Chapter 9
IFRS Convergence and Revisions: Evidence of Accounting Information Quality from East Africa

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ABSTRACT

This chapter is aimed at examining the impact of IFRS convergence and revisions on the financial statements of companies listed in East Africa. This was achieved by determining whether firms report losses (LNEG) when they occur (timely loss recognition) or report small positive income (SPOS) or whether incomes reported exhibit variability in net income (NI) overtime. Simultaneously, the chapter tests whether there is any influence of corporate governance on these three measures which are considered indicators of financial reporting quality. Four models applying GLS random effects are applied on 520 firm year observations for firms listed in Nairobi Securities Exchange (NSE) between 2005 and 2014. The result shows that a positive coefficient on frequency of large losses reported in the finding interpreted as firms with converged and revised IFRS recognize large losses (LNEG) as they occur. The findings also show a negative coefficient on small positive income (SPOS) interpreted as firms applying non-converged and revised standards manage earnings towards small positive amounts more than firms applying converged standards. The post convergence revisions are significant for Chi, \( R^2 \) and the residual which suggest that variability in net income (NI) improved in the post convergence period while corporate governance show insignificant mixed coefficient with the three indicators.
INTRODUCTION

The objective of this chapter is to examine the impact of IFRS convergence and revisions on the financial statements of listed companies in East Africa. Specifically, the study attempts to determine whether firms in East Africa report losses when they occur (timely loss recognition) or report small positive income, and whether incomes reported exhibit variability in net income (NI) over time. The study also checks whether there is any influence of corporate governance on these three measures that are considered indicators of financial reporting quality in line with Chen and Rezaee (2012). The authors state that effective internal corporate governance helps companies to be more aligned with IFRS and thus provides high quality financial information. The study is motivated by the lack of direct measures on the impact of convergence and revisions. Kaboyo (2014) reported that 69 of listed companies in East African practice earnings management, Ernst & Young (2013) in a global survey involving 100 Kenyan firms, reported that 53 per cent of managers believed their companies over-report their financial performance, driven by increased pressures to hit targets in an increasingly challenging business environment. Paanen et al. (2008) attributes the untimely loss recognition and increased earnings management in post IFRS Germany to changes in IFRS, a finding that needs to be closely monitored. The study is also timely as IASB continues with reforming its conceptual framework where accounting conservatism is featuring and raising questions.

The current study looks at two time periods, 2005-2009 and 2010-2014, and compares how the three indicators have changed over the two time periods as the revisions and convergence to IFRS occur and are implemented. During this period, there was accelerated issuance of IFRS to close off the convergence period and also address some of the controversies arising from the financial crisis of 2008. Francis et al. (2004) and Lee (2013) have shown that financial reporting quality measures can either be market based or conservative with conservative measures being timely loss recognition, earnings management and discretionary accruals. The two authors have criticized conservative measures for not providing direct evidence of the usefulness of accounting information to its end users. On the other hand, they have indicated market based approaches as value relevance and liquidity studies and the measures have the advantages of directly addressing end users but are criticized for the fair value weaknesses. Fair values can provide managers with more discretion in accounting, which might diminish the quality of accounting information because of increased earnings management (Ormrod and Taylor. 2004). This chapter takes the conservative approach on the basis of difficulties of applying fair value approaches in less developed markets such as those of East Africa.

Very few studies have been undertaken in this area in East Africa. A related study by Outa (2011) focused on the impact of IFRS/IAS adoption on the accounting quality before and after IFRS adoption from the perceived low quality standards issued by International Accounting Standards Committee (IASC). The period ‘1995-2004’ is based on an outdated data given the changes that have taken place in the standards, the firms and the economy in general. The data for the current study is up to 2014, with improved methodology that is designed to demonstrate how the revisions and convergence to the standards are applied in developing markets, and how it impacts on the financial reporting quality. Capital Markets of East Africa exist in the four countries except Burundi and Sudan but Nairobi Securities exchange (NSE) remains the biggest. Furthermore, East Africa is becoming a key economy that deserves attention. Oil and gas discoveries together with major infrastructure developments is putting spotlight in the region hence the need to assess how financial reporting which is critical to investors, is in tandem with these dynamics and global aspirations.
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