

Impact of Implementation of International Financial Reporting Standards-9 on Profitability and Dividend Payout Ratio of Pakistani Banks

Mazhar Hussain Choudhary* Husnain Ali**

Abstract

The objective of this paper is to analyze the” impact of “the International Financial Reporting Standards-IFRS-9 implementation on earnings and dividend payout ratio of Pakistani banks. The data is collected from the yearly financial reports of banks from 2008 to 2020. For that purpose, the panel regression method is utilized. The study reveals, a positive relation between the IFRS-9 and earnings of banks in Pakistan. While, there is negative association among the IFRS-9 and dividend payout ratio of banks in Pakistan. The Institute of Chartered Accountants of Pakistan (ICAP) may provide training and development program for auditors and other related members, thereby significantly improving the implementation of IFRS 9 in the banking sector of Pakistan. Therefore, this study contributes for the regulators, Institute of Chartered Accountants of Pakistan (ICAP), Federal Board of Revenue (FBR), auditors, investors and other stakeholders of the banking sector of Pakistan. To my knowledge, no prior research has examined this topic.

Keywords: International financial reporting standards-IFRS-9 implementation; earnings per share; dividend payout ratio; Pakistan banking sector; stakeholders.)

JEL Classification: G2, G21

1. Introduction

In the contemporary scenario, the quality of financial statements of banks’ disclosure is the main concern of investors, creditors, regulators, the general public and all other stakeholders in Pakistan as well as all around the globe. In this regard, Pakistani banks have adopted International Financial Reporting Standards (IFRS) in 1st January 2013. Moreover, due to the enhancement of technology and internationalization, the capital inflow increased in capital markets of different economies through foreign portfolio investments. Thus, it is significant to understand the latest impact of changes in International Accounting Standards on the earnings and dividend payout of

*Assistant Professor, Department of Economics and Finance, College of Business Administration, University of Ha’il, Kingdom of Saudi Arabia. Email: drmazharhussain76@gmail.com & m.choudhary@uoh.edu.sa

** MPhil Scholar at International Islamic University Islamabad, Pakistan. Email: hussnain.ali120arcade@gmail.com

the banking sector of Pakistan. The core concern of embracing the IFRS in Pakistan is to attain the benefits of the International Accounting Standards issued by the International Accounting Standard Board in preparation of financial statements of Pakistani banks.

Earlier to the implementation of the IFRS, the Generally Accepted Accounting principles (GAAP) were used internationally for the examination of firms' earnings and dividend payout, which were entrenched in conventional, legal, economic, socio-cultural and regulatory practices of the world. Pakistani banking sector realized "that the adoption of IFRS will improve the" international trade, investment decisions, performance of Pakistani Stock market and ultimately surge the foreign portfolio investment and foreign direct investment in Pakistan. Hence, it is pertinent to investigate the impact of IFRS implementation on the performance of Pakistani banks, which is important for all the stakeholders linked with financial reporting.

Since the development of international markets, investment platforms have been established and the inflow of capital has increased through foreign direct investment, so the emerging and developed economies are adopting the IFRS to become more competitive in global markets. According to Owolabi and Iyoha (2012), the quality of financial statements is significant for rational investment decisions for the users of accounting information and for other relevant objectives. Therefore, through the adoption of IFRS, the banking sector is able to produce relevant, reliable and comparable accounting information for all the stakeholders.

The banking sector played a vital role in the economic prosperity of any economy, because it provides the savings of the first economic agents to the second economic agents. Therefore, a developed banking sector is significant for the economic growth of Pakistan, as it creates links between other economic sectors. Thus, reliable information about banks is important for the managers and other decision makers. As the role of the banking sector is critical for the economic growth of every country, so the high-quality accounting standards are the demand of managers and business entrepreneurs.

Most of the studies related to the implementation of IFRS have been conducted by Fuensanta et al. (2016), Jermakowicz (2004), Pownall and Schipper (1999), Rees and Weigback (2002), Hope et al. (2006), Blanco and Osma (2008) and Robyn and Graeme (2009) with the focus on developed countries. Moreover, a few studies of Abolaji and Adeolu (2015), Asian (2015), and Grossman et al. (2016) emphasized the IFRS and Earnings of firms of developing countries. Nevertheless, the previous literature totally ignores the effect of IFRS-9 on profitability and dividend payout of the banking sector of Pakistan. Therefore, this study tries to fill this gap in the existing literature.

