

## INNOVATIONS

### **IFRS adoption and evaluation of total asset contribution to financial performance of listed insurance companies in Nigeria and South Africa**

1. **Adebawo, O. Owolabi PhD.**

Bursary Department, Adeleke University, Ede, Nigeria

2. **Adebawojo, A. Oladipupo PhD.**

Bursary Department, Babcock University, Ilisan-Remo, Nigeria

Correspondence Author: Adebawo, O. Owolabi PhD. ([owolabiadebawo@yahoo.com](mailto:owolabiadebawo@yahoo.com))

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#### **Abstract**

The international diversity which form the basis of differences observed in the financial reports produced by various countries of the world have hindered cross border investment opportunities hence, the need for harmonization of accounting standards and the eventual convergence on International Financial Reporting Standard (IFRS). This study seeks to evaluate the effect of IFRS adoption and contribution of total assets to financial performance of listed insurance companies in Nigeria Stock Exchange (NSE) market and Johannesburg Stock Exchange (JBS) market, South Africa between 2001 and 2018. Ex-post facto research design was adopted and secondary data were obtained from the audited financial statements of the companies. Purposive sampling technique was used to select 5 insurance companies out of the population of 25 quoted on NSE market. While 5 were also selected from the population of 8 leading insurance companies operating in Johannesburg. Pooled OLS model with the aid of stata computer software were used to analyze the data. The findings reveals that, the total assets of insurance companies in both Nigeria and South Africa have significant contributions to the profit after tax at  $P \geq 0.000$  at both pre and post adoption of IFRS. Furthermore, the extent of similarities of local accounting standard to IFRS determines the level of changes in dependent variable explained by the independent variable. Hence, for Nigeria, Adjusted  $R^2$  is 14% while South Africa is 82%. The study will assist the accounting standard setters (IASB) and insurance regulatory bodies by providing them with veritable tools to formulate appropriate standards and policies to tackle issues that may arise from post adoption of IFRS. It is a useful contribution to the body of knowledge upon which the foundation for future research in this area can be laid.

**Keywords:** 1. International Financial Reporting Standard 2.Total assets 3. Performance 4. Profit after tax

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#### **Introduction**

##### **1.0 Background to the study**

There is no gain saying that no two countries are the same economically, politically, legally, socially, and culturally. This informed the differences that various countries of the world exhibit

in the ways and manners their affairs are conducted. Locally, each country of the world has developed its own economic, political, social and cultural systems upon which the foundation of their economic growth and development are laid. Hence, the international diversity which form the basis of differences observed in the financial reports produced by various countries of the world. These reports have been prepared in compliance with their locally developed Generally Accepted Accounting Principles (GAAP). However, the differences in business activities have impacted negatively on crossborder investments, trade relations and expansion as firms compete globally for scarce resources. Hence, the need for harmonization of accounting standards to reduce cost of international trading activities and enhance foreign direct investments and access to foreign funds and aids.

On this note, Lainez and Callao (2000) as cited in Klug (2009) stated that different organizations like International Accounting Standards Committee (IASC) and European Union (EU) have made considerable effort to harmonize the accounting rules that are enforced in different countries with the objective of improving the comparability of the financial statements of companies located in these various parts of the world.

Studies have shown that the adoption of International Financial Reporting Standard (IFRS) issued by International Accounting Standard Board (IASB) makes it easier to reconcile the financial statements from various countries for cross border investment purposes and corporation performance evaluations (Unachukwu, 2019; Baker and Barbu, 2007).

The objective of this study is to generally analyzed the impact of adoption of IFRS on the performance of Insurance Companies in Nigeria and South Africa from 2001 to 2018. The selection of this period was informed by the fact that, Nigeria commenced the implementation of IFRS in 2012 while South Africa as one of the early adopters of IFRS in Africa implemented it in 2005. The selected period will enable the researchers the opportunity to study the pre and post adoption trends of performance of the insurance companies in these countries. Also, studies have shown that the local Generally Accepted Accounting Principles (GAAP) of South Africa are similar in quality to IFRS (Smith, 2017; Sherman and deklert (2015). Whereas, the essence of Nigeria's adoption of IFRS was to improve the quality of financial statement presentation, enhance comparability, public confidence in financial reporting and increase foreign direct investment flows. (Odo, 2018). This study also aim at drawing inference on whether the mandatory adoption of IFRS in a country where the local GAAP is similar in quality to IFRS (South Africa) has effect on corporate performance and vice versa (Nigeria).

