FINANCIAL REPORTING QUALITY AND INTERNAL CONTROL SYSTEM OF NIGERIAN STOCK EXCHANGE LOTUS ISLAMIC INDEX

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Abstract

In 2012 the Nigerian Stock Exchange (NSE) in collaboration with an Islamic fund manager launched Lotus Islamic Index (LII) to attract investors and fund managers interested in businesses that are compliant with shari’ah law particularly those from Asia and Middle East. The emphasis of shari’ah compliant businesses is that they are fundamentally based on ethical low-risk approach; they create links between the financial sector and real sector through in-built checks and balances through risk and profit-sharing structures. The primary objective of the study is to examine the financial reporting quality and the internal control system of the 15 companies that made the Lotus Islamic Index for period of 2012-2016. A quantitative panel data approach was employed based on extracted information from the annual reports and accounts of these companies. Multiple regressions aided the analysis of the data collected; findings revealed that the internal control system significantly relates to financial reporting quality. The study recommends the sustainability of the business approaches and policy framework of these companies by their management.

Keywords: financial reporting quality, internal control system, Nigerian Stock Exchange Lotus Islamic Index

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1. Introduction Financial reporting is basically a means to providing useful accounting information to external users for economic decision making. Section 31.7b of the Nigerian security and exchange commission SEC code, 2011 makes mandatory the evaluation of controls to encompass the reliability and integrity of financial and operational information. More so, relevance and faithful representation of such information which provides comparability, verifiability, timeliness and understanding makes financial
reports useful to a reader (International Accounting Standard Board IASB, 2010), hence, the higher the quality of financial reporting, the more significant are the benefits to be gained by investors and end users (Herath & Albarqi, 2017).

Choi & Pae, (2011) view financial reporting quality FRQ as the faithfulness of the information conveyed by the financial reporting process and the importance of a reporting system comes from being a tool that provides representative and relevant information (Lius, 2011). This implies that financial reporting entails series of actions directed towards the specific aim of presenting quality accounting information and such series of actions are an embodiment of an organizational system like an internal control. In this wise, it is right to infer that financial reporting process hinge on an effective internal control system ICS to achieve such aim. Effectiveness is the capacity to obtain results that are consistent with targeted objectives (Arena, Arnaboldi & Azzone, 2006). The ICS is a process affected by an organization's board of directors and all the levels of management designed to provide reasonable assurance regarding the effectiveness and efficiency of operations, reliability of financial reporting and compliance with management policies (COSO, 2009; 2013). From this definition, it can be seen that firstly, effectiveness and efficiency of operations addresses a firm's basic business objectives, Secondly, reliability of financial reporting relates to the preparation of reliable financial statements, including interim and condensed financial statements and selected financial data derived from such statements, such as earnings releases. It is important to note that, financial statements are a reflection of managerial competence and by extension performance it is not unlikely that managers will engage in manipulating earnings within an accounting regulatory framework to insinuate that they are good managers (Beystresser & Phillipon, 2006). Discretionary accruals occur when managers transfer the accounting earnings from one period to another by using accounting methods, for example, changing depreciation methods (Al-Fayoumi, Abuzayed & Alexander, 2010).

Interestingly, quite a number of studies have used governance mechanisms to examine financial reporting quality Man & Wong, 2013 found that corporate governance can reduce or even eliminate the extent of earnings management. Also, good governance mechanism impact on discretionary behavior of managers (Warfield, Wild & Wild, 1995; Klein, 2002). On independent directors, Hassan, (2011) in Nigeria, found board with independent directors are associated with high manipulative earnings. Concluding differently, Xie, Davidson III & Dadalt, (2003) discovered that boards with more independent outside directors
engage less in manipulating abnormal accruals. On Audit Committee, Dabor and Adeyemi (2009) revealed that audit committee significantly relates to earnings management. On institutional shareholding, Hartzel & Stark, 2003 posits that large institutions have more resources and ability to monitor, discipline and influence managers not to practice earnings management. On executive compensation Cheng and Warfield, 2005 revealed that stock based incentives leads to higher manipulation and insider trading. Furthermore, Lee, Rose-Green & Huang (2012) found a positive connection between the older ages of chief executive officers (CEOs) and financial reporting quality. Also, CEO inside debt promotes high financial reporting quality (He, 2015).

