AA = Average aggregate.

**Table 3.** Using responses to Question 5 in Table 1 to test H0<sub>2</sub>: Adoption of global accounting standards leads to increased access to local and foreign capital by SMEs in Nigeria.

<b>Q5: Adoption of global financial standards increases access to local and foreign capital</b>																
<b>External users of financial statements</b>						<b>Internal users of financials</b>										
<b>Options</b>	<b>Point</b>	<b>Response</b>		<b>X<sup>2</sup></b>	<b>Y<sup>2</sup></b>	<b>Point</b>	<b>Response</b>		<b>X<sup>2</sup></b>	<b>Y<sup>2</sup></b>	<b>AA point</b>	<b>AA response</b>		<b>AA</b>	<b>AA</b>	<b>AA</b>
	<b>x</b>	<b>y</b>	<b>xy</b>			<b>x</b>	<b>y</b>	<b>xy</b>			<b>x</b>	<b>y</b>	<b>xy</b>	<b>x<sup>2</sup></b>	<b>y<sup>2</sup></b>	
VHE	5	43	215	25	1849	5	45	255	25	2025	5	44	220	25	1936	
HE	4	57	228	16	3249	4	47	188	16	2209	4	52	208	16	2704	
SE	3	7	21	9	49	3	25	75	9	625	3	16	48	9	256	
VSE	2	1	2	4	1	2	4	8	4	16	2	2.5	5	4	6.25	
NAT	1	0	0	1	0	1	2	2	1	4	1	1	1	1	1	
	15	108	466	55	5148	15	123	498	55	4879	15	115.5	482	55	4903	

Decision: Since r calculated is more than 0.5% level of significance, we reject null hypothesis. Accepting the alternate hypothesis means that there is a significant relationship between adoption of International Financial Reporting Standards by Nigerian SMEs and access to local and foreign capital by SMEs.

gradually implemented. Sanctions should only be meted out to defaulters at the expiration of the period allowed for voluntary compliance.

- Government agencies like SMEDAN, should be encouraged and empowered to train and retrain

owners, managers, and accountants of SMEs on the benefits of proper financial reporting.

- The Financial Reporting Council of Nigeria (FRCN) should ensure proper monitoring of compliance and further promote awareness

of the standards.

- Trainings on IFRS for SMEs should be made more affordable and accessible by owners, management, and accountants of SMEs through SMEDAN and FRCN to boost

its implementation.

- IFRS for SMEs should be made part of the school curriculum (secondary and tertiary levels). This will equip school leavers with the basics even before going into small and medium-sized businesses.

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