The performance of the insurance companies is measured in terms of the contribution of their assets to generating profit after tax. Hence the assets and profit after tax are applied as variables to measure the performance. In the light of this, the general objective of the study is to determine the effectiveness in the use of the assets of the insurance companies to generate profits in both Nigeria and South Africa. However, the specific objectives are as stated below:

1. To determine the contribution of the assets of insurance companies in Nigeria in generating profit after tax at both pre and post adoption of IFRS period.
2. To determine the contribution of the assets of insurance companies in South Africa in generating profit after tax at both pre and post adoption of IFRS period.

In line with the above objectives, the following research questions were generated:

1. What is the contribution of the assets of Insurance companies in Nigeria towards generating profit after tax at both pre and post adoption of IFRS?
2. How have the assets of Insurance Companies in South Africa contributed towards generating profit after tax at both pre and post adoption of IFRS?

In line with the above questions, the following hypotheses were formulated and tested:

1. Ho: The assets of insurance companies in Nigeria have no significant contribution to generating profit after tax at both pre and post adoption of IFRS.

2. Ho: The assets of insurance companies in South Africa have no significant contributions to generating profit after tax at both pre and post adoption of IFRS

The study will no doubt assist the preparers of financial statements, standard setting bodies like NASB, government and regulatory bodies by providing them with a veritable tool that will go a long way in their policy formulation to tackle issues that may arise from post implementation of IFRS. The academic body will also find it as a useful contribution to knowledge upon which the foundation of future researches in this area of knowledge can be built.

The study was designed to cover a cross section of all the companies operating in the insurance sectors of the capital market in Nigeria and South Africa. The panel data of the companies in the sector will be obtained over a time series of 18years (2001 to 2018) for insurance companies operating in Nigeria and South Africa. A time series of 18years was chosen to enable the researchers to assess the effectiveness of the assets of insurance companies in both Nigeria and South Africa in contributing to the generation of profit after tax at both pre and post adoption of IFRS periods.

The study is restricted to insurance companies listed on Nigeria Capital Market and Johannesburg Stock Exchange in South Africa. However, the results would have a wider applicability. The selected companies in Nigeria are AIICO Insurance Company Plc, Royal Exchange Plc, African Alliance Insurance Company Plc, Niger Insurance Company Plc and Cornerstone Insurance Plc. While for South Africa, the insurance companies selected are Santam Limited, Mutual and Federal Insurance Company Limited, Sanlam Group, Liberty Life Assurance and Discovery

### 1.1 Operationalization of variables

Y = Dependent Variable = Profit After Tax

X = Independent Variable = Total Assets

$$Y = f(X)$$

$$Y = \beta_0 + \beta_1 X + \mu$$

Where:

Y = Profit after tax

X = Total asset

$\beta_0$  = Intercept of the variables

$\beta_1$  = Coefficient of Independent Variable (Total Asset)

$\mu$  = error term

## 2. Review of literature

According to Senyigit (2012) the importance of insurance industry to the stability and healthy growth of the economy of a nation cannot be over emphasized. It is important to state that the financial reporting of insurance companies has been guided by more of insurance regulations and provisions than accounting principles. This is why various insurance contracts around the

world are accounted for using different measurement frame work (PWC,2017). However, the increased comparability of financial statements worldwide for globalization of capital markets occasioned the need for a set of accounting standard that can be used globally.

Smith (2017) posited that the call for global accounting standards had been on since 1950s and several projects had been undertaken to harmonize and converge accounting standards. International Accounting Standard Board (IASB) was established in 2001 to create IFRS, a set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in financial statements and other financial reporting (Deloitte,2014). IFRS 4 (insurance contracts) was issued by IASB in 2004 and to provide insurance companies with a global standard. The standard was meant to achieve high comparable financial statement for the insurance companies (Meyer,2005 and Senyigit, 2012)

However, IFRS 17 (insurance contract) has been issued based on the observed deficiencies of IFRS 4. The new standard tries to achieve a more consistent insurance accounting framework than IFRS 4. It is expected to become effective in January,2021 (PWC,2017)

Since the introduction and adoption of IFRS by various countries of the world, studies have been conducted to determine the impact of the global standard on the performance of companies in different sectors of the economy. As far as insurance sector is concerned, not much had been done (Senyigit, 2012).