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Other studies examined financial reporting quality using investment decision making processes to establish positive relationship (Holthausen & Verrecchia (1988); Schipper and Vincent, (2003); Dechow, Ge, and Schrand, 2010); Others studies obtain evidence of how higher levels of earnings management are associated with lower disclosure and lower future performance Jo and Kim (2007) Tu (2012) while Gunny (2005) posits earnings management affects future current income. On the other hand very few studies examined internal control system ICS and financial reporting quality FRQ. Some studies have established the effectiveness of internal control over quality financial reporting (Lin, Pizzini, Vargus, & Bardhan 2011; Gramling, Maletta, Schneider & Church, 2004), lower levels of earnings management. Others found the positive association between internal control quality and accruals or discretionary accruals (Bédard, 2006; Doyle, Ge, & McVay, 2007; Ashbaugh-Skaife, Daniel, Kinney, & LaFond, 2008; Van de Poel & Vanstraelen, 2009). García, Barbadillo and Pérez (2012) observed internal control system audit as an important mechanism to safeguard the reliability of annual accounts. Furthermore, Wang, (2008); Krishnan & Yu (2012) discovered that auditor attestation for the effectiveness of internal control adds value for investors by increasing the perception of the revenue quality. Also, Lee, Rose-Green & Huang, 2012) discovered that larger companies that establish effective internal controls and are heavily subject to closer scrutiny from auditors have fewer restatements. More so, Cohen, Dey, & Lys 2008) find a sharp decrease of the level of earnings management after the implementation of SOX. From a different perspective Altamuro and Beatty, 2006; Ewert and Wagenhofer, 2005; Doyle, Ge & Mcvay 2007; Nagy 2010 posits that firms with certain characteristics or firms in countries where internal control regulations have been implemented experience increases in earnings quality. To the best of our knowledge there are no studies in Nigeria that have examined ICS and FRQ on any of the Nigerian stock exchange indexes. This makes the study different and
unique, hence to what extent does ICS influences FRQ of Nigerian stock exchange lotus Islamic index NSELII? This question influenced identifying the singular objective of examining the extent to which ICS's control environment CE, control activity CA, risk assessment RA, monitoring MO, information and communication impacts the FRQ of NSELII. Based on this objective the following null hypotheses were formulated and tested: H Internal control system ICS's control environment CE is not 01 significantly related to financial reporting quality FRQ of Nigerian stock exchange lotus Islamic index NSELII H Internal control system ICS's control activity CA is not 02 significantly related to financial reporting quality FRQ of Nigerian stock exchange lotus Islamic index NSELII H Internal control system ICS's risk assessment RA is not 03 significantly related to financial reporting quality FRQ of Nigerian stock exchange lotus Islamic index NSELII H Internal control system ICS's monitoring MO is not 04 significantly related to financial reporting quality FRQ of Nigerian stock exchange lotus Islamic index NSELII H Internal control system ICS's information and communication IC is not significantly related to financial reporting quality FRQ of Nigerian stock exchange lotus Islamic index NSELII

The findings of this study will be a point of reference and a trigger for researchers alike and provide empirical evidence on the financial reporting quality of the 15 firms that constitutes the NSELII. The remaining part of this paper is divided into five sections. Section one is the introduction including this paragraph; section two presents the conceptual and theoretical frame work; section three is the methodology that present's the study's design, variables and model specification, technique of data analysis, diagnostics and robustness tests; section four shows the finding and chapter five shows the conclusion, recommendation and implications.

