Financial Reporting Quality of Nigeria Firms: Users' Perception

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Abstract

This study assesses the quality of annual reports and accounts of Nigerian firms from the perspective of users of such accounting information. The study administered one hundred (100) questionnaires to respondents from seven (7) user group selected at random with a minimum qualification of first degree or Higher National Diploma (HND) to ensure high quality of responses. Taking the qualities of accounting information of understandability, relevance, consistency, comparability, reliability, objectivity and completeness and using a five point Likert scale and Chi-Square for test of hypothesis, the study provides evidence that, the quality of annual reports and accounts of Nigerian firms is only moderate. Consequently, the study recommends that Nigerian firms should strive to achieve higher financial reporting quality.

Key Words: Financial Reporting, Quality, Annual Reports, Nigerian firms, Users.

1.0 Introduction

A wide range of users of financial reports need information about financial position, performance and changes in financial position of enterprise in order to make economic decision. Interested parties in the financial affairs of business organization vary in their information need, but it is expected that all disclosed information must be adequate, fair and complete. The Corporate Report of 1975 released by a sub-committee appointed by the Accounting Standard Steering Committee (ASSC) identified seven (7) separate user groups of accounting information as the equity investor group, the loan creditor, the employee, the analyst-advisor, the business contact, the government and the public (David and Anne, 1999). The equity group, according to the Corporate Report, consists of existing and potential shareholders and holders of convertible securities, options and warrants. This group needs accounting information to consider whether or not to invest in a business (to buy shares or to buy more shares) or to disinvest (sell shares in the business). They do this for the purpose of income by way of dividend and or capital gain.

The loan creditor group includes existing and potential holders of debentures and loan stock, and providers of short term secured and unsecured loans and finance. The Report excludes trade creditors from this group. The loan creditors need accounting information need is to assess whether or not they will get their money back. They are interested in the amount of cash a business has got or will get and the net realizable value of all the assets as a safeguard. They are also interested in the economic stability and vulnerability of the borrower. The employee group includes existing, potential and past employees. They or their representatives need accounting information about the business for fair and open collective bargaining (wage negotiations) and to assess present and future job security. The analyst-advisor group consists of financial analysts and journalists, economists, statisticians, researchers, trade unions, stockbrokers and credit-rating agencies. They are a collection of experts who advice other user groups. The accounting information needs of the analysts-advisor group are essentially the needs of the particular user group they are advising. Being experts and advisors, they need more detailed and sophistication in the accounting information presented to them.

The business contact group includes customers, trade creditors, suppliers and competitors, business rivals and those interested in mergers, amalgamation and takeovers. Apart from continuity of the relationship, suppliers and trade creditors need to appraise the future of their potential customers both in terms of financial viability, sales volume and market share. Customers want to be sure that they will get their goods on time and in good condition. They also want to be sure of after sales service and an effective guarantee. Competitors and business rivals want to find out about the financial, technical and marketing structure of the business. Those considering a merger, amalgamation and takeover bids want to know what the existing management is likely to achieve and what the new management could achieve with different policies.

The government consists of tax authorities, departments and agencies concerned with the supervision of commerce and industry and local authorities. Their accounting information need is not only for purposes of taxation but for control of particular firms, and to base their economic decisions as regards the economy as a whole. The public which comprises taxpayers, ratepayers, consumers and other community and special interest groups such as political parties, consumer and environmental consumer protection societies and regional pressure groups is the seventh user group in the Corporate Report. They are interested for example in energy usage, effective use of subsidies, dealings with foreign governments and contributions to charity in money or kind. Accounting information, according to Wolk, Francis and Tearney (1992), is a public good. It can be freely passed from person to person. Each person can consume the content of the information.

There is a growing interest in published accounts of companies in Nigeria and worldwide owing to the collapse of giant firms like Enron etc. The distress phenomenon in the banking sector which led to the fall in share prices on the floor of many stock exchanges has heightened the quest for qualitative financial reports, hence, the need to assess public perception of the quality of annual reports being released by firms. Furthermore, Isa (2006), Kantudu and Atabs (2007) and Nyor (2010) provide evidence that Nigerian firms comply with standards governing the publication of their financial statements. This means that financial reporting quality by Nigeria firms is given a pass mark and their financial statements are seen as transparent and reliable. Since the aforementioned works rely on the annual reports and accounts of the companies to examine their compliance with accounting standards and also provide some evidence of quality financial reporting, this study applies a survey technique by evaluating users' perception on the quality of financial statements of selected Nigerian firms.
This study aims to assess whether the published annual financial statements of Nigerian firms pass the required quality as to guide users in their decision making. The study has become imperative because capital markets have become global and international business is growing at a very fast rate. Hence, the reporting quality of countries and firms has come into focus.