The study is all about satisfying the shareholders quest for quality financial reporting on firms' performance. Most of the time, the real investors are not the managers of the investment entities. They manage the business by proxies through the engagement of Agents. Hence, applicable theories in the light of investors desirous of quality financial information on firms' performance are agency theory, legitimacy theory and stakeholder theory. However, the study will be anchored on agency theory by Jensen and Meckling (1976) as cited by Laiho (2011). According to them, when professional managers (agents) are hired to manage a business entity on behalf of the shareholders (principals), the performance of such entity improves due to their managerial skills and incentives paid to the managers which helped to mitigate conflict of interest between the managers and the owners. This means that the agents are expected to provide the needed financial information to the shareholders regularly for them to take informed business decisions.

The empirical study carried out by Unachukwu (2019) on implementation of IFRS as a tool for the financial performance of Nigerian Insurance companies revealed that, IFRS implementation has a positive and significant correlation with financial performance. Although, the level of its implementation by the insurance companies in Nigeria is still low. He concluded that, the distressed syndrome currently being experienced in the industry is attributable to the sector's low implementation of IFRS. On the other hand Post, Grundl, Schmidl and Dorfman (2007) posited from their study that, the implementation of IFRS on insurance companies are overstated because, it only have an impact on insurance product design.

Furthermore, it has been established that the local GAAP of South Africa is similar in quality to IFRS hence, the country had a smooth transition on mandatory adoption of IFRS. Also, studies conducted in this area revealed that adoption of IFRS in countries where local GAAP is of similar quality to IFRS does not have significant effect on quality of accounting information provided but on comparability benefits because the cost of comparing firms performances will be reduced (Smith, 2017; Joos & Leung, 2012; Jagolinzer and Riedl, 2012)

Firms' performance can be measured by either using earnings approach or profitability approach. In this study, profitability approach was employed and the variable measured was

contribution of the assets of insurance companies towards generating profit after tax i.e. assets and profit after tax. It is expected that the mandatory adoption of IFRS will have significant impact on profitability of companies. This view has been confirmed by Unachukwu (2019) in his study on implementation of IFRS as a tool for the performance of Nigeria insurance companies. He confirmed that there is a strong relationship between financial performance and implementation of IFRS.

However, Chavent, Ding, Fu, Stolowy and Wang (2006) posited that the level of information disclosure is measured by the amount of provisions made in the accounts. This depends on company size, leverage and market expectations and profitability level. In the same vein, Soye (2016) reported from his study on the comparability of pre and post adoption of IFRS by Nigerian Insurance companies that, a strong relationship existed between the performances of insurance companies and IFRS adoption as confirmed by the differences which existed between the pre and post IFRS adoption performances of the companies.. Also, Charitou, Floropoulos, Karamanuo and Loizides (2018) concluded from their studies that, firms' disclosure is associated with higher levels of market liquidity. Similarly, firms that are better governed and those with weaker financial performance tend to disclose more. This suggest that IFRS have significant impact on the financial performance of both financially strong firms and distressed firms since the strong ones will disclose more information to show their strength, the weak ones will also disclose more information to show why they require financial assistance.

### 3.0 Methodology

The study was designed along the line of ex-post facto research design. It made use of secondary data generated from the annual audited accounts and reports of the Insurance Companies. The study made use of purposive sampling method to select 5 sampled insurance companies from the population of 25 listed companies on the Nigeria Stock Exchange and 5 insurance companies from the population of 8 leading Insurance Companies listed on the Johannesburg stock exchange in South Africa.

The ex- post facto research design was adopted due to the fact that it had been used in similar studies to evaluate the impact of the adoption of IFRS on firms' performance by Amahalu and Ezechukwu (2016) and Alu and Akinwunmi (2017).

In other to achieve the objective of the study, panel data on asset and profit after tax of the sampled insurance companies were obtained from their audited financial statements from 2001 – 2018. The dependent variable (Y) was the Profit After Tax (PAT) while the independent variable (X) was the Total Asset (TA) of the company.

#### **Profit after tax as a performance measurement**

Profit after tax is one of the firm's performance measurement variables under profitability approach. It is the total amount that a business earns after all expenses including taxes have been deducted from the total revenue or sales of the company.

The formula is:

$$\text{Profit after tax (PAT)} = \text{Total Revenue/Sales} + \text{Other Income} - \text{total expenses}$$

Note that Total Expenses include:

Cost of goods/services + Operating Expenses + Depreciation + Interest+ Taxes. Profit after tax belongs to the company and it is from it that dividend is paid to the shareholder while the balance is ploughed back into the business. The higher the profit after tax a business can generate, the higher the level of profitability of its operations. In this study, PAT represents the dependent variable (Y).