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2. Reviews

Concept 2.1 Financial Reporting Quality FRQ There is no universally accepted definition of FRQ. Tasio & Belkiaris (2012) cited Verdi (2006), to define FRQ as the precision with which financial reports convey information about the firm's operations, in particular its cash flows, in order to inform equity investors. For Tang, Chen & Zhijun 2008 it is the extent to which the financial statements provide true and fair information about the underlying performance and financial position. Also, Jonas and Blanchet (2000),
defines it as full and transparent financial information that is not designed to obfuscate or mislead users. This study defines FRQ as financial information created without taking advantage of accounting rules and principles to present them as reliable information. FRQ has qualitative characteristics (IASB 2008). Characteristics include; firstly, relevance which indicates that FRQ present information that relates to the issues that are of prime concern to the users. Fair value is considered one of the highly significant indicators of relevance (Beest, Braam, & Boelens, 2009). Annual reports have a crucial role in determining the level of relevance by disclosing forward-looking information, disclosing information about business opportunities and risks, and providing feedback on how major market events and significant transactions affected entities (Beest, Braam, & Boelens, 2009). Secondly, faithful representation suggests that the reliability of the economic phenomenon presented is analyzed based on the qualities of complete, free from error, verifiable, and neutral information (Cheung, Evans & Wright, 2010). According to Willekens (2008) auditors' report adds value to financial reporting information by providing reasonable assurance about the degree to which the annual report represents economic phenomena faithfully. Thirdly, enhancing qualitative characteristics comprises of comparability, verifiability, timeliness and understandability.

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According to Cheung, Evans & Wright (2010) comparability demands that identical events in the two situations will be reflected by identical accounting facts and figures different events will be reflected by different accounting facts and figures in a way which quantitatively reflects those differences in a comparable and easily interpretable manner. More so, the better the understanding of the information from users, the higher the quality that will be achieved. When assessing the quality of reporting in an annual report, timeliness is evaluated using the period between the year-end and the issuing date of the auditor's report the period of days it took for the auditor to sign the report after the financial year-end (Beest, Braam, & Boelens, 2009).

2.2 Internal Control System ICS The ICS is a process affected by an organization's board of directors and all the levels of management designed to provide reasonable assurance regarding the effectiveness and efficiency of operations, reliability of financial reporting and compliance with management policies (COSO, 2009; 2013). The board of directors retains oversight responsibility for management's design, implementation, and conduct of internal control. Studies have examined the effectiveness or quality of ICS from different perspectives Kinney and McDaniel, 1989; DeFond and Jiambalvo (1991); Krishnan;

Ogeneva, Raghunandan & Subramanyam, (2005) used implied cost of equity; Kinney and McDaniel (1989); McMullen, Raghunandan, & Rama (1996) used restatements. Lee, Rose-Green & Huang, 2012 noted that larger companies that establish effective internal controls

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and are heavily subject to closer scrutiny from auditors have fewer restatements. Others looked at the determinants of restatements Kinney and McDaniel (1989) and DeFond and Jiambalvo (1991); Richardson, Tuna & Wu, (2003). Past research finds that financial reporting errors are negatively associated with performance (DeFond and Jiambalvo, 1991) and that the existence of a loss is positively associated with reporting an internal control problem in audit-change firms (Krishnan, 2005). Fen, Li, McVay & Skaife. (2015) found that firms that correct their inventory-related material weaknesses on internal controls report significant increases in performance after remediation. For Ashbaugh-Skaife, Daniel, Kinney, & LaFond (2008) change in accruals quality in different periods is contemporaneous to change in the strength of internal control. The ICS has five components:

Control Environment: This component directs establishing integrity and ethical values, oversight structures, authority and responsibility, expectations of competence, and accountability to the board. It is the control component that insists, management assigns responsibilities, organizes and develop people and pay attention to the direction it provides (Boyd and Edward, 1995). Control environment has a pervasive impact on the overall system of internal control (Piazza, 2013). It has been established that one of the positive impact of internal audits on the process of financial reporting largely depends on clear definition of roles and responsibilities (Burton, Starliper., Summers, & Wood., 2015) with appropriate positioning and organizational reporting lines (Zain and Subramaniam 2007; Cohen and Sayag 2010; Soh and Martinov-Bennie 2011).

Control Activities: This component provides oversight to senior management in the development and performance of control activities. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse
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as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties (Dobrowolski, 2006).

Risk Assessment: Risk is defined in the COSO Framework as the possibility that an event will occur and adversely affect the achievement of objectives. This component is employed to oversee management's assessment of risks to the achievement of objectives, including the potential impact of significant changes, fraud, and management override of internal control.

Monitoring activities: assess whether each of the five components of internal control is present and functioning. The organization uses ongoing, separate evaluations, or some combination of the two, to ascertain whether the components of internal control (including controls to affect principles across the entity and its subunits) are present and functioning. Monitoring is a key input into the organization's assessment of the effectiveness of internal control. It provides valuable support for assertions, if required, regarding the effectiveness of the system of internal control. From shareholders perspective, important part of monitoring component of internal control is internal auditing (Franck, 2009), which is defined as contracting process between shareholders and managers of the firm (Adams, 1994). Additionally, Krishnan and Visvanathan (2007) and Hoitash, Hoitash & Bedard (2009) show that the presence of internal control weaknesses ICWs is positively associated with the number of audit committee meetings but negatively associated with the proportion of accounting financial experts on audit committees.