2.0 Accounting Information and Financial Reporting Qualities

Accounting is an information system that measures, processes, and communicates financial information about an identifiable economic entity (Kenter and Pressley, 2008). Furthermore, this information is designed to make it easier for individuals with an interest in an organization to make better decisions about that particular entity. Accounting relates to the provision of information to people about what they have got, what they used to have, and the changes in what they have got and what they may get in future (Alexander, *et. al.* 2003). SAS 2 defines Accounting information as data that are found in Financial Statements.

Accounting is often looked at as performing the stewardship role, and a steward would have to account to those who have put him in charge of their estate by way of reporting to them. Accounting information also refers to information on the economic activities of a business organization which is identified, measured and communicated to users to enable them make an informed judgment about the business enterprise (Wood and Sangster, 2000). The identification and recording of financial or economic information is done by way of accounting system known as double entry book keeping. Measurement of accounting information involves making judgment about the value of assets and liabilities of a business. It also measures the profit or loss of an organization during a period.

For accounting information to be useful, it has to be communicated to users of such information. This is what is termed financial reporting. The communication is accomplished through the preparation of and reporting performance in financial statements, which shows the financial position of the business organization during a particular period. The major objective of financial reporting is to provide high-quality accounting information concerning organizations which are financial in nature that is useful for making economic decisions (FASB, 1999; IASB, 2008). Financial reporting quality therefore, relates to the accuracy with which reported financials of a firm reflects its operating performance and how useful they are in forecasting future cash flows (Scott and Irem, 2008). Such qualities include but are not limited to understandability, relevance, consistency, comparability, reliability and objectivity.

American Accounting Association (as cited in Wolk et al., 1992) identified four standards for evaluating accounting information namely, relevance, verifiability, freedom from bias and quantifiability. The Financial Accounting Standards Board (FASB) from its Conceptual Framework Project as cited in Wolk et al. (1992) published two quantitative characteristics of accounting information as relevance and reliability.

Relevance as a quality of accounting information is expressed as being capable of making a difference in a decision by helping users form predictions about the outcome of past, present and future events, or to confirm or correct expectations. Relevance has three other aspects of predictive value, feedback value and timeliness. Accounting information should be available to decision makers before it loses its capacity to influence decision.

Reliability is made up of four components: verifiability, representational, faithfulness and neutrality. Reliability is a quality of financial statement that indicates users' confidence in the accounts. This quality does not imply that the accounts are necessarily factual, but it should be as credible and as believable as possible. This is why auditors are brought in to carry out an independent verification as a means of securing as far as possible the quality of reliability (Christiana, n.d).

Alexander et al. (2003) include completeness as other characteristics of useful accounting information and said users should be given a total picture of the reporting business entity as far as possible. The quality of completeness ensures that users are given a round picture of the economic activities of the firm.

Wolk et al. (1992) refers to the characteristics of accounting information as qualities of accounting information. Other qualities of accounting information as mentioned in the Conceptual Framework Project by FASB include conservatism, comparability, consistency and materiality. Materiality relates to whether an item is large enough to influence users' decision. Lambert, Leuz and Verrecchia (2007) demonstrated that the quality of accounting information can influence the cost of capital both directly and indirectly.

Financial reporting quality is measured in a number of ways including simple measures that capture the aggregate discretion reflected in reported income statements. The use of discretion is a necessary part of financial reporting as it necessitates preparers of financial statements to make numerous accounting estimates, which are subject to neutral errors and strategic manipulation. Scott and Irem, 2008 opined that companies that exercise more accounting discretion have weaker financial reporting quality, while those that exercise less discretion have stronger financial reporting quality.

Beest, Braam, and Boelens, (2009) documents measurement tool to assess the quality of financial reporting used in prior research with their advantages and disadvantages. The accrual model used by Jones, 1999; Healy & Wahlen, 1999 and Dechow *et al.*, 1995 examines the level of earnings management as a proxy for earnings quality. The value relevance literature method is employed by Barth *et al.*, 2001; *Choi et al.*, 1997; Nichols &Wahlen, 2004; Nelson, 1996 to examine the relationship between stock returns and earnings figures in order to measure the relevance and reliability of financial reporting information. Hirst *et al.*, 2004; Beretta & Bozzolan, 2004; Cohen *et al.*, 2004 examines specific elements in the annual report in depth, for instance, by conducting an experiment. The use of qualitative characteristics approach by Schipper & Vincent, 2003; Van der Meulen, *et al.*, 2007; Barth *et al.*, 2006 examines the level of decision usefulness of financial reporting information by operationalizing the qualitative characteristics.