**Firm Total Asset (TA)**

This refers to the total amount of assets owned by a company. Assets are items of economic value which a company can use over time to generate benefit for the owners of the business. They are usually recorded in the accounting records of the company and as well as in the statement of financial position of the company.

Total assets can be categorized into noncurrent assets (which are long-term assets that a company cannot sell within one year) and current assets (which are assets that a company can sell within one year).

Generally, assets are arranged in the balance sheet in order of illiquidity that is how quickly they can be converted to cash. In this study, total assets represent the independent variable X.

$$Y = \text{Dependent Variable} = \text{Profit After Tax}$$

$$X = \text{Independent Variable} = \text{Total Assets}$$

$$Y = f(X)$$

$$Y = \beta_0 + \beta_1 X + \mu$$

Where:

$$Y = \text{Profit after tax}$$

$$X = \text{Total asset}$$

$$\beta_0 = \text{Intercept of the variables}$$

$$\beta_1 = \text{Coefficient of Independent Variable (Total Asset)}$$

$$\mu = \text{error term}$$

Stata statistical software was used to analyze the data generated to determine the contribution of total assets of insurance companies in both Nigeria and South Africa to generating profit after tax. The results on pooled OLS, fixed effect and random effect were analyzed and discussed based on the result of Hausmann Test carried out.

**4.0 Analysis, Results and Discussions**

In this section, we present the data analysis on Nigeria and South Africa based on pooled OLS, Fixed effect, Random effect and Hausmann Test.

**4.1.0 Results for Nigerian insurance companies**

The Table 1 below shows the results of Pooled OLS, Fixed effect, Random effect and Hausmann Test of data analyzed on Nigerian Insurance companies.

**Table 1: Pooled OLS, Fixed effect, Random effect and Hausmann Test Results (Nigeria)**

Source	Pooled OLS	Fixed Effect	Random Effect	Hausmann Test
Constant	-377794	-307911.1	-377794	Na
Assets	0.0370341	0.0332848	0.0370341	
R <sup>2</sup>	0.1497	0.1497	0.1497	Na
Adjusted R <sup>2</sup>	0.1400	Na	Na	Na
P>F	0.0002	0.0023		Na
P> Chi <sup>2</sup>	Na		0.0001	0.4361



Number of Observations	90	90	90	
Numbers of groups	5	5	5	

Source: Researchers' Model, 2020

**4.1.1 Discussion of Results**

Table 1 shows the statistical summary of the data obtained from the financial statements of the sampled insurance companies in Nigeria on the variable used for the study.

Test of Hypothesis 1: The assets of insurance companies in Nigeria have no significant contributions to generating profit after tax at both pre and post adoption of IFRS.

Testing for the Null Hypothesis shows significance at  $P > F = 0.000$  under pooled ols and  $P > F = 0.002$  under fixed effect. The random effect was significant at  $P > \text{Chi}^2 = 0.000$ . However, Hausmann test was run to choose a suitable model between fixed and random effect which gave a probability result of 0.436 ( $\text{Prob} > \text{Chi}^2 = 0.436$ ). The standard rule is to select fixed effect if the probability value  $< 0.05$  otherwise random effect should be selected.

The Hausmann test result was  $\text{Prob} > \text{Chi}^2 = 0.436$  hence random effect results were selected.

**4.1.2 Random Effect Result**

The null hypothesis tested significant at  $P > \text{Chi}^2 = 0.000$  under random effect model hence, the alternative hypothesis was accepted. This means that, the assets of insurance companies in Nigeria have significant contributions to the generation of profit after tax at both pre and post adoption of IFRS in Nigeria. This result is consistent with the findings of Unachukwu (2019) and Soye (2016) that there is strong relationship between the adoption of IFRS and performance of insurance companies. On the other hand, the result is also in consonant to the findings of Ozcan and Yener (2017), and Babalola (2013) that firms' total assets have strong significant effect on their profitability measured either in terms of Returns on Assets (ROA) or Total Sales. This result is also consistent with the appropriate expectation that, total assets of insurance companies in Nigeria have significant contributions to the generation of profit after tax at both pre and post adoption of IFRS period.

