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Research Article

CORPORATE GOVERNANCE AND FINANCIAL REPORTING QUALITY IN NIGERIA

[1]Joseph Babatunde Akeju and [2,*]Ahmed Adeshina Babatunde

[1]Chief Lecturer, Department of Accountancy, Yaba College of Technology, Lagos, Nigeria
[2]Principal Lecturer, Department of Accountancy, Lagos city Polytechnic, Ikeja, Lagos, Nigeria

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ABSTRACT

The purpose of this paper is to investigate corporate governance and financial reporting quality in Nigeria. This research has been performed using a sample of 40 companies listed on the Nigeria Stock Exchange (NSE) from 2006 to 2015. The relationship between corporate governance mechanisms (board characteristics, audit committees, board independence, board size and growth) and financial reporting quality was observed. The results of the multiple regression analysis were statistically significant at 0.05 level. The F statistics of 3.641 shows that the results typically explained the model. The findings of the study revealed thatcorporate governance improves the financial reporting quality in Nigeria.

INTRODUCTION

Corporate governance is the mechanism, process and practice by which companies are governed and controlled. The rate at which accounting scandals occurred recently in the international financial community has raised many criticisms about the financial reporting quality (Agrawal and Chadha, 2005; Brown et al., 2010). The involvement of companies such as Enron, Worldcom, Marconi, Parmalat etc. in accounting frauds has weakened the investors' confidence in the quality of financial reporting. There is need to improve financial reporting quality and strengthen the control of managers by setting up good governance structures in order to prevent failure in financial disclosure (Karamaou and Vafeas, 2005; Beekes and Brown, 2006; Brown and Caylor, 2006; Firth et al., 2007; Petra, 2007). The link between corporate governance and financial reporting quality has been critically analysed in developed countries (Klai and Omri, 2011). Emphasis was placed on governance mechanisms such as concentrated shareholding, board independence, director shareholding and auditor reputation (Klai and Omri, 2011). Good corporate governance is a corporate set-up that leads to maximisation of shareholders wealth legally, ethically and on a sustainable basis while ensuring equity and transparency to all stakeholders (Murthy, 2006).

***Corresponding author: Ahmed Adeshina Babatunde,**
Principal Lecturer, Department of Accountancy, Lagos city Polytechnic, Ikeja, Lagos, Nigeria.

Today, corporate governance becomes a key determinant in identifying company's strengths and weaknesses. One of the most important functions performed by corporate governance is to ensure the quality of financial reporting process (Cohen et al., 2004). Countries around the world are now setting the best acceptable corporate governance practice as a guide; Cadbury Report was produced in United Kingdom, Sarbanes-Oxley in United States, The Dey Report in Canada, The Vienot Reportin France, the Olivencia Report in Spain, the King's Report in South Africa, Principles and Guidelines on Corporate Governance in New Zealand and the Cromme Code in Germany (Klai and Omri, 2011). The ultimate goal of these corporate governance reports is to improve corporate governance environments (Bhagat and Botton, 2009). Financial reporting quality is the precision with which financial reporting conveys information about a firm's operation (Biddle et al, 2009). The primary objective of financial reporting is to provide high quality financial information aboutentities useful for economic decision making (IASB, 2008). The provision of high quality financial reporting information is important because it influences the providers of capital and other stakeholders positively in making investment, financing and similar allocation decisions that enhance the overall market efficiency (IASB, 2008). Financial reporting quality does not only refer to financial information but also to disclosures and non-financial information useful for decision making included in the financial statement. This paper examines corporate governance and financial reporting practice in Nigeria.

LITERATUREREVIEW

There has been a wide variety of interests among researchers, scholars, governments and global agencies on corporate governance after the financial crisis of 2008 that led to the collapse of many institutions in the world (Babatunde and Akeju, 2016). Cohen et al (2004) argued that one of the most important functions of corporate governance is to ensure the quality of the financial reporting process. Sloan (2001) argued that financial information is the first source of independent communication on managerial performance. Obona and Ebimobowei (2012) opined that financial reporting forms the basis for economic decision making by various stakeholders and that the financial reports produced by the Accountant should be based on certain fundamental qualities for various stakeholders to understand the content of the report.

