

CROSS BORDER ACCOUNTING FOR OPTIMAL INVESTMENT DECISION – HOW RELEVANT IS THE IFRS?

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ABSTRACT: *Cross border trade, which thrives on the active participation of investors, is a dominant feature of globalisation. International diversity in accounting standards, however, creates information asymmetry, which increases the cost of raising funds and monitoring managers. Empirical evidences point to the fact that adoption of International Financial Reporting Standards is a panacea for reducing information asymmetry. This study examines the relevance of IFRS in addressing cross border accounting challenges. It was hypothesized that adoption of International Financial Reporting Standards (IFRS) in some African Countries (South Africa, Nigeria, Ghana, Kenya and Sierra Leone) would promote Foreign Direct Investment (as a proxy for optimal investment decision) as it reduces information processing costs for foreign investors. Descriptive analysis of secondary data on Foreign Direct Investment from 2005 to 2013 obtained from World Bank was carried out. The result of the Pearson correlation 2- tailed test showed that there was no significant correlation between or among the selected countries. Using year 2012 (where adoption of IFRS cut across the countries) it was found out that the net inflow of Foreign Direct Investment to Ghana, Nigeria and Sierra Leone dropped by 2.05%, 21.01% and 35.99% respectively thereby invalidating the initial assumption that adoption of IFRS would boost Foreign Direct Investments. Meanwhile, Foreign Direct Investment to South Africa and Kenya grew by 75.49% and 98.91% respectively. Further research is required to unravel the factors that are responsible for decline in inflow of Foreign Direct Investment to Ghana, Nigeria and Sierra Leone in spite of adoption of IFRS.*

KEYWORDS: Cross Accounting; Cross Border Investors; Cross Border Trade; Internationalizing Accounting; International Financial Reporting Standards; Optimal Investment Decision

INTRODUCTION

Cross border trade is a dominant feature of globalisation. Interdependence of national economies, listings in foreign markets, foreign direct investments, etc. are being propelled by advances in transportation and information technology. The intensification of competition at both domestic and international levels has driven firms to look beyond their domestic markets for new opportunities (Geiersbach, 2010). Doguwa et al. (2014) submitted that cross border capital flows are, amongst other factors, motivated by investors' desire to optimize their investments by seeking destinations that offer higher returns at manageable levels of risk.

Audited balance sheets, income statements, and cash-flow statements, along with supporting disclosures, form the foundation of the firm-specific information set available to investors and regulators (Bushman and Smith, 2003). Quality accounting information is crucial to making informed economic decisions, especially in cross border transactions where the potential for information asymmetry is high. (Healy and Palepu, 2001) contend that financial reporting and disclosure are potentially important means for management to communicate firm performance and governance to outside investors. Okpala (2012) emphasizes that the quality of financial reporting is indispensable to the need of users who requires them for investment and other decision making purposes. Prior researches have alluded to the fact that cross-border frictions do lead to high information asymmetry between firms and their subsidiaries, which increases ultimately the cost of monitoring within multinational corporations.

High-quality financial reporting with better disclosures is a panacea for reducing information asymmetry. Reduced information asymmetry lowers the cost of raising funds and shareholders' cost of monitoring managers and brings about efficient allocation of resources. A commitment to increased level of disclosure reduces the possibility of information asymmetries arising either between the firm and its share-holders or among potential buyers and sellers of firm shares (Leuz and Verrecchia, 2000). Corporate disclosure is critical for the functioning of an efficient capital market (Healy and Palepu, 2001). Beke (2010) in International Accounting Harmonization: Evidence from Europe submits that the usage of harmonized international accounting system leads to a reduction of the information asymmetry between the owners and the managers.

THEORETICAL CONSIDERATION

The Old Trade Theory Trade -Heckscher–Ohlin Model

Two Swedish economists – Eli Filip Heckscher (1879 - 1952) and Bertil Gotthard Ohlin (1899 - 1979) came up with a theory which explained the patterns in international trade. The theory, an off shoot Ricardian theory of comparative advantage, is built on the imperativeness of uneven factor endowments among countries as the pivotal axis on which international trade rotates. It is believed that countries should produce and export goods that require resources which are relatively abundant and import goods that require resources which are in relative short supply. Consequently, it is suggested that countries should export those goods that make intensive use of locally abundant factors while goods with locally scarce factors should be imported.

