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Analysis of the incidence pattern of the Qualitative Characteristics Model of Accounting Reports of Deposit Money Banks in Nigeria

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Abstract

The aimed of the study was to examine the incidence of the qualitative characteristics model of accounting reports of deposit money banks in Nigeria based on the concerned to assess how qualitative the reports are. Data were obtained from ten deposit money banks in Nigeria purposively selected and mainly secondary while descriptive research approach was adopted. Data were analysed using regression model and the result revealed that relevance had the highest impact on the accounting reports of the banks in terms of compliance to requirements and standards. The following recommendations are proffered for further improvement: Policy revision should be carried out in the banking industry to ensure stricter compliance of standards, any bank that failed to disclosed required information should be sanctioned and the preparers of financial reports should pay attention to details in the process of reporting to ensure all relevant information is captured.

Introduction

The reporting of business activities are expected to comply with certain defined requirements and standards. Anything short of this will result in adverse condition that may lead to early demise of the organization. The collapse of Bristol-Myers, Merrilll Lynch, Mirrant, Nicor and Peregrine Systems in 2002 in the United States of America and the aftermath investigation revealed that the Audit Reports failed to identify the weaknesses of these firms, namely: inflated revenues, illegal payments, financial misstatements, overstated assets and liabilities, misleading accounting practices and improper booking of sales. Studies have shown proper reporting of the activities of the business is indispensible for the survival. Business activities must be monitored periodically through accounting reports.

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It is inferred that such relationship will provide a foundation for effective monitoring of the activities and improved performance of the firm. The collapse of Enron, World.Com, Bank of Credit, Commerce and Industry (BCCI), Robert Maxwell Pension Funds, Global Crossing, Adelphia, Tyco and the demise of Arthur Andersen and Co, one of the “Big Five” accounting firms are cases in point (Cadbury’s Report, 1992; Heath and Norman, 2004). Recently, KPMG was indicted by Security and Exchange Commission (SEC) in United States of America and fined $8.2 million over breach of auditors’ independence (Lynch, 2014). This is as a result of compromising independence status which undermined good accounting practices expected of external Auditors.

The Nigerian economy is not spared from the incidence of corporate collapse, especially in the banking sector. Between 1994 and 2006 the number of failed and acquired banks stood at 45 and as at 2006, fourteen more bank licenses were revoked by the Central Bank of Nigeria. Therefore, the end result of corporate collapse in this sector is a drag in the economy and reduces the purchasing power of those whose funds are lost and a loss of public confidence and apathy towards banking.

The root cause of these failures were traced to window dressing accounting practices that ultimately resulted in accounting reports that does not reflect the reality of the enterprise activities. Several measures have been adopted at various times to improve the quality of reporting by businesses using various models. Some banks were discovered to have liquidity problems and measures were taken by the Central Bank of Nigeria (CBN) to bail out these banks by injecting funds, removing their top executives and filing court cases against those who committed some infractions. Surprisingly, in the face of these crises, banks involved in the crises have continued to post healthy figures in their financial reports. This scenario raises doubt about the quality of accounting reports and the capacity of such reports in providing shareholders and other interested parties with reliable information that sincerely or fairly confirms their health. Therefore, there is need to evaluate the incidence pattern of the qualitative characteristics model of accounting reports of deposit money banks in Nigeria. The uniqueness of the qualitative characteristics model is that it examines the level of decision usefulness of financial reporting by operationalizing the qualitative characteristics.

Statement of the Problem

Financial reports more often than not are aimed at providing reliable, credible and dependable information to the informed users. This information needed is to be provided in quality and quantum for decision making.

The preparation and presentation of financial reports demand the observance of certain elements of quality. However, most financial reports lacked these important elements hence resulting in inadequate disclosures and lack of transparency. This suggests that without transparency, accountability, fairness and responsibility, in the determination of a firms' true value, business survival and growth will be impossible (Courtis,1995). The absence of this fundamental feature explains the 'clean' accounting reports amidst bank failures and crises in the recent past (Bushman and Smith, 2003). Using these reports as a fair basis of ascertaining the value of these banks has remained an unresolved issue especially in Nigeria with the present economic situation. Therefore, there is need to analyse the incidence pattern of the qualitative characteristics model of accounting reports of deposit money banks in Nigeria for a period of fifteen years (2001 – 2015) to serve as a basis of determining investment decisions.