Furthermore, the researchers like (Barth et al., 2008, Daske et al., 2008, and Ahmed et al., 2013) explain the positive impact of IFRS on the earnings of listed firms, however, other researchers like Vera (2013), and Matthew (2015) found the negative impact of the same. These

mixed results are inconclusive in the context of emerging countries. While dividend payout are important for shareholders are explained by DeAngelo and DeAngelo (2006). Moreover, in previous literature of “Shevlin (1982), DeAngelo et al. (1992), and “Naveen et al. (2008) discussed about firms pursue a consistent dividend payout policy. Therefore, the research “about the effect of the compulsory implementation of” IFRS-9 on earnings and dividend payouts is significant” for banking sector of Pakistan. The results of this study contribute for the regulators, the Institute of Chartered Accountants of Pakistan (ICAP), Federal Board of Revenue, external auditors, and shareholders of companies. Moreover, the results are also applicable for the Pakistani banks, which are able to pay dividends from unrealized profits originating from the reappraisal of financial assets”.

Hence, “the goal of this research is to analyze the connection between the IFRS-9” implementation and earnings per share (EPS) as well as the dividend payout ratio of listed banks in Pakistan. Moreover, in this study the author tries to answer the research question regarding what is the impact of the IFRS-9 implementation on earnings per share and dividend payout ratios.

The second section explains the literature review and the hypotheses. Section three elaborates the methodology followed by the section of results and discussion. The last section explains the conclusion and future directions.

2. Literature Review

The quality of report in accounting literature is usually summarized as reliable disclosure of facts and figures which were empirically tested like “Dechow and Dichev” (“2002) “examined accrual quality”, “Jones (1991)” investigated abnormal accruals”, “and earnings smoothing were analysed by” e.g., (Leuz et al., 2003; Barth et al., 2008; Parte Esteban 2008; “Ahmed et al., 2013). Moreover, the compulsory implementation of IFRS-9 was discussed by e.g., (Armstrong et al., 2010; De Fond et al., 2011”; Yip & Young, 2012”; “Brochet et al., 2013)”. Previous literature also elaborates that higher liquidity and greater firm evaluations is depend on higher reporting quality as explained by (Lang et al., 2012; Behn et al., 2008) discussed about little analyst prediction mistake.

Adah (2012) asserts that IFRS give authentic financial data, which can be compared, uniform, and simple for financial sector reporting businesses to comprehend. Moreover, the implementation of IFRS will enhance the relevance and dependability of financial statements produced by the industry of banks. Collins argued in 2002 that it is widely believed that operators of financial statements improve the reputation by offering exceptionally better accounting rules that are consistent and dependable in replicating the financial authenticity of transactions.

Sanusi (2012) concluded that Earnings per Share (EPS) exerts a significant influence on determining both share value and overall firm value. Banking industry provides advances to customers and also accomplishes other crucial goals. The banking industry is a vital sector of

the nation that effectively and competently fulfills its objectives in order to achieve the nation's financial development. He added that when a robust financial organization provide reliable, consistence, and correctness of the statistics accessible to all those who create financial reports and other participants, the organization of banking industry will function even more efficiently. The goals of these enhancements were to tighten internal controls, correct the distinctive flaws in the banking system, and raise the monetary sector's profitability.

The concept of consistent dividend payout policy was introduced by Lintner's (1956); Shevlin", 1982"; "DeAngelo" et al., "1992)". The" stable "dividend payouts" policy reflects the firm's stable financial position ("Brown" et al., "1977; Dickens" et al., "2002"). "In Brav et al. (2005) argued that before reducing dividend payments, companies sell assets, reduce employees, increase funds through external source of financing or even relinquish positive NPV projects. Naveen et al. (2008) explain that the reduction in dividends leads to negative effect on the share price of the firm, which is why the firm hesitates to do so. The researchers like (Miller & Rock, 1985; Wood, 1997; Berk & DeMarzo,2007; Guttman et al., 2010; "Lambrecht & Myers,2012) suggested that companies manage their dividends due to the signals and tax avoidance.