Heckscher–Ohlin model (H–O model) relies on the under listed assumptions:

- Labor and capital flow freely between sectors
- The amount of labor and capital in two countries differ (difference in endowments)
- Technology is the same among countries (a long-term assumption)
- Tastes are the same

The New Trade Theory - Krugman Model

The substratum of Krugman Model is that economies of scale in production (which are internal to firms) and a preference for diversity in consumption are the real drivers of International

Trade as against comparative advantage's fulcrum advanced by Ricardian and Heckscher-Ohlin models. The theory states that consumers prefer a diverse choice of brands, and that production favours economies of scale. The model affirms that countries with similar factor endowment and productivity levels can engage in cross border trade. Krugman (1979) using a simple, general equilibrium model of non-comparative advantage trade, explains that trade, and gains from trade, will occur, even between countries with identical tastes, technology, and factor endowments.

LITERATURE REVIEW

International diversity in accounting standards creates its own set of challenges which inhibit the growth of international trade. Cross border investors have great difficulty in reading and interpreting foreign financial statements owing to unfamiliar reporting rules and country specific tones. Variation in social, economic and political factors can lead to deep-rooted differences in financial reporting practices across countries, resulting in substantial variation in the quality and comparability of published financial statement information (Ball, Kothari and Robin 2000, Hung 2000, Leuz, Nanda and Wysocki 2003 cited in Alves et al., 2010). Indeed many countries' financial reporting rules are not designed to reflect underlying economic performance (Revsine, Collins and Johnson 2001, Ball, Kothari and Wu 2003 cited in Alves et al., 2010).

Harmonisation of diverse accounting standards has obvious advantages in terms of comparability and reliability of financial statements. Armstrong et al. (2007) cited in Owolabi and Iyoha, (2012) argue that one single set of accounting standards cannot reflect the differences in national business practices arising from differences in institutions and cultures, proponents argue that substantial benefits can be reaped from greater cross-country comparability of firms' financial reports. Barth (2007) picked from Owolabi and Iyoha, (2012) argues that by adopting a common body of international standards, countries can expect to lower the cost of information processing and auditors of financial reports can be expected to become familiar with one common set of international accounting standards than with various local accounting standards.

Cai and Wong (2010) noted in Taiwo and Adejare (2014) conjectured that having a single set of internationally acceptable financial reporting standards will eliminate the need for restatement of financial statements, yet ensure accounting diversity among countries, thus facilitating cross-border movement of capital and greater integration of the global financial markets. Similarly in Taiwo and Adejare (2014), Meeks and Swann (2009) revealed that firms adopting IFRS exhibited higher accounting quality in the post-adoption period than in the pre-adoption period.

The effect of globalisation, advent of information technology, activities of multinational companies and Foreign Direct Investments are responsible for the sustained call for harmonisation of accounting standards. Fosbre, Kraft & Fosbre (2009) mentioned in Ocansey and Enahoro (2014) affirmed that there was a movement of business toward a global economy and have accelerated the need to move toward global accounting standards.

There is a preponderance of empirical studies on the usefulness of adopting International Financial Reporting Standards among countries of the world. The convergence of opinions is

that using a single set of internationally financial reporting standards in preparing financial statements encourages comparability and reliability.

Expected benefits of internationalizing accounting standards include increased comparability and providing financial report users with better quality information on which to base their investment and credit decisions (AASB 1994 cited in Gallery, 2006).

The benefits of ease of using one consistent reporting standard in subsidiaries from different countries will accrue to companies while investors will develop, amongst others, more confidence in the information presented in financial statements which they can understand and use (Owolabi and Iyoha, 2012).

Barzani (2014) carried out a study on The Effect of Regulation on the Quality of Published Information Disclosure of Listed Companies in Tehran Stock Exchange and found out that showed significant differences between earnings forecast errors before and after the regulations were not disclosed.