Literature Review

Conceptual Review

Accounting, Quality, and Financial Reporting

Accounting is the process of collecting, recording, classifying, summarizing, interpreting and communicating economic information to permit informed judgments and decisions by the users of the information and on the other hand, quality is meeting or exceeding of expectations provided by the company and complying with the standards and other regulations of appropriate institutions. Financial Reporting is process of producing statements that disclose an organization financial status to management, investors, and the government.

Audit Committee Role in Financial Reporting

It is an obvious fact that qualified independent and tough minded audit committee represent the most reliable guardians of public interest. The audit committee undertakes on behalf of the shareholders, responsibilities of oversight of effective internal control, reliable reporting which companies with regulatory matters and corporate code of conduct Habib and Azim (2008) and Carcelllo and Neal (2000). An audit committee should be established in accordance with S.359 (3 & 4) of CAMA. The functions of the committee as detailed in S.359 (6) sufficiently capture the critical areas the committee should focus its attention.

To strengthen the audit committee for efficient and effective performance of its mandates the following should be considered: the committee's terms of reference should be clearly set out in writing, the chairman of the committee should preferably by a non-executive or independent director and not the CEO as had been observed in some companies, the committee's members should meet minimum financial literacy standards and at best one of the members must be a financial management expert with good understanding of the company and risk profile, the company annual financial statements should be reviewed and discussed with management and the external auditors prior to publication and filing, the committee meeting should be held to allow appropriate monitoring of the annual and quarterly frequently enough financial reports and the audit committee should oversee the company's internal function including review of the reports submitted by internal audit.

Internal Audit Role in Financial Reporting

Internal auditing is a fulcrum for good corporate governance mechanism to thrive. The monitoring, evaluation, review and recommendations made to management in all aspects of operational activities in the organization cannot be achieved without the effort of internal audit unit, Adeniyi (2004). Therefore, policies, rules, plans and regulations designed by management to ensure economy, effectiveness and efficiency in the performance of tasks must be controlled. Reports on the level of compliance to policies, plans and rules will provide management with a useful and essential basis of assessing the level of compliance or otherwise Agrawal and Chadha (2005).

In the case of non- compliance, it provide management the opportunity to strategically plan, taking cognizance of the current trends in the economic, socio-cultural, political, religion, demography and technological environment. Since corporate governance represent the structure and directive put in place to maximize the objective of the organizations, internal audit department/unit must be given free hand to carry out assign functions with latitude of freedom, integrity and independence.

Okezie (2004) and Akpakpan (2002) listed internal auditors' functions to include: Assessment of the internal control systems; early detection of errors and fraud; early prevention of errors and frauds; offer assistant to external auditor; carryout compliance and substantive tests; carryout special or ad-hoc investigation; assess the extent of compliance with rules and regulations; carryout verification of assets and liabilities; and carryout stock taking.

Theoretical Review

Agency Theory

Agency theory having its roots in economic theory was exposited by Alchian and Demsetz (1972) and further developed by Jensen and Meckling (1976). Agency theory is defined as “the relationship between the principals, such as shareholders and agents such as the company executives and managers”. In this theory, shareholders who are the owners or principals of the company, hires the agent to perform work. Principals delegate the running of business to the directors or managers, who are the shareholder’s agents (Beasley, 1996). Indeed, Daily, Dalton and Canella (2003) argued that two factors can influence the prominence of agency theory. First, the theory is conceptually and simple theory that reduces the corporation to two participants of managers and shareholders. Second, agency theory suggests that employees or managers in organizations can be self- interested.

The agency theory, shareholders expect the agents to act and make decisions in the principal’s interest. On the contrary, the agent may not necessarily make decisions in the best interest of the principals. Such a problem was first highlighted by Adam Smith in the 18th century and subsequently explores by Ross (1973) and the first detailed description of agency theory was presented by Jensen and Meckling (1976). Indeed, the notion of problems arising from the separation of ownership and control in agency theory has been confirmed by Davis, Schoorman and Donaldson (1997).

