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Compliance with International Financial Reporting Standard 7 (IFRS 7): A Study of Listed Banks in Ghana

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Abstract

The aim of this study is to identify the extent to which listed banks in Ghana comply with International Financial Reporting Standards, with particular reference to financial instruments IFRS 7. The level of mandatory compliance with IFRS 7 was measured using a mandatory disclosure index (MDI) from a self-constructed compliance checklist. The sample consisted of six listed banks and covers the period 2008 and 2009.The overall results show a high degree of compliance with IFRS 7, though not absolute. The study recommends that though the enforcement mechanism seems to be working well in the short-run resulting in high compliance, effort should be made to sustain it in the long run.

Keywords: IFRS, Compliance, Listed Banks, mandatory disclosure index

1. Introduction

Corporate financial statements are only as useful as the underlying accounting data and degree of disclosure provided. Unfortunately, uniform standards of accounting and disclosure do not exist worldwide; each country has its own unique financial reporting system. The lack of uniform standards creates information barriers for the international investment community. Unfamiliar foreign accounting principles and lack of disclosure can prevent investors from diversifying their portfolio internationally in an optimal manner (Eitemann, Stonehill & Moffett 2011: 605). Moreover, differences in accounting standards across countries act as impediment to the international offering of securities (IASC 1989: 2).

When Daimler Benz was first quoted in New York, the same set of financial statements disclosed a profit of 630DM in Germany but a loss of 1300DM, using US rules (Kirk, 2005). The move to an integrated global capital market requires a harmonization of accounting systems across international borders. Harmonization can be defined as the reduction in differences in accounting practices across countries, ultimately resulting in a set of international norms to be followed worldwide.

The International Accounting Standards Board (IASB) has become increasingly influential in the world of commerce. Its principal objective is to issue International Accounting Standards (IFRS) in order to increase comparability in financial reports produced by companies regardless of their country of origin (Choi, Forst & Meek, 2002). The European commission passed a legislation requiring all European listed companies preparing consolidated financial statement to comply with international accounting standards (IAS) as of 1 January 2005 (EC, 2005). As of mid-2005, over 90 countries have claimed they have adopted or will adopt IASs in the future (IASB, 2005).

Ghana adopted IFRS on 1st January, 2007, requiring all public interest entities (banks, insurance companies, listed companies and Government business) to comply with IFRS effective 1st January, 2009. The CPA Journal (2007) asserted that banks have high concentration of certain types of transactions and accordingly a high exposure to certain types of risk. A bank is exposed to liquidity risk, foreign currency risks, interest rate movement and change in market price (Kirk, 2005).

The dynamic nature of international financial market has led to a widespread use of a variety of financial instruments, ranging from primary to various forms of derivatives. The objectives of IFRS on financial instrument are to enhance users' understanding of the significance of financial instrument to an entity's position, performance and cash flows, as well as to establish principles for recognizing and measuring financial assets and liabilities (Kirk, 2005).

Accounting for financial instruments has recently attracted tremendous attention due to the enormous growth of the exchange-traded derivative financial instruments market, which enjoyed a turnover for financial futures and options contracts in the third quarter of 2002 of over 190 trillion US dollars, more than thirty times its level ten years ago (Bank for International Settlements, 2002). Its sheer size and the prominence of the market players (large, financial institutions central to the world's financial system) mean that the stakes in the financial instrument game are very high (Tan, 2005).

This rapid growth also brought increased concerns about spectacular losses in organizations around the world (Guerrera, Parker & Pretzlik, 2003; Tan, 2005). In Australia, AWA Ltd suffered losses of $49.8 million in forward foreign exchange contracts. Barings PLC is probably the most publicized case involving huge derivative losses where the company lost in excess of US$1 billion and faced receivership.

In Australia, concerns have been raised over possible billion dollar losses incurred by the Federal Treasury as a result of losses on certain swap contracts (Davidson, 2002; Tan, 2005). In addition, the National Australia Bank (NAB) reported losses totaling $360 million in unauthorized foreign exchange options trading (Maiden, 2004; Kemp, 2004).