The above literature elaborates that the corporate managers maintain a consistent dividend policy and avoid dividend reduction for the value creation of the firm. It is also perceived that, if the firm's earnings surge, then it will pay high dividend payments leads to create value for it. The law of dividend disbursement is not based on revaluation gain; however, the firm's dividend payout ratio increases after the acceptance of unrealized earnings to ignore, what shareholders may observe as a decrease in the dividend payments. Moreover, to avoid a reduction in dividend payments, the dividends disbursement "from unrealized" gains "may" act "as a signal" for "the quality of the" company's "unrealized gains". (Van Tendeloo & Vanstraelen, 2005; Barth et al., 2008; Ahmed et al., 2013)" raised "the" controversy related with the "fair value" of "accounting" that "is about the" modifications in "the" actual worth of liabilities and assets occur due to increase in unrealized earnings, which show real economic earnings or managed earnings. Furthermore, ((Riedl & Serafeim, 2011; "Magnan & Wang, 2012) examined "the fair value accounting"and mentioned that the reliability of fair valuation is related with firm's cost of capital and specifically to the cost of debt". It's clear from the literature that firms manage their dividends for the sake of signalling and pay dividends from unrealized earnings.

In 2013, "Daske et al. (2008) suggested that the voluntary implementation of IFRS" improves the transparency of the firm. Furthermore, in 2014, Hail et al. concluded that while the number of dividends paid continues to rise over time, he also discovered a notable decline in the willingness to pay dividends following the implementation of IFRS. Lintner (1962), conducted a study which found that dividends are sticky. Businesses that have been consistently paying out sizable dividends are unlikely to violate the IFRS dividend payment policy.

The reliability of accounting information is based on the adoption of International Accounting Standards through, which investors and other stakeholders feel confidence on the firm. In fact, the prior literature totally ignores to investigate the impact of IFRS 9 on earnings and dividend payout of the banking sector of Pakistan. Hence, this study tries to examine this research gap and contributes in the existing literature, which is beneficial for all the stakeholders of the banking sector of Pakistan. On the basis of above-mentioned literature, the following hypotheses are constructed:

H1: IFRS 9 adoption has no significant impact on earnings per share of the listed banks of Pakistan.
H2: IFRS 9 adoption has no significant impact on the dividend payout ratio of the listed banks of Pakistan.

3. Methodology

The population for this study comprises of banks in Pakistan listed on the Pakistan Stock Exchange. Total 38 banks were included as a sample. The data for each of the sample banks is therefore taken from the 2008–2020 bank annual reports. Secondary information related to earnings per share and dividend payout ratio is collected from financial records of banks. To meet the investigation's goals, an econometric formula has been created to look at how the adoption of IFRS-9 has affected Pakistani banks' earnings per share and dividend payout ratio. It is listed below.

$$EPS_{it} = \beta_0 + \beta_1 IFRS + \beta_2 VLS_{it} + \beta_3 BS_{it} + \beta_4 FS_{it} + \beta_5 MP_{it} + \mu_{it} \quad (1)$$

$$DPR_{it} = \beta_0 + \beta_1 IFRS + \beta_2 VLS_{it} + \beta_3 BS_{it} + \beta_4 FS_{it} + \beta_5 MP_{it} + \mu_{it} \quad (2)$$

IFRS-9 implementation is represented by a Dummy variable. According to the notification of SBP every bank operating in Pakistan needs to adopt the IFRS-9. "The before implementation of IFRS-9 time period" is represented by 0 while "the after implementation of IFRS-9 time period" is represented by 1. EPS shows the Earnings per Share, which is used to measure the percentage of earnings of a corporation assigned to each unit of outstanding shares. The dividend Payout Ratio is calculated the return on investment to shareholders. Therefore, it is measured as below mentioned formula:

$$\text{Dividend Payout Ratio} = \text{Dividend per Share} / \text{Earnings Per Share (EPS)} * 100''$$

The control variables include Firm Size (FS), measured as the natural logarithm of the company's total assets. Volume of Shares Traded (VLS) refers to the number of shares or contracts exchanged for a particular security or across the entire market within a given time frame. Market Price (MP) represents the agreed-upon price at which a security is traded in the open market at a specific point in time. Board Size denotes the total number of directors serving on the company's board.

The panel regression method is utilized for the analysis “to explore the impact of IFRS-9 implementation on the earnings and dividend payouts ratio of banks in Pakistan. In this method, the researcher decides whether to use models of fixed effect or random effect. The test of Hausman is used to determine whether fixed effects or random effects is appropriate.