Leuz and Verrecchia (2000) in The Economic Consequences of Increased Disclosure study German firms that have switched from the German to an international reporting regime (IAS or U.S. GAAP), thereby committing themselves to increased levels of disclosure. They found that proxies for the information asymmetry component of the cost of capital for the switching firms—namely, the bid-ask spread and trading volume—behave in the predicted direction compared to firms employing the German reporting regime.

Beke (2011) in How can International Accounting Standards support Business Management analysed and valued the effects of international standards on the business economic environments. The study shows that uniform management accounting standards will increase market liquidity, decrease transaction costs for investors, lower cost of capital, and facilitate international capital formation and flow. In addition, reduced costs will also result in more cross-listings and cross-border investments.

Lin, Hua, Lin and Lee (2012) worked on IFRS Adoption and Financial Reporting Quality: Taiwan Experience. The study investigates (using value relevance and the magnitude of earnings management) the converge impacts on reporting quality over 1999 to 2009, which divided into three timeframes: the U.S. GAAP-based era ranging from 1999-2005, the IFRS convergence era ranging from 2006-2007, and the preparation period of IFRS adoption ranging from 2008-2009. The empirical results show that the financial reporting quality got improvement under the amendment towards IFRS adoption.

Chiha, Trabelsi and Hamza (2013) study The Effect of IFRS on Earnings Quality in a European Stock Market: Evidence from France. The study which covers a period of nine years (2002 to 2010) indicates that accounting information quality has been improved by the increase of the association degree. Earnings measured using IFRS are more useful for firms' evaluation.

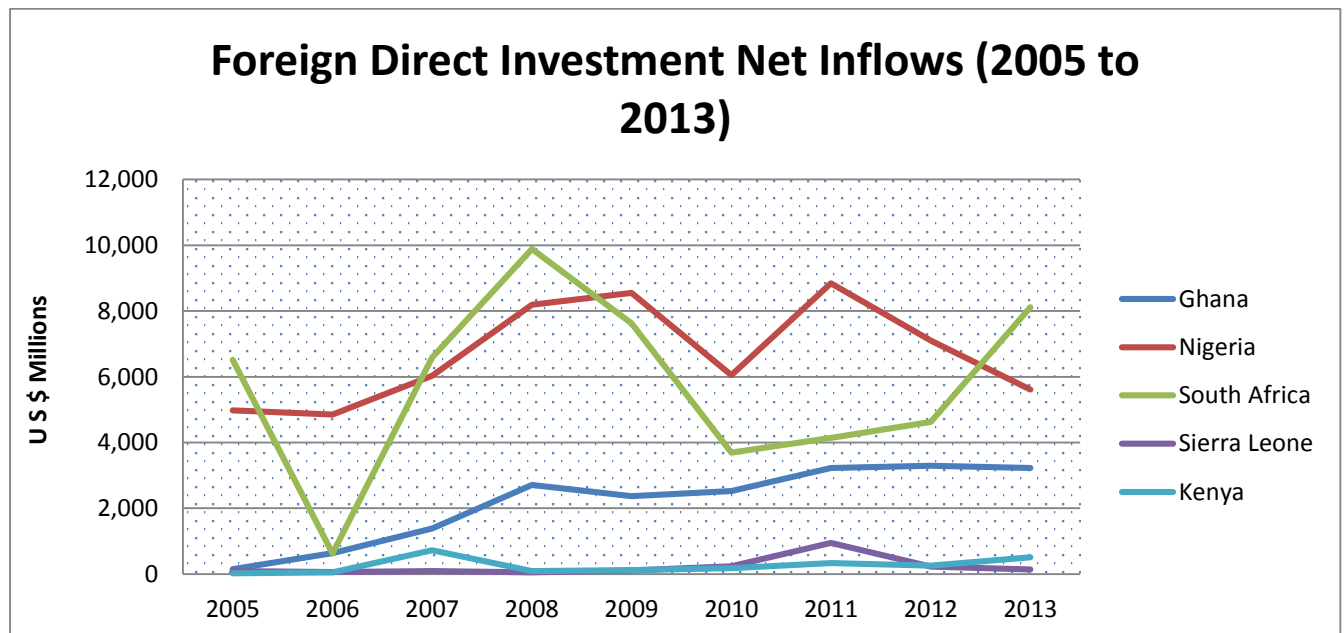
Data Presentation and Analysis

This study employed secondary data obtained on net inflow of Foreign Direct Investment from World Bank for a period of nine years covering 2005-2013 to analyse the growth after adoption of IFRS.