However, it should be noted that the result of the adjusted  $R^2$  of 0.1400, approximately 14% revealed that only 14% of the variations in the dependent variable (PAT) were explained by the independent variable and the remaining 86% of the changes in the same dependent variable (PAT) were caused by other factors not included in the model. This justified the wide gap between the quality in the contents of Nigeria local generally accepted Accounting Principles (NGAAP) and the International Financial Reporting Standard (IFRS) before the adoption of IFRS in 2012. Also, the period covered by the study was 2001 to 2018, while Nigeria adopted IFRS in 2012. This means that the preadoption period of IFRS in Nigeria was 11 years while post adoption was 5 years. This revealed that, despite the fact that total assets of insurance companies had significant contributions to their profit after tax, the longer years of preadoption period of IFRS had negative effect on the profit of the companies as explained by the explanatory variable that only 14% of the variations in profit after tax can be explained by the contributions of assets of the insurance companies in Nigeria.

**4.2.0 Results for South African insurance companies**

The Table 2 below shows the results of Pooled OLS, Fixed Effect, Random Effect and Hausmann Test.

**Table 2 : Pooled OLS, Fixed Effect, Random Effect and Hausmann Test Results for insurance companies (South Africa)**

Source	Pooled OLS	Fixed Effect	Random Effect	Hausmann Test
Constant	-13778.89	-15046.9	-14979.03	
Assets	0.0908846	0.0956163	0.0953631	
R <sup>2</sup>	0.8245	0.8245	0.8245	
Adjusted R <sup>2</sup>	0.8226			
P>F	0.0000	0.0000		
P>Chi <sup>2</sup>	Na		0.0000	0.1811
No of Observations	90	90	90	
No of Groups	5	5	5	

Source: Researchers' Model, 2020

**4.2.1 Discussion of Results**

Table 2 reveals the statistical summary of the data obtained from the financial statements of the sampled insurance companies in South Africa on the variable for the study.

Test of Hypothesis 2: Total assets of insurance companies in South Africa have no significant contributions in generating profit after tax at pre and post adoption of IFRS.

Testing for the null hypothesis reveals significance at  $P>F = 0.0000$  under pooled OLS and  $P>F = 0.0000$  under fixed effect. The random effect was significant  $P> Chi^2 = 0.0000$ . However Hausmann test was run to choose suitable model between fixed effect and random effect which gave a probability result of  $P> Chi^2 = 0.1811$ . Hence, random effect was preferred.

**4.2.2 Random Effect Results**

The null hypothesis 2 tested significant at  $P> Chi^2 = 0.000$  under random effect model hence, the alternative of hypothesis 2 was accepted. This means that the assets of insurance companies in South Africa contributed significantly to their generation of profit after tax at both pre and post adoption of IFRS. This result is also consistent with the findings of Unachukwu (2019) and Soye (2016) that, there is strong positive relationship between the adoptions of IFRS and performance of insurance companies. Also, the findings from the study conform with that of Prasetyantoko and Parmono (2009) and Babalola 2013 who established through their studies on the relationship between firm size and profitability, that firm's size measured in terms of total assets, number of employees and sales have strong positive impact on the profitability of companies

Also, it should be noted that the adjusted R<sup>2</sup> of 0.8226, approximately 82% revealed that 82% of the changes observed in the dependent variable (PAT) of insurance companies in South Africa were explained by the independent variable (Total Assets) while the remaining 18% were explained by other factors not included in the model.

It is worthy of note that, South Africa adopted IFRS in 2005 and going by the period covered by the study (2001 – 2018), South Africa had 4 years preadoption period and 13 years post



adoption period despite the similarities in the content of IFRS and South Africa Local GAAP. This justified the reason why higher percentage (82%) of variations observed in dependent variable (PAT) were explained by the independent variable (total assets of insurance companies in South Africa).

### 5.0 Conclusion

The study concluded that the assets of insurance companies generally have significant contributions to their performance as measured by the level of profit after tax generated. It also concluded that the quality of the content of the local accounting standard of the country in terms of its closeness to IFRS goes a long way to contribute to the performance of insurance companies. This fact was revealed by the explanatory variable which showed that 82% of the changes in the profit after tax of insurance companies in South Africa were explained by the independent variable that is, total assets. While that of the Nigerian insurance companies was only 14%. Also, the longer the period a country adopts IFRS the better it would have adjusted to the compliance of IFRS which will translate to enhance financial performance in terms of profit after tax.

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