2.0 Methodology

This study evaluates the opinion of stakeholders on the quality of firms' financial statements in Nigeria. The study employs the seven (7) separate user groups of accounting information identified by the Corporate Report of 1975, which are, the equity investor group, the loan creditor group, the employee group, the analyst-advisor group, the business contact group, the government and the public (David and Anne, 1999).

The researcher administered questionnaire to one hundred (100) respondents on a drop and collect basis selected at random. The minimum qualification of respondents was being a holder of first degree or HND. This is to ensure high quality of responses and that, the respondents are actually knowledgeable on the subject of discussion. The researcher extracts from literature review seven (7) qualities of accounting information (understandability, relevance, consistency, comparability, reliability, objectivity and completeness) and applies them to establish a bench mark for assessing the public opinion of the quality of annual reports and accounts of Nigerian firms.

A five point Likert scale of very high, high, moderate, low and very low was used (Chechet, 2010). Decision criterion is based on mean scores and is calculated as:

$$\text{Mean (X)} = \sum fx / \sum x$$

Where fx = total frequency,
f = frequency

A mean of 5.0 indicates that reporting quality is very high. The mean of 4.0 indicates high reporting quality, 3.0 indicates moderate quality, 2.0 means low quality and 1.0 very low reporting quality. We employed the use of Chi-square to test the hypothesis that financial reporting by Nigerian firms is of significant quality. Decision rule is, if the calculated value of X^2 is greater than the critical value, reject the null hypothesis (H_0) and accept the alternative hypothesis (H_1). If otherwise, then accept the null hypothesis and reject the alternative hypothesis.

4.0 Results and Discussion

This section presents the results of users' opinion of financial reporting quality of Nigerian firms as captured through the administration of questionnaire

Table 1: Analysis of Responses by User Group

User Groups of Accounting Information	Very High	High	Moderate	Low	Very Low	Mean scores	Remarks
The Equity Investor Group	9 x 5 = 45	40 x 4 = 160	82 x 3 = 246	21 x 2 = 42	2 x 1 = 2	495/ 154 = 3.2	Moderate
The Loan-creditor Group	0 x 5 = 0	3 x 4 = 12	11 x 3 = 33	6 x 2 = 12	1 x 1 = 1	58/ 21 = 2.8	Moderate
The Employees Group	2x 5 = 10	34 x 4 = 136	101 x 3 = 303	29 x 2 = 58	2 x 1 = 2	505/ 168 = 3.0	Moderate
The analyst-Advisor Group	11 x 5 = 55	23 x 4 = 92	50 x 3 = 150	14 x 2 = 28	0 x 1 = 0	325/ 98 = 3.3	Moderate
The Business Contact Group	1 x 5 = 5	1 x 4 = 4	22 x 3 = 66	15 x 2 = 30	3 x 1 = 3	108/ 42 = 2.6	Moderate
The Government Group	2 x 5 = 10	25 x 4 = 100	62 x 3 =186	32 x 2 = 64	5 x 1 = 5	359/ 126 = 2.9	Moderate
The Public Group	0 x 5 = 0	14 x 4 = 56	43 x 3 = 129	28 x 2 = 56	6 x 1 = 6	247/ 91 = 2.7	Moderate
Total Scores	25 x 5 = 125	140 x 4 = 560	371 x 3 = 1,113	145 x 2 = 290	19 x 1 = 19	2107/ 700 = 3.0	Moderate

Source: Researcher's Design, 2013

From table one (1) above, it can be seen that the lowest rating of the financial reporting quality of Nigerian firms is from the business contact group, which is the mean of 2.6. This is followed by the general public with mean rating of 2.7, the Loan Creditor group with 2.8 and the Government with 2.9. Although these are approximated to 3.0 to give moderate rating, what it means is that, the rating of the quality of annual reports of Nigerian firms by these user groups lies between low and moderate.

The employees' group rating is a mean of 3.0, while the investor group mean rating is 3.2 and the analyst-advisor group is 3.2 which is the highest among the group. The total mean score is 3.0. This means that in the opinion of financial statements users, the quality of financial reports of Nigerian firms in terms of understandability, relevance, consistency, comparability, reliability, objectivity and completeness is only moderate.

Table 2: Analysis of Responses

Characteristics of Quality of Accounting Information	Very High	High	Moderate	Low	Very Low	Total No. of Respondents
Understandability	08	33	54	03	02	100
Relevance	08	28	52	10	02	100
Consistency	03	22	52	21	02	100
Comparability	00	22	58	19	01	100
Reliability	03	12	49	31	05	100
Objectivity	01	14	58	24	03	100
Completeness	02	09	48	37	04	100
Total Scores	25	140	371	145	19	700

Source: Researcher's Design, 2013

Table two is analyses of respondents. It is summed up in columns and rows to be used for Chi-square calculation. This is to enable us test the null hypothesis that financial reporting quality of Nigerian Firms is of no significant quality.