Audit committees have contributed to enhancing the quality of financial reporting (Blue Ribbon Committee 1999; DeZoort 1997). Furthermore, changes in the audit committee governance are associated with enhancements of financial reporting quality (Zang, Mansur Lubabah Kwanbo & Muhammad Tanko 2013). Prior researchers have provided some evidence that suggests an association between the existence of a financial expert on an audit committee and a higher level of financial reporting quality (Krishnan & Visvanathan, 2008) the importance of including a financial accounting expert on the audit committee has resulted in higher financial reporting quality more than just including a financial expert (Zang, Kim, Benjamin& Dan, 2013). Having a financial accounting expert on audit committees is
positively associated with forecast accuracy and negatively associated with forecast dispersion (Abernathy, 2010).

Information and Communication: Information is necessary for the enterprise to carry out internal control responsibilities to support the achievement of its objectives. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is the means by which information is disseminated throughout the organization, flowing up, down, and across the entity. It enables personnel to receive a clear message from senior management that control responsibilities must be taken seriously. This component supports the functioning of all components of the ICS. In combination with the other components, it supports the achievement of the entity's objectives, including objectives relevant to internal and external reporting. Controls within the component support the organization's ability to use the right information within the system of internal control and to carry out internal control responsibilities.

2.3 Reliability Theory Reliability is the probability that an item will perform a required function under stated conditions; environmental and operational for a stated period of time (Lackner and Anderson, 1985; ISO, 1986; Smith, 1997). In research reliability means repeatability or consistency. A measure is considered reliable, if it would give the same result over and over again on the assumption that what is measured is not changing (Trochim, 2006). The reliability theory proposes that a system can perform any required function adequately when given an enabling environment and adequate operational condition within a specific period. A well designed system can perform such or different functions over and over again by achieving organizational objectives. Cushing and Bodnar, (1975) took a snap from reliability engineering and introduced the reliability theory to evaluate internal control system. In the same vein, Stratton, (1981) and Srinidhi and Vasarhelyi, (1985) represented complex ICS in a reliability network and used reliability theory to evaluate ICS. This theory underpins this study.

3. Methodology Defining the determinants of financial reporting quality FRQ or its quantification have been fundamental issues in accounting research (Achim and Chis, 2014). Most empirical studies aimed to assess the decision usefulness of financial reports using quantitative measures that focus on specific attributes of financial reporting information like; earnings quality, accounting conservatism, accruals
The analysis of internal control system ICS disclosure for the Nigerian stock exchange lotus Islamic index NSELII was performed on the chairman, executive director, audit committee, corporate governance compliance and the external auditor's report sections of the annual reports. Disclosure is an abstract concept that cannot be measured directly (Cooke & Wallace 1989) however, constructing a disclosure index that serves as a means to gain insight in the level and quality of disclosed internal control information will possibly provide a direct measure (Hossain, Perera, & Rahman, 1995) and Herath & Albarqi, (2017) while citing Prencipe, 2004 considered this a valid measuring tool. The rationale to use a disclosure index is to produce a cross-sectional ranking of internal disclosure levels based on predefined criteria provided by the sample firms in their annual reports (Botosan 1997).

This study used content analysis to extract information on the ICS index created, using the scores by each component as a measure of ICS. Content analysis is a widely accepted and often applied method within the disclosure literature (Beattie McInnes, & Fearnley, 2004; Lajili & Zéghal 2005; Mohobbot 2005; Linsley and Shrives 2006; Elzahar, Khaled & Hunziker, 2012). It is important to note that, Herath & Albarqi, (2017), suggests the inclusion of enough control variables to strengthen explanatory capacity of a researcher's model is of utmost importance. This study used firms leverage, growth and size as control variables. This study is a post-positivism design that is causal in nature due to its ability to determine the extent to which ICS influences FRQ. The focus of the study is the 15 firms that made the NSELII for the period 2012 to 2016.

