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FINANCIAL REPORTING QUALITY AND SHARE VALUES OF QUOTED NON-FINANCIAL FIRMS IN NIGERIA

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ABSTRACT

The study examined the level of compliance with financial reporting standards of quoted non-financial firms in Nigeria and examined the extent of financial reporting quality among the firms. It also determined the factors influencing financial reporting quality of quoted non-financial firms and investigated the impact of financial reporting quality on share values of the quoted non-financial firms in Nigeria. These were with a view to determining the effect of financial reporting quality on the firms' value of quoted non-financial firms between 2002 and 2017.

The study employed secondary data. The population of this study was 176 quoted non-financial firms listed on the Nigeria Stock Exchange. Fifty firms were purposively selected based on the availability of complete financial information for the sampled period. Data on cashflow accrual ratio, statements of financial position accrual ratio as proxies of financial reporting quality, firms' size, auditors' type, share values, board size, leverage, audit committee size, age and firms' liquidity were sourced from the audited annual financial report of the firms and factbook of Nigeria Stock Exchange. Data collected were analysed using percentages fixed effect model, random effect model and pooled OLS method.

The results showed that the compliance of firms had been increasing over the years with Income Tax (IAS 12) having the highest level of compliance of 100% among the six sampled standards. Also, results on the extent of financial reporting quality established that the level of manipulation of financial statement had been reducing every year and it had been reduced to 0% in both years 2016 and 2017 respectively. Furthermore, results revealed that both leverage and size of the firm ($t = -0.3412$, $p > 0.05$; $t = 0.1325$, $p > 0.05$) respectively, had no significant

impact on the financial reporting quality of quoted non-financial firms in Nigeria. Finally, result showed that the financial reporting quality had significant positive effect on the share value of firms ($t = 2.1385$, $p < 0.05$).

The study concluded that financial reporting quality has a positive impact on the market value of quoted non-financial firms in Nigeria.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Nigeria Capital market has been established to be information inefficient (Nwosa & Oseni, 2011). According to the Efficient Market Hypothesis, (Fama 1991) stated that share value reacts completely and immediately to all information available to the market. Efficient Market Hypothesis (EMH) states that an operationally efficient stock market is expected to be externally and informationally efficient. Therefore, share value is an unbiased estimate of all the available pieces of information on the expected future cash flows and the estimated risk involved in buying such a share (Reilly & Brown, 2003). Therefore, efficient market provides information regarding the intrinsic value of the security which is equivalent to its price. Another perspective was presented by Lo (1997), that the market efficiency theory states that only the newly arrived information is capable of changing security price. Consequently, analysis of available information to determine the intrinsic value of a firm will not worth the effort in an efficient market, as the analysts will not beat the market by making abnormal profit. This implies that the investors will be discouraged to analyze or gather information, having realized that that the information gathered and analyzed has been reflected in the price of the security and the price is an unbiased estimate of the true value of the share (Fama, 1965; Lo, 1997).

The information required in the capital market to which price should respond to is supplied through financial report of the listed firms. According to the World Bank Report (2004) having investigated the Financial Reporting environment in Nigeria, the report revealed that financial analysts, creditors and other stakeholders held the view that the financial statements are not of quality and standard. Hence, the financial statements in Nigeria are not regarded as credible and there was an observation that multinational firms prepared more quality financial statements compared to other firms in Nigeria. On these bases, the low quality financial statements prepared for consumption in Nigeria Capital Market may be responsible for inefficiency of Capital Market. There is a growing evidence that disclosure generally improves transparency and thus reduces information problems (Healy & Palepu, 2001). The manipulation of financial statement should not even occur as the International Financial Reporting Standard (IFRS) has stipulated a framework and objective for financial Reporting.

The general objective of financial reporting is to make available financial information about the reporting entity that is useful to current and potential investors, financiers and other creditors in making choices about providing resources to the entity (IASB, 2005). Although it relies on the assumption that the informational need of investors is the same as other stakeholders as defined by the Revised Conceptual Framework of financial reporting, users do not have the capability to force the entity to supply them with the required information to make decisions about their investments. It is of utmost importance that the information supplied through financial reporting should not be less than being credible.

Incorporation of firms which has characterized the twenty first century firms segregates management from ownership. As a result of this separation, the management of a firm owes the owners and stakeholders the responsibility to give accurate account on the resources that have been placed in their care which is done in form of financial statement. Financial Reporting is a means through which information both quantitative and qualitative is communicated to shareholders and other interested parties about the performance of an entity in form of stewardship account. Choi (1973) defined financial reporting as a "publication of economic information which relates to businesses quantitative or non-quantitative that can help users in making economic decisions". The coverage of the definition was extended by defining it as a process where firms communicate with outside stakeholders (McKinnon, 1984). It could be inferred from the definitions that consumers of financial statements are many, especially those that place their confidence and assessment on the reliability of financial statements like financial analysts, equity analysts and tax assessors. The importance of financial statement which is an output of financial reporting cannot be overemphasized. Financial Statement is an important information that (potential) investors need in making an informed decision. Analysts and stockbrokers analyze this information and make recommendation to their clients on whether to buy, sell or hold a particular financial instrument. It gives information not only about profitability but also reflects firms' ability to generate cashflow and meet expenditure as at when due. The owners are keenly interested in the feedback from reporting because financial reporting provides an indicator to show the management and utilization of the resources of the firms. The information from financial statement is also used to appraise the performance of the management and their rewards in form of bonuses are determined using performance disclosed in financial statement which could be a source of incentive to manipulate financial information disclosed.

1.2 Statement of Problem

Although both International Accounting Standard Board (IASB) and Financial Reporting Council of Nigeria (FRCN) point out the essence of high-quality financial reporting, one of the ways of determining a financial statement with high quality is the application of and compliance with accounting standards that underlie preparation of financial statements alongside with Generally Accepted Accounting Principles (GAAPS). Evaluating financial reporting quality comes with challenges. Earnings persistence, accrual model, timely loss recognition and smoothness are methods that have been adopted by different authors. It should not be expected that the proxies will work the same in all situations as they have their individual shortcomings (Dechow *et al*, 2010). Most studies apply the Jones and Modified