Stakeholder Theory

Stakeholder theory can be defined as “any group or individual who can affect or is affected by the achievement of the organization’s objectives”. Unlike agency theory in which the managers are working and serving for the stakeholders, stakeholders theorists suggest that managers in organizations have a network of relationships to serve- this include the suppliers, employees and business partners. And it was argues that this group of network is important other than that owner-manager-employee relationship as in agency theory (Freeman, 1999).

Freeman (1984) contends that the network of relationships with many groups can affect decision making processes as stakeholder theory is concerned with the nature of these relationships in terms of both processes and outcomes for the firm and its stakeholders.

Donaldson and Preston (1995) argued that this theory focuses on managerial decision making and interests of all stakeholders have intrinsic value, and no set of interests is assumed to dominate the others.

Qualitative Characteristics Model of Accounting Reports

Relevance

Relevance is referred to as the capability of making a difference in the decisions made by users in their capacity as capital providers. Many researchers have operationalized predictive value as the ability of past earnings to predict future earnings (Francis, LaFond, Olsson and Schipper, 2004). Predictive value explicitly refers to information on the firm's ability to generate future cash flows: information about an economic phenomenon has predictive value if it has value as an input to predictive processes used by capital providers to form their own expectations about the future. Predictive value is the most important indicator of relevance in terms of decision usefulness and measure predictive value using three items namely: measures of the extent to which annual reports provide forward-looking statements, measures to what extent the annual reports discloses information in terms of business opportunities and risks and measures of company's use of fair value

Faithful Representation

Faithful representation is the second fundamental qualitative characteristic. To faithfully represent economic phenomena that information purports to represent, annual reports must be complete, natural, and free from material error. Economic phenomena represented in the annual report are economic resources and obligations and the transactions and other events and circumstances that change them. Consistent with prior literature, faithful representation is measured using five items referring to neutrality, completeness, freedom from material error, and verifiability (Beasley, 1996; Jonas and Blanchet, 2000; Maines and Wahlen, 2006; Gaeremynck and Willekens, 2003).

Understandability

The first enhancing qualitative characteristic, understandability, will increase when information is classified, characterized, and presented clearly and concisely. Understandability is referred to, when the quality of information enables users to comprehend their meaning.

Understandability is measured using five items that emphasize the transparency and clearness of the information presented in annual reports (Jonas and Blanchet, 2000 and Courtis, 2005). These items include organisation of data, the presence of tabular or graphic formats and free from jargon or technical language.

Comparability

A second enhancing qualitative characteristic is comparability, which is the quality of information that enables users to identify similarities in and differences between two sets of economic phenomena. In other words, similar situations should be presented the same, while different situations should be presented differently. Comparability is measured using six items that focus on consistency. Four items refer to the consistency in use of the same accounting policies and procedures from period to period within a company (Jonas and Blanchet, 2000; Schipper and Vincent, 2003; Beuselinck and Manigart, 2007). Two items are used to measure the comparability in a single period across companies (Jonas and Blanchet, 2000 and Beuselinck and Manigart, 2007). Comparability not only refers to the consistency of the use of accounting procedures by a single company, it also refers to comparability between different companies. When assessing the comparability of annual reports of different companies, the accounting policies used, the structure of the annual report, and the explanation of transactions and other events are of special importance (Jonas and Blanchet, 2000). In addition, ratios and index numbers can be useful when comparing companies' performance.

Timeliness

The final enhancing qualitative characteristic is timeliness. Timeliness means having information available to decision makers before it loses its capacity to influence decisions. Timeliness refers to the time it takes to reveal the information and is related to decision usefulness in general. When examining the quality of information in annual reports, timeliness is measured using the natural logarithm of amount of days between year-end and the signature on the auditors' report after year end is calculated. Based on the natural logarithm of this amount of days, each company received a scored between (Beuselinck and Manigart, 2007).