These events raise important questions on the role of financial reporting and whether the current accounting for financial instruments and related disclosure allows investors to make a proper assessment of a company's risk exposure from its financial instruments (Matolcsy & Petty, 2001; Tan, 2005).

The International Federation of Accountants (IFAC) has observed auditors asserting that financial statements comply with IASs, when in actual fact the accounting policies and notes to the financial indicate otherwise (Cairns, 1997). Street and Gray (2001) also found evidence of non-compliance with IASs by companies claiming to have adopted them and latter confirmed by Glaum and Street (2003). Given these findings, the activities and effectiveness of enforcement bodies that are responsible for promoting IASs compliance have been questioned (Glaum & Street, 2003).

These indicate that, there is always a gap between claiming to have complied with specific accounting standards and the level of compliance by corporate bodies.

Since 2005, over 90 countries around the world claim to have made IFRS compliance mandatory (IASB, 2005) and Ghana claimed to have adopted IFRS in financial reporting since 2007. This has become necessary to ensure financial statement comparability among countries as a result of globalization. However, dwelling on past experiences, there is always significant gap between claiming to have complied and complying with accounting standards. The same could be true for companies listed on the Ghana Stock Exchange claiming to have complied with IFRS.

This paper empirically study compliance with IFRS by listed banks in Ghana from 2008 to 2009, paying particular attention to IFRS 7 which deals with financial instrument disclosure requirement. The study contributes to the general body of knowledge by filling the void in the academic literature with respect to the compliance of IFRS and particularly IFRS 7. The disclosure of IFRS 7 is selected for two reasons. Financial instruments is a common feature of financial intuitions operations and its disclosure is important for stakeholder because it reveals risks associated with both recognized and unrecognized financial instruments and how these risks are managed (Spector,2009). Also, the combination of IAS 32& 39 with some augmentation makes it one of the difficult to comply with especially the early stages of adoption such as our case.

The results of the study show high compliance level indicating smooth transition into the IFRS of the listed Banks. The rest of the study is organize as follows; section 2 looks at the methodology, results and discussion at section 3 and conclude in section 4.

2.0 Research Methodology

2.1 Sample Size and Data collection

The sample chosen for the study consists of banks incorporated in Ghana which are listed on the Ghana Stock Exchange on or before 2008. In all six banks out of the eight listed banks were selected. The banks comprise Ghana Commercial Bank Limited, Standard Chartered Bank Limited, ECOBANK Ghana Limited, Cal Bank Ghana Limited, HFC Bank Ghana Limited, and SG-SSB Bank Limited. These banks have been selected for the study because they are at the moment, the only banks listed on the Ghana Stock Exchange and incorporated in Ghana, and therefore appropriate The selection of the sample was based on purposive sampling because of small nature of the listed banks. Banks are selected for the study because the banking sector is one of the most important sectors in every economy. The well-being of banks, particularly their liquidity and solvency position is of interest to every economy (Tackie, 2007). On the other hand, banks by their nature have high concentration of certain types of transactions and accordingly a high exposure to certain types of risk CPA (2007). The study covers 2008 and 2009 because, though Ghana adopted IFRS in 2007, due to some implementation problems the listed banks were given 2008 to mandatorily comply with IFRS.

Financial instrument was selected for the study because there is wide evidence of problems in the accounting for financial instruments around the world (Chalmers, 2001). Additionally, standards on financial instruments are seen as complex, requiring difficult implementation by companies (Larson & Street, 2004). Hence, the desire to research into this to find out how Ghanaian banks listed on Ghana Stock Exchange are performing with respect to financial instrument disclosure requirement IFRS 7 since the mandatory compliance required by the Bank of Ghana.

Data was collected from the annual reports published by the banks, periodicals and relevant internet resources. Specifically, the banks' annual reports and audited financial statements for the years 2008 to 2009 were the principal sources of data for the study.