Brownlee et al (1990) posits that the quality of corporate financial reports should be judged against a changing standard that has evolved over time in relation to the information needs, expectations and demands of financial statement users. Klai and Omri (2011) examined corporate governance and financial reporting quality of Tunisian firms using multiple regression model. The results revealed that the governance mechanisms that affect the Tunisian firms are lack of board independence and high level of ownership concentration. The governance mechanisms have a significant effect on the financial reporting quality of Tunisian firms. Gois (2014) investigated the financial reporting quality and corporate governance of Portuguese firms using multivariate regression model.The research evidence shows that board composition changes and its degree of independence does not produce any influence on the quality of the accounting information in Portugal.

Norwani et al (2011) examined corporate governance failure and its impact on financial reporting of selected firms in Malaysia. The evidence of the findings revealed that failure in corporate governance leads to failure in financial reporting in Malaysia. Adegbie and Fofah (2016) investigated ethics, corporate governance and financial reporting in the Nigerian banking industry using Analysis of Variance (ANOVA).The research evidence revealed that good corporate governance will produce good ethical behaviour which will eventually produce reliable and faithful financial report. Al-sufy et al (2013) investigated corporate governance and its impact on the quality of accounting information in Amman Financial Market, Jordan using arithmetical mean, standard deviationand T-Test.The findings of the study showed that there is a significant positive relationship between corporate governance and quality of financial reporting in Amman. Chalaki et al (2012) investigated corporate governance attributes and financial reporting quality in Iran using multiple regression analysis.The evidence of the findings shows that there is no relationship between corporate governance attributes (board size, board independence, ownership concentration, institutional ownership) and financial reporting quality. Chen et al (2006) tested the effect of ownership structure and boardroom characteristics on corporate financial fraud in China using univariate analysis. The research evidence revealed that ownership structure and board characteristics are important in explaining fraud. Jiang et al (2008) tested the relationship between corporate governance and earnings quality. The result indicated that only firms in the highest category of corporate governance experience significantly improved quality of earnings. The findings also revealed that firms with weak corporate governance are more likely to manage earnings in order to meet analyst forecasts. D'onza and Lamboglia (2014) examined the relationship between corporate governance characteristics and financial statement frauds in Italy using logit regression analysis. The research covers a period of 11 years (2001-2011). The research evidence shows a significant positive relationship between corporate governance characteristics and financial reporting fraud in Italian context. Dyer and McHugh (1975) examined the determinants of financial reporting lag in 120 Australian companies listed on the Sydney Stock Exchange. The evidence of the findings revealed that larger companies are associated with shorter delays due to the economies of scale in preparing financial statements. Moreover, more profitable companies are associated with moretimely reporting due to bad news taking longer to be disclosed. The findings also found a little evidence that profitability influences financial reporting timeliness.

Myring and Shortridge (2010) investigated corporate governance and the quality of financial reporting disclosures in US using ranked regression analysis. The result provides mixed evidence that the strength of corporate governance impacts on the quality of financial statement information. Fathi (2013) examined corporate governance system and quality of financial information in Tunisia using multivariate analysis and Pearson correlation matrix.The study covers a period of 2004 to 2008. The research evidence revealed that the quality of financial information is positively related to the quality of the board and quality of the ownership structure. Kantudu and Samaila (2015) investigated board characteristics, independent audit committee and financial reporting quality of oil marketing firms in Nigeria using multiple regression analysis.The evidence of the study revealed that power separation, independent directors, managerial shareholdings and independent audit committee influence the financial reporting qualities of oil marketing firms in Nigeria. Hassan and Bello (2013) investigated firm characteristics and financial reporting quality of quoted manufacturing companies in Nigeria using correlation analysis with pooled balanced panel data.The research evidence reveals that there is a significant positive relationship between firm characteristics and financial reporting quality in Nigeria. The result also shows that profitability and independent directors are positively related to earnings quality while an inverse relationship exists between liquidity and quality of financial reporting in Nigeria.