Review of Empirical Studies

Bushman and Smith (2001) undertook research on “Financial accounting information and corporate governance” in United State of America. The aim of the study was to evaluate and propose additional economics-based empirical research concerning the governance role of financial accounting information as the use of externally reported financial accounting data in control mechanisms that promote the efficiency governance of corporation. The study adopts secondary research method in generating data. The study reveals the significance of financial accounting information in performance evaluation and management decisions. The important of accurate, dependable and reliable financial accounting information cannot be over emphasized.

Baumann and Nier (2004) undertook a study on ‘Disclosure, Volatility and transparency: An empirical investigation into the value of bank disclosure’. The main motivation to the study was to establish whether an increase in quantitative disclosures may not necessary increase transparency and if more disclosures would cost to the banks operations. The aim objective of the study was to present evidence on whether disclosure is beneficial for banks and whether disclosure is useful for financial markets. The study adopted desk research method relying solely on secondary data from thirty one countries 1993-2000 using regression analysis and hypotheses to analyse the data. The study revealed that information would be useful to both investors and banks and the more information disclosed by the banks the lower the volatility of stock price. The study recommends that information disclosure that is beneficiary to banks, investors has cost implications that the more the disclosure the more the cost.

Methodology

The study was a descriptive design research type based on survey research design. The study was conducted in the six geographical zones of Nigeria where the deposit money banks are located. The population of the study consists of all the deposit money banks that were listed on the Nigerian Stock Exchange between 2001 and 2015. However, the banks that have not suffered significant restructuring in the last 15 years (2001-2015) are those considered. This is to reduce data distortion that may result from such restructuring.

The study adopted purposive sampling technique to select the deposit money banks that have not suffered major restructuring from 2001 to 2015 and are listed on the Nigerian Stock Exchange. A total of 10 banks were selected and their annual reports for the period as stated in the population of the study were all considered. Secondary data was used for the study. The data were analysed using regression as a basis.

Model Measures Utilized for the Qualitative Characteristics

Qualitative characteristics	**Items**
Relevance	
R1	The annual report discloses forward-looking information
R2	The annual report provides feedback information on how various market events and significant transactions affected the company?
R3	The company uses fair value as measurement basis
R4	The company reports discloses information in terms of business opportunities and risks
Faithful representation (Reliability)	
F1	The annual report explains the assumptions and estimates made clearly
F2	The annual report explains the choice of accounting principles clearly
F3	The annual report includes an unqualified auditor's report
F4	The annual report highlights the positive and negative events in a balanced way when discussing the annual results
F5	The annual report extensively discloses information on corporate governance issues
Understandability	
U1	The annual report is well organized
U2	The notes to the balance sheet and the income statement are clear
U3	Graphs and table clarify the information presented
U4	The use of language and technical jargon is easy to follow in the annual report
U5	The annual report included a comprehensive glossary
Comparability	
C1	The notes to changes in accounting policies explain the implications of the change
C2	The notes to revisions in accounting estimates and judgments explain the implications of the revision
C3	The company's previous accounting period's figures are adjusted for the effect of the implementation of a change in accounting policy or revisions in accounting estimates
C4	The results of current accounting period are compared with results in previous accounting periods
C5	Information in the annual report is comparable to information provided by other organizations
C6	The annual report presents financial index numbers and ratios
Timeliness	
T1	Natural logarithm of amount of days it took for the auditor signed the auditors' report after book-year end
T2	Information in the annual reports is available to decision makers (shareholders) and on time
T3	Is the annual reports published in line with the standards (GAAP & IFRS)

Source: Author's compilation,2016.

Results and Discussions

There was need to evaluate the elements of the Qualitative Characteristics Model (QCM) to determine the element with the highest impact. The data obtained is presented in table 4.1b. The ranking of these elements are shown in the table.