The choice of the period is influenced by it coming after the issuance of the 2011 security and exchange commission SEC code of corporate governance in respect to FRQ and ICS. Data for this research were extracted from the audited financial statements of the firms on the index.
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3.1 Variable Measurement and Model Specification

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Nature</th>
<th>Name</th>
<th>Proxy/ Measurement A-Priory expectation</th>
</tr>
</thead>
<tbody>
<tr>
<td>FRQ</td>
<td>Dependent Variable</td>
<td>Financial Reporting Quality</td>
<td></td>
</tr>
</tbody>
</table>

Financial Reporting Quality is proxied by Total Accrual Adjustments (TAA)

\[
TAA_{it} = [(D_{CAit}) - (D_{CASHit})] - [(D_{CLit}) - (D_{RLTPit})] - DA_{it}
\]

Where:

- \(TAA_{it}\) = Total accrual adjustments of firm \(i\) at time \(t\)
- \(D_{CAit}\) = Change in current assets for firm \(i\) at time \(t\)
- \(D_{CASHit}\) = Change in cash held for short term financial investments of firm \(i\) at time \(t\)
- \(D_{CLit}\) = Change in current liabilities for firm \(i\) at time \(t\)
- \(D_{RLTPit}\) = Change in reclassified long term obligations for firm \(i\) at time \(t\)
- \(DA_{it}\)
Depreciation and Amortisation for firm $i$ at time $t$

Positive Relationship

ICS: C E Independent Variable

Control Environment

Control environment index disclosure ratio of actual scores to the expected scores

Positive Relationship

ICS: CA Independent Variable

Control Activities

Control activities index disclosure ratio of actual scores to the expected scores

Positive Relationship

ICS: RA Independent Variable

Risk Assessment Risk assessment index disclosure ratio of actual scores to the expected scores Negative Relationship

ICS: MO Independent Variable

Monitoring Monitoring index disclosure ratio of actual scores to the expected scores

Positive Relationship

ICS: IC Independent Variable

Information and Communication

Information and communication index disclosure ratio of actual scores to the expected scores
Negative Relationship

LVG Control Variable

Leverage Natural log of Long term liability plus debt plus current asset

FGR Control Variable

Firm Growth Ratio of Market to book value of shares

FSZ Control Variable

Firm Size Natural log of total assets

Authors Computation, 2018

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From table 3.1 the following mathematical model is presented

\[ TAA = \beta + \beta_{CE} + \beta_{CA} + \beta_{RA} + \beta_{MO} + \beta_{IC} + \beta_{LVG} + it_{0} + it_{1} + it_{2} + it_{3} + it_{4} + it_{5} + it_{6} \]

\[ \beta_{FGR} + \beta_{FSZ} + \mu \]

Where: \( TAA \) = Total Adjusted accruals

CE = Control Environment

CA = Control Activities

RA = Risk assessment

MO = Monitoring

IC = Information and Communication

\( \beta \) = Intercept

\( \beta_{0} \) = Coefficient of explanatory variables

\( \mu \) = error term (discretionary accruals) for firm \( i \) at time \( t \)

4. Findings

4.1 Presentation and Discussion of Results

4.1 Descriptive Statistics

Descriptive statistics: Dependent Variable

The measure of FRQ of the NSELII has a mean of 4.29 with standard deviation. This implies that the dispersion of the data from the mean is

<table>
<thead>
<tr>
<th>Variables</th>
<th>FRQ</th>
<th>CE</th>
<th>CA</th>
<th>RA</th>
<th>MO</th>
<th>IC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>4.29</td>
<td>0.23</td>
<td>0.43</td>
<td>0.69</td>
<td>0.03</td>
<td>0.12</td>
</tr>
<tr>
<td>Std devn</td>
<td>0.21</td>
<td>0.18</td>
<td>0.09</td>
<td>1.01</td>
<td>3.06</td>
<td>0.04</td>
</tr>
<tr>
<td>Variance</td>
<td>6.29</td>
<td>0.46</td>
<td>0.36</td>
<td>0.04</td>
<td>1.03</td>
<td>0.01</td>
</tr>
<tr>
<td>Skewness</td>
<td>2.55</td>
<td>0.59</td>
<td>-0.63</td>
<td>-0.91</td>
<td>3.12</td>
<td>2.79</td>
</tr>
<tr>
<td>Kurtoisis</td>
<td>9.14</td>
<td>1.94</td>
<td>2.91</td>
<td>3.66</td>
<td>10.97</td>
<td>21.58</td>
</tr>
<tr>
<td>Observations</td>
<td>75 75 75 75 75 75</td>
<td>75 75 75 75 75 75</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Source: Extract STATA Output Listing, 2018