4. Results Discussion

Table # 1 reveals the data for 38 listed banks, which has been evaluated over a period of 10 years by using the panel ordinary least squares method of regression. The fixed effect is appropriate for this model because the result of the hausman test for random effect the p-value was less “than 0.05 and reject the null hypothesis”. Therefore, random effect has not been proper. When fixed effect has been applied, its p-value is 0.0000, which is statistically significant as mention in Table # 2. IFRS-9 is the independent variable and coefficient of the IFRS-9 is 0.256491, which shows that IFRS-9 and earnings per share has a positive relationship. The researchers such as (Aurangzeb, 2012; Hayfa et al., 2013; and Jinadu et al., 2016) found the likewise results that a significant positive relationship among the adoption “of IFRS 9 and EPS.”

The result shows the probability of the f-statistic is 0.000000, which demonstrates the significance of the model. The outcome additionally demonstrated that the explanatory variable suggests that 45% of the change in the dependent variable (EPS) can be explained by the explanatory variable in light of the R2 of 45%. Nevertheless, the Durbin-Watson of 1.919727 demonstrates that there is no serial auto correlation problem. The coefficient of IFRS is 0.256491 with a P = 0.0000 at 5% level of significance of Pakistani listed banks. This depicts that the EPS of Pakistani listed banks have benefited greatly from the implementation of IFRS-9.

A direct correlation between the two variables is shown by the scrutiny, which shows the relationship between the implementation of IFRS on the EPS with a coefficient (r) of 0.256491. This evidence reveals “that the association between the adoption of IFRS and the EPS of” listed banks in Pakistan is significantly positive. Hence, the alternative hypothesis is accepted and reject the null hypothesis result, which states that the implementation of the EPS of Pakistani listed banks is significantly impacted by IFRS provisions.

Table 1
Impact of IFRS 9 on EPS

Dependent Variable: EPS				
Sample: 2008-2020				
Total Panel (Balanced) Observations : 380				
Variable	Coefficient	Std. Error	t-Statistics	Prob
IFRS 9	0.256491	1.112677	0.230517	0.0000
LNBS	10.79026	8.635354	1.249544	0.0000
LNFS	-13.24426	16.59638	-0.798021	0.0000
LNMP	0.155795	1.380407	0.112862	0.0000
LVNST	0.637162	0.702822	0.906577	0.0000
C	8.159993	50.02331	0.163124	0.0000
Effect Specification				
Cross-Section Fixed (Dummy Variable)				
R-Squared	0.454828	Mean Dependent Var	5.187705	
Adjusted R-Squared	0.386884	S.D. Dependent Var	11.77122	
S.E. of Regression	9.217066	Akaike info criterion	7.386218	
Sum Squared Resid	28629.60	Schwarz criterion	7.832079	
Log Likelihood	-1360.381	Hannan-Quinn criter.	7.563138	
F-Statistics	6.694138	Durbin-Watson stat	1.919727	
Prob (F-Statistics)	0.000000			

The data of 38 listed banks of Pakistan were evaluated over 10 years' time period by using the panel least square technique of regression. After running the panel data in E-views, random effect is applied and then hausman test is applied. The findings indicate that the p-value exceeds 0.05, which demonstrate that it is impossible to reject the null hypothesis and random effect is appropriate for this model. Table #2 depicts that the impact of IFRS 9 adoption on Dividend Payouts Ratio (DPR) is negative because there is a negative sign with the amount of coefficient of IFRS 9 and value of coefficient is -0.192933 with a P = 0.0000 at 5% level of significance. This suggests that there is a negative and significant impact between the implementation of IFRS and the DPR of listed banks in Pakistan. This is similar with the study of Hail et al. (2014), it explains why the amount of DPR decreased with the implementation of IFRS-9. "The companies" are paying less dividend to their shareholders because most of the banks retain the earnings for reinvestment purpose and they are not paying regular dividend to shareholders and some are retaining it for meeting their expenses.

The result depicted the probability of the f-statistic is 0.006055, which showed the significant of the model. Moreover, the result revealed that the R2 is 42%, which indicates that the explanatory variable accounts for 42% of the variation in the dependent variable (DPR) while the Durbin-Watson of 1.98 shows that there is no correlation problem, since its value is less than 2.