Incidence Patterns of the Qualitative Characteristics Model Accounting Reports of Banks in Nigeria

Item	Elements of Qualitative Characteristics Model (QCM)	1	2	3	4	5	Incidence index	Ranking
A	**Relevance**							
1	Forward-looking statement for expectations and predictions	0.70	0.00	5.30	24.0	70.0	0.993	1st
2	Provision of feedback to users	0.00	0.7	16.7	36.0	46.7	0.987	2nd
3	Use of fair value and historical cost	30.0	45.3	4.0	3.30	17.3	0.246	4th
4	Presence of non-financial information	0.0	4.7	16.7	33.3	45.3	0.953	3rd
B	**Faithful Representation**							
1	Valid arguments that support decisions for estimates and assumptions.	0.0	4.7	14.0	35.3	46.0	0.953	2nd
2	Bases of accounting principles on valid arguments.	0.0	0.0	24.7	30.0	45.3	1	1st
3	Type of auditors' report	0.0	0.0	0.0	0.7	99.3	1	1st
4	Highlight of Positive and negative events,	0.0	4.7	16.7	33.3	45.3	0.953	2nd
5	Information on corporate governance	2.7	17.3	15.3	15.3	49.3	0.799	3rd
C	**Understandability**							
1	Presentation of annual reports in a well-organized manner.	0.7	8.7	10.0	12.0	68.7	0.907	3rd
2	Sufficiency and clarity of notes to the balance sheet and income statement.	0.0	0.0	12.0	33.3	54.7	1	1st
3	Use of graphs and tables.	22.7	16.0	18.7	32.7	10.0	0.614	4th
4	Use of language and technical jargons in the annual reports.	0.0	0.7	1.3	38.0	60.0	0.993	2nd
5	Size of glossary.	36.7	26.7	10.7	16.0	10.0	0.367	5th
D	**Comparability**							
1	Notes to changes in accounting policies explain the implication of the changes.	0.7	2.0	8.0	20.0	68.7	0.967	3rd
2	Notes to revision in accounting estimate and judgments explain the implications.	0.0	1.3	34.7	26.0	38.0	0.987	1st
3	Adjustment of previous accounting period's figures.	3.3	20.0	54.7	9.3	10.7	0.747	6th
4	Provision of result of current accounting period with previous periods.	0.7	18.0	43.3	32.7	5.3	0.813	5th
5	Comparison of information in annual reports.	0.0	2.7	27.3	68.7	1.3	0.973	2nd
6	Presentation of index number and ratios in annual reports.	10.7	10.0	21.3	44.7	13.3	0.793	4th
E	**Timeliness**							
1	Duration of endorsement by the auditors after book-year end.	2.7	6.0	12.7	20.7	58.7	0.921	3rd
2	Duration of publication of annual reports.	0.0	1.3	2.0	4.7	92.0	0.987	2nd
3	Bases of accounts preparation.	0.0	0.0	0.0	63.3	36.7	1	1st

Source: Survey Data, 2016.

The table shows the incidence of each component of the quality of accounting report on the overall Quality of Accounting Report over the 15 year period. It shows the component of Quality most adhered to or complied with. The table also shows the ranks of the sub-element per the major component and its contribution to the status of the Quality of accounting Report. The table reveals that relevance in terms of forward-looking statement for expectations and predictions, Provision of feedback to users, and presence of non-financial information had high incidence of 99.3, 98.7, and 95.3 respectively, while use of fair value and historical cost had a very low incidence of 24.6. Among these components, faithful representation had the highest incidence on the quality of accounting report than other components with an average of 94.1 followed by timeliness and comparability. This shows that these banks within the years have consistently complied with the reporting requirement of faithful representation, timeliness and comparability.

The implication of this analysis is to show the how qualitative our deposit money banks are and provide the basis of decision making to investing public and potential shareholders. The level of reporting requirements compliance were also x-ray on yearly basis in order to explain the trend and regulatory authorities policy direction.

Conclusion and Recommendations

The study revealed that qualitative characteristics model of accounting influenced the quality of information provided and usage by decision makers. This is because the elements of the qualitative model relate information concerning the performance of enterprise through financial reports. The analysis is significance in that it aided decision makers on how to evaluate an enterprise performance and the expectations in future. The investors used the compliance of the elements to standards as a basis of assessing management transparency and reliability on the financial reports. Relevance was found out to have the highest significant impact on the overall reports all the banks examined. The following recommendations are proffered for further improvement:

i. Policy revision should be carried out in the banking industry to ensure stricter compliance of standards.
ii. Any bank that failed to disclosed required information should be sanctioned
iii. The preparers of financial reports should pay attention to details in the process of reporting to ensure all relevant information is captured.

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