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wide because the standard deviation is higher than the mean as indicated by the large variance of 39.52. The tailedness of the data is shown by kurtosis of 9.13 which is >3 suggesting that the data tend to have high tails. The coefficient of skewness of 2.55 reveals that the data is positively skewed, they are spread same way to the left and right hand side of the normal curve, indicating that it satisfies the symmetrical distribution assumption.

Descriptive Statistics: Independent variables CE, CA, and RA of NSELII records mean values of 0.23, 0.43, and 0.69; standard deviations of 0.21, 0.18, and 0.19 shows that the standard deviations are lower than the mean and their variance values of 0.46, 0.36 of CE and CA indicates that the dispersion of the data from the mean is large but low with RA whose variance is 0.04. The skewness values of 0.59, -0.63 and -0.91 for CE, CA and RA respectively shows that except for CE, CA and RA data are negatively skewed to the left hand side of the normal curve indicating that the Gaussian symmetric distribution for CA and RA are not met but that of CE is met as its coefficient of skewness is 0.59 implying that it is positively skewed and it meets the assumption. However, MO and IC of NSELII have mean values of 0.03 and 0.12 with standard deviations of 0.09 and 1.01 this indicates that the deviations are higher than the mean implying a lower variance of 0.01 for MO and 1.03 for IC revealing that the dispersion from the mean is wide. The coefficient of skewness of 3.12 and 2.79 for MO and IC reveals that the data is positively skewed, they are spread same way to the left and right hand side of the normal curve, indicating that it satisfies the Gaussian symmetrical distribution assumption. The kurtosis value for CE is 1.94, which is almost 2; CA is 2.91 which is almost 3; RA, MO and IC have 3.66, 10.97 and 21.58 respectively which are > 3 on the whole these values are higher than the means implying that the data have high tails which proves the absence of outliers.

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4.2 Model Selection In order to choose the model that appropriately explains the findings of the study, firstly, multiple regression technique was employed using STATA. Secondly, in determining the individual heterogeneity of the firms in the index the longitudinal nature of the data were used, more so, two step regression was used to determine the level of financial reporting quality FRQ of the NSELII that is proxied by discretionary accruals by adopting the modified jones model by Dechow, Sloan and Sweeney (1995) from the first step and the second step was using the FRQ proxy (DACC) with internal control system proxies (CE, CA, RM, MO and CI).
4.2.1 Diagnostics Tests

Thirdly diagnostics test were conducted to satisfy the assumption for a linear model; Shapiro-wilk test for data normality revealed that FRQ and CE, RM, MO and CI are significant at 1% while CA is significant at 5% this gives an indication that the data are not normally distributed hence rejection of the null. Multi-collinearity test indicates there was none as the VIFs were > 1 but <10. The mean of VIF stood at 2.29; hetoroscedasticity test using brook pagan/cook-Weisberg test indicates that chi-square coefficient stood at 12.25 with a significance level > 1 confirming the presence of the effect of hetoroscedasticity. This implies that the variations of the error term is not constant this will affect the best linear unbiased estimation BLUE of the study. Consequently, OLS is not fit for the study but a GLS of Fixed and Random effects were run. The Hausman specification and Breusch and Pagan Lagragian Multiplier test chi-square coefficient indicate 6.49 and 1.28 with significance level of 0.5999 and 0.2595 respectively. This implies the Random effect model is most appropriate.

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Table 4.3 presents the regression result. The total variation in FRQ as explained by ICS indicates 76%. This reveals the fitness of the model. The Wald statistics shows a coefficient of 135 with a significance level of 1%, further revealing the fitness of the model and the confirmation that 99.9% probability relationship among the study variables is not due to chance.