In view of the above scrutiny, the association between the implementation of IFRS and DPR has a correlation coefficient (r) of -0.192933, demonstrating an inverse relationship between the two variables. The evidence of this result shows, the association between the "implementation

of IFRS and the DPR of listed banks in” Pakistan is significantly at 5% level of significance; hence, the alternative hypothesis is accepted and rejects the null hypothesis result, which claims that the DPR of Pakistan’s listed banks is significantly impacted by the adoption of IFRS.

Table 2: “Impact of IFRS-9 implementation on dividend payouts ratio (DPR)”

Table 2

Impact of IFRS 9 on DPR

Dependent Variable: DPR				
Sample: 2008-2020				
Total Panel (Balanced) Observations : 380				
Variable	Coefficient	Std. Error	t-Statistics	Prob.
IFRS 9”	-0.192933	0.219754	-0.877951	0.0000
LNBS	0.071497	0.613372	0.116563	0.0000
LNFS	-0.603847	1.548038	-0.390072	0.0000
LNMP	0.269351	0.150067	1.794872	0.0000
LNVST	0.217656	0.070527	3.086151	0.0000
C	-2.020101	4.665071	-0.433027	0.0000
Effect Specification		S.D	Rho	
Cross-Section Random		0.948529		0.1712
Idiosyncratic Random		2.087219		0.8288
		Weighted Statistics		
R-Squared	0.42463	Mean Dependent Var		0.242610
Adjusted R-Squared	0.29662	S.D. Dependent Var		2.129669
S.E. of Regression	2.097846	Sum Squared Resid		1645.959
F-Statistics	3.317117	Durbin-Watson Stat		1.983148
Prob (F-Statistics)	0.006055			
		Unweighted Statistics		
R-Squared	0.067144	Mean Dependent Var		0.424756
Sum Squared Resid	1960.132	Durbin Watson Stat		1.716868

5. Conclusion and Recommendation

This study significantly adds to the body of current knowledge because, prior to the implementation of IFRS 9, the profitability and dividend disbursement ratio of banks of Pakistan was completely disregarded. According to the stakeholder theory, the implementation of IFRS 9 improves stakeholders’ capacity for making decisions. This study investigates the stakeholder theory and helps managers increase earnings per share through efficient and effective decision-making and accurate reporting of information in annual reports. Furthermore, stakeholders might gain a better understanding of the companies’ earnings by implementing accounting standards. By adopting IFRS 9 on the profit payout proportions of Pakistani banks, it also helps to enhance the capacity of all the various investors and partners. The accuracy, dependability, and comprehension of financial statements can all be improved for users of IFRS 9, which also enhances their ability to make decisions. The findings of these analyses are beneficial to the management of Pakistani banks because, in order for their organization to be successful, they must consider the worries of

different partners and investors and provide true and accurate financial information by applying IFRS 9 on earnings and dividend payout ratios of banks of Pakistan. Investigating financial details in Pakistan is crucial because it will benefit the people of Pakistan by providing them with a more accurate and fairer picture of the financial situation by adopting IFRS 9 on the profitability and dividend disbursement ratio of banks of Pakistan. Controllers, policymakers, and managers who may be concerned about the impairment of true profitability and are trying to identify ways to improve the budget quality by adopting IFRS 9 on profitability and dividend disbursement ratio in Pakistan will find great value in the examination's findings.

The reporting criteria that are used in each nation vary from one another. Some nations implement accounting standards in their entirety, while others just apply a portion of them. These standards are developed by recognized accounting standard bodies. Since, it is more expensive to adopt accounting standards and because it is challenging to interpret them for reporting standards. To achieve better results for Pakistan's banking and non-banking sectors, all senior auditors, policymakers, regulators, and upper-level managers in the banking industry must put in a lot of effort to improve the way IFRS 9 is implemented. It would be necessary to hire a number of skilled and experienced auditors to guarantee that IFRS is implemented successfully and efficiently throughout Pakistan's banking industry. The adoption of IFRS 9 in Pakistan's banking industry might be greatly enhanced by the Institute of Chartered Accountants of Pakistan (ICAP) offering training and development programs for auditors and other relevant members.

6. Limitations of the Study and Future Research

This study was conducted in the financial sector and solely represents the findings of Pakistan's banking industry. Therefore, it's critical to assess how IFRS 9 is being applied in the non-financial sector. Additionally, this study only looks at two factors with the implementation of IFRS 9; however, future research could look at the impact of IFRS 9 on other variables and add a few more variables.

Conflict of interest & declaration statement

The authors declare that there are no conflicts of interest concerning this manuscript.

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