Karimet al (1998) investigated 146 firms in Bangladesh using 91 voluntary disclosure requirements. The results show that firms only disclose 26% of the 91 voluntary disclosure requirements on average. Adebimpe and Peace (2011) tested the relationship between corporate governance, company attributes and voluntary disclosures of quoted companies in Nigeria using univariate, multivariate and cross-section models. The evidence of the findings revealed that only board size has a significant positive relationship with the extent of voluntary disclosures in selected firms. Dimitropoulosb and Asteriou (2010) investigated the effect of board composition on the informativeness and quality of annual earnings. The research covers a period of 5 years (2000-2004). The result revealed that the informativeness of annual accounting earnings is positively related to the fraction of outside directors serving on the board but not related to board size.

The result further revealed that firms with a higher proportion of outside directors report earnings of higher quality than firms with a low proportion of outside directors. Beest et al (2009) measured the qualitative characteristics of financial reporting in Netherlands using ordinary least square (OLS) regression and Pearson correlation matrix. The measurement tools employed are internal validity, inter-rater reliability and internal consistency. The evidence of the findings revealed that the measurement tools are significantly positively related to the quality of financial reporting information.

RESEARCH METHODOLOGY

The broad objective of this study is to investigate corporate governance and financial reporting quality in Nigeria. Data were obtained from annual reports of 40 quoted companies in Nigeria from 2006 to 2015. Three models were used in measuring financial reporting quality. The first model is McNicholas (2002) which uses the standard deviation of the residuals or error terms as a measure of financial reporting quality. Large value of the residual implies a considerable level of discretionary accrual thereby resulting to a poor quality of financial reporting. The model is given as follows:

$$ACCt = \frac{\beta 0}{TA_{t-1}} + \frac{\beta 1OCF_{t-1}}{TA_{t-1}} + \frac{\beta 2OCF_{t}}{TA_{t-1}} + \frac{\beta 3OCF_{t+1}}{TA_{t-1}} + \frac{\beta 4\Delta R_{t}}{TA_{t-1}} + \frac{\beta 5NCA_{t}}{TA_{t-1}} + \mu_t$$

Where

ACCt = Total current accrual
OCF_t = Operating cashflows of the current period
OCF_{t-1} = Operating cashflows of the previous period
OCF_{t+1} = Operating Cashflows of the next period
ΔR = Change in revenue
NCA = Level of non-current assets
μ_t = Stochastic error term

All assets are scaled by lagged total assets

The second model considers the information content of earnings (Ball and Brown, 1968; Collins and Kothari, 1989). If the accounting earnings are informative, the stock return will reflect the available information. This provides a good quality of financial reporting (Ashbaugh et al, 2006). The poor quality of financial reporting is measured by the standard deviation of the residuals.

The model is stated as:

$$R_t = \beta 0 + \beta 1E_t + \beta 2\Delta E_t + \beta 3NEG_t + \beta 4E_t * NEG_t + \mu_t$$

Where R_t = Stock return of the current year
β = Regression Coefficient
E_t = Earnings per share of the current year
ΔE = Change in earnings per share between the previous year and the
current year
NEG_t = Binary variable equals 1 if a firm makes loss or 0 if a firm makes
Profit
$Et*NEG_t$ = The interaction between the earnings per share and their signs
μ_t = Stochastic error term
The third model considers the relationship between corporate governance and financial reporting quality which is expressed as:
$RQ_t = \beta 0 + \beta 1BC + \beta 2AC + \beta 3BI + \beta 4BS + \beta 5G + \mu_t$
Where
RQ = Reporting Quality
β = Regression Coefficient
BC = Board Characteristics
AC = Audit Committee
BI = Board Independence
BS = Board Size
G = Growth
μ_t = Stochastic error term