In other to ascertain the level of mandatory compliance with IFRS 7, a self-constructed compliance checklist was developed. The checklist contains the disclosure requirements of IFRS 7, spelt out in the full volume of IFRS 2009, and published by the International Financial Accounting Board (IASB).

To validate the checklist, it was given to an experienced auditor to check the comprehensiveness and the applicability to IFRS 7 disclosure requirements. The individual components of the disclosure requirement were given equal weight in the index. This is consistent with previous IFRS compliance studies (Street & Bryant, 2000; Street & Gray, 2001; Glaum & Street, 2003). Information items can be weighted based on their perceived importance; however, equal weight was used for the following reasons:

- Equal weight avoids subjective, judgmental ratings of items that can arise with unequal weighting (Wallace & Naser, 1995; Owusu-Ansah, 2000; Owusu-Ansah & Yeoh, 2005).
- User preferences are unknown, and different users across countries are likely to assign different weight to similar items (Chong, Most & Brain, 1983).
- Several prior studies have argued that the result of the equal weighting procedure tend to be similar to those of other weighting systems (Firth, 1979; Robbins & Austin, 1986; Chow and Wong-Boren, 1987; Zarzeski, 1996; Prencipe, 2004).

2.2 Compliance index

The level of mandatory compliance with IFRS was measured using a mandatory disclosure index (MDI). A properly constructed MDI is seen as a reliable measurement device for corporate compliance (Marston & Shrives, 1991) and is consistent with previous studies (Street & Bryant 2000; Street & Gray, 2001; Glaum & Street, 2003). A checklist is also used by audit firms to check their clients' compliance with IFRS. The index summarizes the disclosure requirements of IFRS 7 into a composite figure ranging from zero to one, which is used to determine the level of compliance of each bank.

The problem with the disclosure index methodology is that some of the information items in the index may not be applicable to all the banks. Following Owusu-Ansah and Yeoh (2005), a relative score is computed for each bank. The relative score is the ratio of what a bank disclosed in its annual report to what it is expected to disclose under IFRS in each year investigated. Because the constituents of the disclosure index are mandated information items, the relative score obtained by a company is interpreted as its MDI, derived by using the following formula:

$$MDI_{jt} = \frac{\sum_{i=1}^{n_{jt}} X_{ijt}}{n_{jt}}$$

Where:

x_{ijt} = number of mandated information items applicable to the sample company j, that it actually disclosed in year t,

n_{jt} = the number of mandated information items applicable to sample company j, which are expected to be disclosed by company j in year t. Banks were not penalized for not disclosing an item if it is deemed obvious that the item does not apply to that company.

3.0 Results and Discussion

The compliance index base on a self constructed compliance checklist is used to analyze the data and determine the level of compliance with IFRS 7. The overall level of compliance was obtained by finding the average compliance level of all the six banks.

3.1 Descriptive Statistics

Table 1 describes the number of disclosure items contained in the IFRS 7 disclosure requirement for 2008 and 2009, those that are not applicable to the banks and those applicable for the purpose of this research.

Table 1: The total number of disclosure items for IFRS 7

Effective year	*Disclosure items*	*Items not applicable*	**Items applicable**
2008	90	12	78
2009	109	12	85

Source: IFRS Manual 2009

Disclosure items for year 2008 are less than disclosure items for 2009. The difference comes from the fact that in March 2009, the IASB published an amendment to IFRS 7 requiring an enhanced disclosure about fair value and liquidity risk. In particular, the amendment requires disclosure of fair value measurement hierarchy and separate liquidity risk disclosure for derivative financial instruments.

Twelve items fall under disclosure requirement for hedging activities and thus considered inapplicable for the purpose of this study. This is because the study is limited to listed banks alone and all the participating banks do not indulge in hedging activities. In all, 118 out of the 194 disclosure requirement, representing 61%, were applicable for 2008. In 2009, it was 124 out of 200, representing 62%.