Table 1 Foreign Direct Investment Net Inflows (BOP, Current US \$)

Year	Ghana	Nigeria	South Africa	Sierra Leone	Kenya
2005	144,970,000	4,982,533,943	6,522,098,178	90,731,670	21,211,685
2006	636,010,000	4,854,416,867	623,291,744	58,869,144	50,674,725
2007	1,383,177,930	6,034,971,231	6,586,792,253	95,470,171	729,044,146
2008	2,714,916,344	8,196,606,673	9,885,001,293	53,095,074	95,585,680
2009	2,372,540,000	8,554,840,769	7,624,489,974	110,430,203	116,257,609
2010	2,527,350,000	6,048,560,266	3,693,271,715	238,404,158	178,064,607
2011	3,222,240,000	8,841,952,775	4,139,289,123	950,477,689	335,249,880
2012	3,294,520,000	7,101,031,884	4,626,029,122	225,112,053	258,607,630
2013	3,227,000,000	5,609,000,000	8,118,153,643	144,089,846	514,387,425

Source: World Bank

**Figure 1 FDI Net Inflows (2005 to 2013)**

Interpretation

Trend analysis shows that Kenya beginning with an FDI of \$144,970,000 in 2005 rose to \$514,387,425 in 2013. It rose to about 1400% in 2007 and dropped drastically to \$95,585,680. It generally maintained a gradual undulating figure from 2008 to 2013. Out of all the countries Ghana was the only country that is close to maintaining a linear and parabolic trend in FDI. Starting from \$144,970,000 in 2005 it rose to \$3,227,000,000. On the other hand South Africa had a valley and plateau sort of trend with FDI. It experienced its lowest FDI in 2006 and 2010 to 2012. The highest was 2008. FDI to Nigeria was \$4,982,533,943 in 2005 and in 2013 rose to \$5,609,000,000. The highest FDI was in 2007 and it stood at \$8,841,952,775. Sierra Leone had a slow increase in FDI compared to other countries. The total FDI rose sharply to \$950,477,689 in 2011 and dropped to normal baseline the following year.

Table 2: Foreign Direct Investment Net Inflows (BOP, Current US \$) year to year percentage Analysis of Countries

Year	Ghana	Nigeria	South Africa	Sierra Leone	Kenya	TOTAL
2005 N (%)	144,970,000 (1.23)	4,982,533,943 (42.37)	6,522,098,178 (55.45)	90,731,670 (0.77)	21,211,685 (0.18)	11,761,545,476 (100.00)
2006 N (%)	636,010,000 (10.22)	4,854,416,867 (78.00)	623,291,744 (10.02)	58,869,144 (0.95)	50,674,725 (0.81)	6,223,262,480 (100.00)
2007 N (%)	1,383,177,930 (9.33)	6,034,971,231 (40.70)	6,586,792,253 (44.41)	95,470,171 (0.64)	729,044,146 (4.92)	14,829,455,731 (100.00)
2008 N (%)	2,714,916,344 (12.96)	8,196,606,673 (39.14)	9,885,001,293 (47.19)	53,095,074 (0.25)	95,585,680 (0.46)	20,945,205,064 (100.00)
2009 N (%)	2,372,540,000 (12.63)	8,554,840,769 (45.56)	7,624,489,974 (40.6)	110,430,203 (0.59)	116,257,609 (0.62)	18,778,558,555 (100.00)
2010 N (%)	2,527,350,000 (19.92)	6,048,560,266 (47.68)	3,693,271,715 (29.11)	238,404,158 (1.89)	178,064,607 (1.40)	12,685,650,746 (100.00)
2011 N (%)	3,222,240,000 (18.42)	8,841,952,775 (50.56)	4,139,289,123 (23.67)	950,477,689 (5.43)	335,249,880 (1.92)	17,489,209,467 (100.00)
2012 N (%)	3,294,520,000 (21.25)	7,101,031,884 (45.80)	4,626,029,122 (29.83)	225,112,053 (1.45)	258,607,630 (1.67)	15,505,300,689 (100.00)
2013 N (%)	3,227,000,000 (18.32)	5,609,000,000 (31.85)	8,118,153,643 (46.09)	144,089,846 (0.82)	514,387,425 (2.92)	17,612,630,914 (100.00)
Total	19,522,724,274	60,223,914,408	51,818,417,045	1,966,680,008	2,299,083,387	135,830,819,122