RESULTS

Multiple regression has been used to test the relationship between corporate governance and reporting quality in Nigeria. The corporate governance mechanisms adopted are board characteristics, audit committees, board independence, board size and growth. Table 2 shows the coefficient of determination (R2) of 0.949 and the adjusted R2 of 0.901, which explained the relationship between corporate governance and financial reporting quality. The R2 of 0.949 indicates that 94.9% variation in financial reporting quality in Nigeria is explained by corporate governance mechanisms. This shows that the result is a good fit of the model. Table 3 shows an F Statistics of 3.641 which implies that the result typically explained the model. The F-Statistics of 3.641 implies that a simultaneous change in financial reporting quality is caused by corporate governance.

The research evidence revealed a significant positive relationship between board Characteristics and financial reporting quality in Nigeria.This is evidenced by a P-value of 0.034 which is statistically significant at 0.05 level. A significant positive relationship was also found between audit committees and financial reporting quality. This implies that high level of independence of audit committees improve financial reporting quality. This is supported by a P-value of 0.022 which is statistically significant at 0.05 level. The evidence of the findings revealed a significant positive relationship between board independence and financial reporting quality. This shows that the higher the level of board independence, the higher the financial reporting quality. This is evidenced by a P-value of 0.011 which is statistically significant at 0.05 level. The result of the multiple regression analysis shows that board size is positively related to financial reporting quality. This is supported by a P-value of 0.004. The empirical evidence also revealed that there is a significant positive relationship between growth and financial reporting quality in Nigeria. This is evidenced by a p-value of 0.026.

Conclusion

This paper examines corporate governance and financial reporting quality in Nigeria. Corporate governance gained more prominence due to failure of some big companies globally. Countries around the world are now developing the most appropriate solutions to address corporate governance issues. The governance mechanisms are represented by board characteristics, audit committees, board independence, size and growth. The findings of the study revealed that there is a significant positive relationship between corporate governance mechanisms and financial reporting quality in Nigeria. This implies that the higher the level of board characteristics, audit committees, board independence, board size and growth, the higher the financial reporting quality in Nigeria.

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APPENDIX 1. DESCRIPTIVE STATISTICS

	N	Minimum	Maximum	Mean	Std. Deviation
Board Characteristics	10	0.36	0.89	0.35	0.148
Audit Committees	10	0.47	0.77	0.10	0.052
Board Independence	10	0.62	0.85	0.48	0.108
Board Size	10	0.58	0.96	0.45	0.106
Growth	10	0.69	0.72	0.25	0.104

Source: Authors' Computation, 2016

APPENDIX 2

MODEL SUMMARY				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.949[a]	.901	.654	.087

Source: Authors' Computation, 2016

a. Predictors: (Constant), Board Characteristics, Audit Committees, Board Independence, Board Size, Growth

APPENDIX 3

ANOVA[a]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.137	5	.027	3.641	.229[b]
	Residual	.015	2	.008		
	Total	.153	7			

Source: Authors' Computation, 2016

a. Dependent Variable: Financial Reporting Quality

b. Predictors: (Constant), Board Characteristics, Audit Committees, Board Independence, Board Size, Growth

APPENDIX 4

COEFFICIENTS

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.148	0.740		0.200	0.001
	Board Characteristics	0.647	7.689	0.246	0.084	0.034
	Audit Committees	0.353	1.468	0.233	0.241	0.022
	Board Independence	0.403	4.257	0.311	0.095	0.011
	Board Size	0.313	0.992	0.235	0.315	0.004
	Growth	0.021	0.933	0.016	0.022	0.026

Source: Authors' Computation, 2016

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