Table 2: Disclosure Compliance Level (%) for 2008

Listed Banks incorporated in Ghana	*No. of disclosures items*	*No. of items not applicable (applicable)*	**Compliance level**	
Cal Bank	78	6(72)	69	95.83%
Ecobank	78	8(70)	64	91.14%
Ghana Commercial Bank	78	6(72)	64	88.89%
HFC Bank	78	9(61)	59	95.08%
SG-SSB	78	8(70)	68	97.14%
Standard Chartered Bank	78	8(70)	69	98.57%
Average				94.7%

Source: Compliance Checklist and Annual Report of the Banks (2008)

Table 3: Disclosure Compliance Level (%) for 2009

Listed Banks incorporated in Ghana	***No. of items disclosures***	***No. of items not applicable (applicable)***	**Compliance level**	
Cal Bank	85	6(79)	79	100%
Ecobank	85	8(77)	77	100%
Ghana Commercial Bank	85	6(79)	75	94.94%
HFC Bank	85	9(76)	74	97.36%
SG-SSB	85	8(77)	75	97.40%
Standard Chartered Bank	85	8(77)	77	100%
Average				98.2%

Source: Compliance Checklist and Annual Report of the Banks (2009)

Table 2 and 3 are detailed bank-by-bank comparison of the actual compliance level and corresponding disclosure requirements with IFRS 7. The figures in the column headed number of disclosures represent all the sub-items required by IFRS 7 that are applicable to banks in Ghana. Those figures in the column headed "not applicable (applicable)" represent the number of IFRS requirement that is not applicable to a particular bank as well as those that are actually complied with by the banks on the basis of their annual reports for 2008 and 2009. Comparatively, all the banks improved upon their IFRS 7 required compliance level, with three of the banks scoring 100% each in 2009. The average compliance level for 2008 stood at 94.7% as compared to 98.2% in 2009. This improvement in IFRS 7 compliance level over time is consistent with the findings of Bader (2005), who finds a similar trend in the Gulf co-operation council member states as explained in the literature review. What might have accounted for this trend could be explained by the fact that, the management and staff of the Ghanaian banks are now getting more familiar with the IFRS in 2009 than in 2008 and that has reflected in their improve performance with the IFRS 7 disclosure requirement.

The average compliance level was found to be high for both years, 2008 recorded 94.7% whiles 2009 recorded 98.2%. This does not support the assertion by Street and Bryant (2000) who report that the overall level of compliance for all sample firms is equal to or less than 75% for many of the standards examined, and that firm compliance is higher for firms with U.S. listings than those without such a listing. The high compliance level with IFRS 7 by the listed banks might have resulted partly from two factors. Firstly, the monitoring and enforcement mechanisms put in place by the Bank of Ghana is very effective. The other reason is that, five of the banks have as their auditor an accounting firm that belongs to the "Big 5". Hodgdon (2009), found compliance level to be positively related to auditor choice (Big5+2). With the "Big 5" experience in auditing and the reputation they have earned in the accountancy field, the "Big 5" will certainly ensure that the banks are in compliance with the standards.

4.0 Conclusion

The study examines the compliance level of IFRS 7 by listed Banks on Ghana Stock Exchange using self-constructed checklist to estimated Mandatory Disclosure Index for 2008 and 2009. We observed high compliance level of listed banks in Ghana with IFRS 7. The compliance level ranges between 94.7% in 2008 and 98.2% in 2009 which is a good feat. However, there is still gap between claiming to compliance and actual compliance with IFRS by companies and this should be a source of worry.

Compliance with IFRS relates positively with time trends in Ghana. Though it can be argue that it is early days yet, the improvement in compliance level between 2008 and 2009 suggests that with time Ghanaian companies can do much better than the situation now. It is recommended that though the enforcement mechanism seems to be working well in the short-run resulting in high compliance, effort should be made to sustain it in the long run.

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