Interpretations

In the years under consideration South Africa and Nigeria total FDI ranges from 24% to 54%, while Ghana ranges from 1% to 21%. Sierra Leone and Kenya FDI portion in the total FDI to the five countries ranges from less than 1% to 2%.

Table 3: Comparative Descriptive Statistics of FDI from 2005 to 2013

Parameters	Ghana	Nigeria	South Africa	Sierra Leone	Kenya	TOTAL
Total FDI (%)	19,522,724,274 (14.37)	60,223,914,408 (44.33)	51,818,417,045 (38.15)	1,966,680,008 (1.45)	2,299,083,387 (1.70)	135,830,819,122 (100.00)
Mean (%)	2,169,191,586 (14.37)	6,691,546,045 (44.34)	5,757,601,894 (38.15)	218,520,001 (1.45)	255,453,710 (1.69)	15,092,313,236 (100.00)
Standard Deviation	1,174,074,819	1,534,649,618	2,781,341,979	282,344,883	235,965,601	4,412,023,519
Minimum (Year)	144,970,000 (2005)	4,854,416,867 (2006)	623,291,744 (2006)	53,095,074 (2008)	21,211,685 (2005)	6,223,262,480 (2006)
Maximum (Year)	3,294,520,000 (2012)	8,841,952,775 (2011)	9,885,001,293 (2008)	950,477,689 (2011)	729,044,146 (2007)	20,945,205,064 (2008)