Table 3: Chi-square Computation

	O	E	O-E	$(O-E)^2$	$(O-E)^2/E$
UNDERSTANDABILITY					
Very High	8	3.57	4.43	19.63	5.50
High	33	20	13	169	8.45
Moderate	54	53	1	1	0.02
Low	03	20.71	-17.71	313.64	15.15
Very Low	02	2.71	-0.71	0.50	0.19
RELEVANCE					
Very High	8	3.57	4.43	19.63	5.50
High	28	20	8	64	3.2
Moderate	52	53	-1	1	0.02
Low	10	20.71	-10.71	114.70	5.54
Very Low	02	2.71	-0.71	0.50	0.19
CONSISTENCY					
Very High	3	3.57	-0.57	0.32	0.09
High	22	20	2	4	0.20
Moderate	52	53	-1	1	0.02
Low	21	20.71	0.29	0.08	0.00
Very Low	2	2.71	-0.71	0.50	0.19
COMPARABILITY					
Very High	0	3.57	-3.57	12.75	3.57
High	22	20	2	4	0.20
Moderate	58	53	5	25	0.47
Low	19	20.71	-1.71	2.92	0.14
Very Low	1	2.71	-1.71	2.92	0.14
RELIABILITY					
Very High	3	3.57	-0.57	0.32	0.09
High	12	20	-8	64	3.2
Moderate	49	53	-4	16	0.30
Low	31	20.71	10.29	105.88	5.11
Very Low	5	2.71	2.29	5.24	1.94
OBJECTIVITY					
Very High	1	3.57	-2.57	6.60	1.85
High	14	20	-6	36	1.8
Moderate	58	53	5	25	0.47
Low	24	20.71	4.71	22.18	1.07
Very Low	3	2.71	0.29	0.08	0.03
COMPLETENESS					
Very High	2	3.57	-1.57	2.47	0.69
High	9	20	-11	121	6.05
Moderate	48	53	-5	25	0.47
Low	37	20.71	16.29	265.36	12.81
Very Low	4	2.71	1.29	1.66	0.61
TOTAL					**85.27**

Chi-square (X^2) value = 85.27

To obtain the Chi-square value from the table at 5% level of significance, we first determine the degree of freedom (df) using the formula:

$$df = (r-1)\ (c-1),$$

Where:
r = Number of rows; c = number of columns;
r = 7, c = 5; df = (7-1) (5-1) = 24

At 5% significance level and a degree of freedom of 24 this gives us a critical value of 36.415
Given the decision rule above, the calculated value (X^2) which is 85.27 is greater than the critical value, which is 36.415. Hence, we reject the null hypothesis that financial reporting quality of Nigerian Firms is of no significant quality.

5.0 Conclusion and Recommendation

From the evidence gathered by this study, we conclude that the quality of annual reports and accounts of Nigerian firms is adjudged to be moderate by users of accounting information in Nigeria, taking into consideration the reporting qualities of understandability, relevance, consistency, comparability, reliability, objectivity and completeness. Consequently, the study recommends that Nigerian firms should strive to achieve higher reporting quality of their annual reports and accounts.

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Questionnaire

This study is assessing users' opinion on the quality of financial reporting by Nigerian firms. Your perception of the characteristics of quality of accounting information will help us to reach a decision regarding the quality of their Annual Reports and Accounts.

1. What is your level of understanding of financial reports?
Very high [ ] High [ ] Moderate [ ] Low [ ] Very low [ ]

2. How do you rate the usefulness of annual accounts of Nigerian firms?
Very high [ ] High [ ] Moderate [ ] Low [ ] Very low [ ]

3. How do you rate the consistency of accounting policies in the financial reports over the years
Very high [ ] High [ ] Moderate [ ] Low [ ] Very low [ ]

4. How do you rate the comparability of financial reports with previous years and with other firms in the industry?
Very high [ ] High [ ] Moderate [ ] Low [ ] Very low [ ]

5. What is the level of your confidence in the of annual reports of Nigerian firms
Very high [ ] High [ ] Moderate [ ] Low [ ] Very low [ ]

6. Rate the objectivity of annual reports of Nigerian firms
Very high [ ] High [ ] Moderate [ ] Low [ ] Very low [ ]

7. How do you rate the annual reports of Nigerian firms in terms of providing a round picture of the economic activities?
Very high [ ] High [ ] Moderate [ ] Low [ ] Very low [ ]