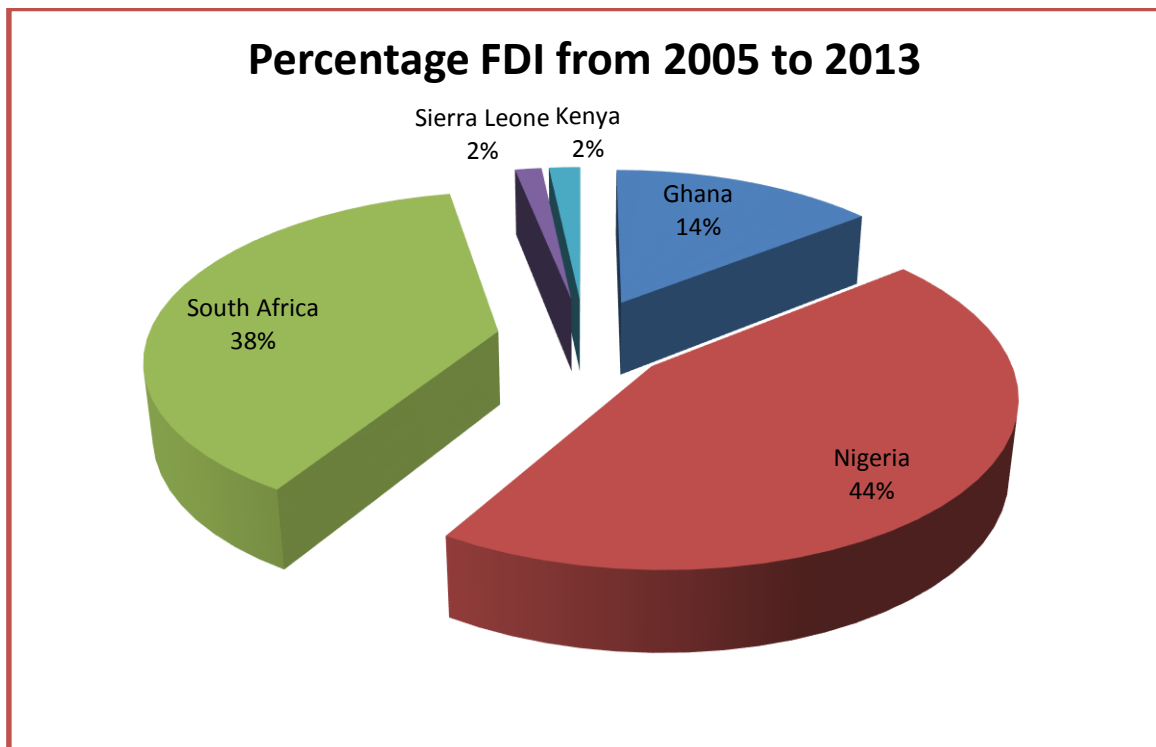


Figure 2 Total FDI among African Countries From 2005 to 2013

Interpretation

Composition analysis showed that Nigeria and South Africa captured about 82.0% of the total FDI to the five countries. Out of the countries under review Sierra Leone had a mean and standard deviation that was lopsided. Nigeria had the largest FDI, closely, followed by South Africa. The minimum value for FDI was recorded by Sierra Leone in 2005, while the largest FDI was received by South Africa in 2008. The only country whose FDI was in sync with the trend of total FDI was South Africa. In 2006 South Africa had \$ 623,291,744 as FDI and the total FDI to the five countries was \$6,223,262,480 and when the total FDI rose to \$20,945,205,064 in 2008 there was also a corresponding increase to \$9,885,001,293.

Comparing Means

By eye observation South Africa and Nigeria are close in mean than Ghana and the other two countries. Nigeria average FDI for the period of nine years stood has \$6,691,546,045 representing 44.34% of the total FDI given to the countries. South Africa on the other hand had an average FDI of \$5,757,601,894 representing 38.15% of the total FDI to the countries. Ghana is alone in a different group away from Nigeria and South Africa and Sierra Leone and Kenya. Kenya and Sierra Leone are also similar to Nigeria in terms of FDI. Kenya had FDI worth about \$255,453,710 representing 1.69%, while Sierra Leone FDI stood at \$218,520,001 representing 1.45% of the total FDI to the five countries.

In the figure below group 1 represent Nigeria and South Africa, group 2 represent Ghana and Group 3 represent Sierra Leone and Kenya. This is one of the reasonable comparison that can be made about the FDI of the five countries.

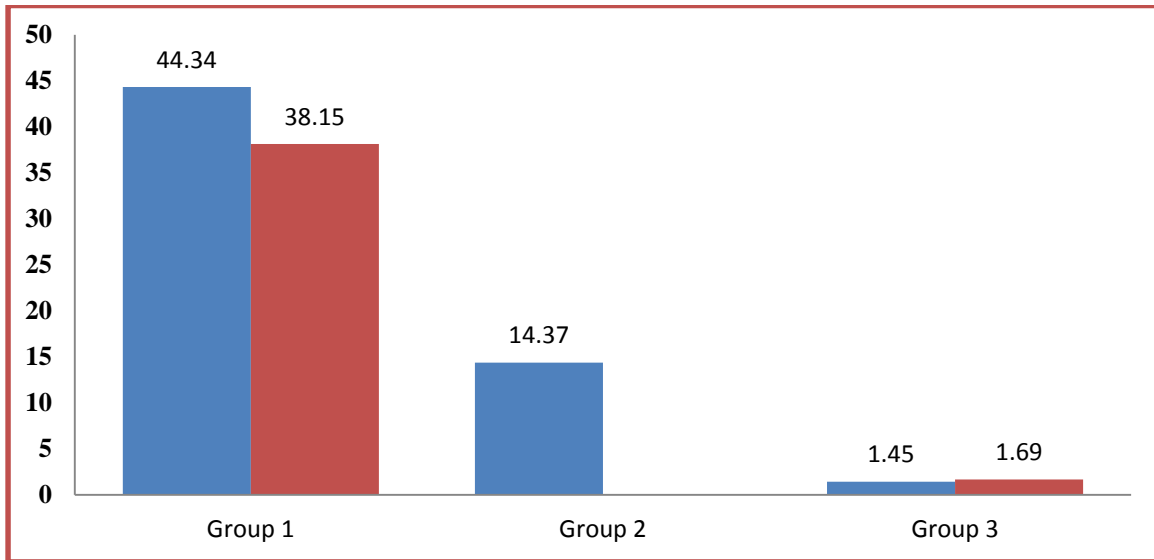


Figure 3 Grouping of countries with similar FDI

Hypothesis testing

Test of hypothesis was conducted on to establish their validity under the following decisions rule, that if the computed p value exceeds the 0.05 levels of significance, the null hypothesis is rejected in favour of the alternative and vice versa.

First a correlation test would be conducted to discover any correlation in the countries. The test would be set at 95% confidence interval, thus if the computed p value exceeds the 0.05 levels of significance, the null hypothesis is rejected in favour of the alternative and vice versa.

Table 4: Correlation Table

		Correlations				
		Ghana	Nigeria	South_Africa	Sirra_leone	Kenya
Ghana	Pearson Correlation	1	.648	.271	.450	.286
	Sig. (2-tailed)		.059	.480	.224	.455
	N	9	9	9	9	9
Nigeria	Pearson Correlation	.648	1	.354	.515	-.032
	Sig. (2-tailed)	.059		.349	.156	.935
	N	9	9	9	9	9
South_Africa	Pearson Correlation	.271	.354	1	-.266	.187
	Sig. (2-tailed)	.480	.349		.488	.629
	N	9	9	9	9	9
Sirra_leone	Pearson Correlation	.450	.515	-.266	1	.157
	Sig. (2-tailed)	.224	.156	.488		.687
	N	9	9	9	9	9
Kenya	Pearson Correlation	.286	-.032	.187	.157	1
	Sig. (2-tailed)	.455	.935	.629	.687	
	N	9	9	9	9	9

Interpretation

The result of the Pearson correlation 2- tailed test showed that there was no significant correlation between or among FDI to Nigeria($r= 0.648$; $P= 0.059 > 0.05$) and Ghana or any other country($r= 0.271$; $P= 0.480 > 0.05$) South Africa($r= 0.450$; $P = 0.224 > 0.05$) Sierra Leone and Kenya($r=0.286$; $P= 0.455$). Likewise there was no correlation between Kenya and any other country($r =0.286$; $P = 0.455 > 0.05$). Furthermore, South Africa did not have any correlation with Kenya or Ghana or Sierra Leone. Thus we fail to reject or accept the null hypothesis following statistical test of significance, which states that there is no significant correlation between the Countries FDI.

Using year 2012 (where adoption of IFRS cut across the countries) it was found out that the net inflow of Foreign Direct Investment to Ghana, Nigeria and Sierra Leone dropped by 2.05%, 21.01% and 35.99% respectively thereby invalidating the initial assumption that adoption of IFRS would boost Foreign Direct Investments. Meanwhile, Foreign Direct Investment to South Africa and Kenya grew by 75.49% and 98.91% respectively.

CONCLUSION AND RECOMMENDATION

Quality accounting information is crucial to making informed economic decisions, especially in cross border transactions where the potential for information asymmetry is high. International diversity in accounting standards, however, creates information asymmetry which increases the cost of raising funds and monitoring managers as well as inhibiting the growth of cross border economic transactions. The adoption of International Financial Reporting Standards is a panacea for reducing information asymmetry. The relevance of International Financial Reporting Standards lies in ensuring comparability and reliability of financial statements.

The result of the Pearson correlation 2- tailed test showed that there was no significant correlation between or among the selected countries. Using year 2012 (where adoption of IFRS cut across the countries) it was found out that the net inflow of Foreign Direct Investment to Ghana, Nigeria and Sierra Leone dropped by 2.05%, 21.01% and 35.99% respectively thereby invalidating the initial assumption that adoption of IFRS would boost Foreign Direct Investments.

The theoretical benefits of adopting International Financial Reporting Standards will not accrue to African Countries in a jiffy. Little patience is needed to watch the trend for objective evaluation of the value proposition.

Based on the outcome of this research, further research is required to unravel the factors that are responsible for decline in inflow of Foreign Direct Investment to Ghana, Nigeria and Sierra Leone in spite of adoption of IFRS.

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