The t-value of CE of NSELI is 5.10 with a coefficient of 20.50. This implies that for every 1% increase in control environment activities of the index, FRQ will be increased by N20.50k. CE significantly relates to FRQ as revealed by a p value of 0.000. The correlation matrix reveals the association to be positive as the value shows 1% (0.007)

4.3 Regression and Correlation Results

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>t-value</th>
<th>P values</th>
</tr>
</thead>
</table>

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Correlation Results

FRQ FRQ  1.00 Constant
20.66
4.47
0.000  CE
20.50
5.10
0.000
0.359*
0.007 CA -12.45 -3.34 0.001 0.087
0.523
RA 0.83 0.20 0.840 0.035
0.799
MO -30.06 -4.70 0.000 -0.154
0.2562
CI 0.65 0.85 0.393 -0.267*
0.044
LVG
6.71
2.77
0.006 FGR
0.23
3.68
significance with a positive correlation coefficient of 0.35. This provides evidence to reject the null hypothesis. The result meets our priori expectations because from the disclosure index, reports indicates that this component directed establishing integrity, ethical values, oversight structures, authority and responsibility, expectations of competence, transparency and accountability in the preparation of financial statements for the examined periods. This is a concurrence to the fact that a system can perform any required function adequately when given an enabling environment and adequate operational condition within a specific period. Furthermore, growth of these companies might have provided the medium for such an accomplishment as explained by the association between the variables which is in line with the study of Hashim, (2012) who found financial reporting quality to be strongly and positively associated with an entity's age or growth.

CA of NSELII has a t-value -3.34 with a coefficient of -12.45. This shows that for every 1% proportionate increases in control activities of the index, FRQ will be reduced by N12.45k. The p value of CA is 0.001; this shows a positive relationship that is having a correlation with FRQ that is positive at 0.08 though not strong. This provides evidence for the rejection of the null hypothesis. This result confirms our priori expectations as the index disclosure revealed that control activities like approvals,
authorizations, verifications, occur throughout the NSELII, at all levels and in all functions and it resulted to the preparation of quality financial statements. This shows that a well-designed system can perform such or different functions over and over again by achieving organizational objectives. The findings on CE & CA are in line with Bédard, 2006; Doyle, Ge, & McVay, 2007; Ashbaugh-Skaife, Daniel, Kinney & LaFond, 2008; Van de Poel & Vanstraelen, 2009 who found positive association between internal control quality and accruals or discretionary accruals.

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The t-value of RA of NSELII is 0.20 with a coefficient of 0.83. This indicates that for every 1% increase in Risk assessment activities of the index, FRQ will be increases by 83K. RA has a p value of 0.840; this shows a negative relationship that is having a correlation with FRQ that is positive and less than 5% (0.035). This provides evidence to fail to reject the null hypothesis. The result is expected as most of the companies on the NSELII have a passive internal audit unit. The disclosure index recorded null for most of the item on the effectiveness portion regarding information on internal audit unit assessment of the ICS, the audit committee chairman interacting with the internal auditor, risk committee and the availability of a risk assessment report. This implies there is the absence of an enabling environment and adequate operational condition for NSELII ICS to carry out RA.

MO of NSELII has a t-value of -4.70 with a coefficient of -30.06. This implies that for every 1% increase in monitoring activities of the index, FRQ reduces by N30.06k. MO significantly relates to FRQ as evidenced in a p value of 0.000. This provides evidence for the rejection of the null hypothesis. This confirms our priori expectations as information on monitoring was very much disclosed and it is in line with the studies of Jo and Kim (2007) & Tu (2012), who established that when statements reported by the company contain a greater volume of information, the trend towards financial reporting quality is higher. More so, the finding is aligned with Bédard, 2006; Doyle, Ge, & McVay, 2007; Ashbaugh-Skaife, Church, Schneider; Daniel, Kinney & La fond, 2008; Van de Poel & Vanstraelen, 2009 who found positive association between internal control quality and accruals or discretionary accruals. Findings on MO upholds the reliability theory that a system can perform any required function adequately when given an enabling environment and adequate operational condition within a specific period.

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The t-value of IC of NSELII is 0.85 with a coefficient of 0.65. This implies that for every 1% increase in information and communication activities of the index, FRQ will be increased by 65k. The association between IC and FRQ is positive as the value shows 1% (0.044) significance. However, IC is not significantly related to FRQ as revealed by a p value of 0.393. This provides evidence to fail to reject the null hypothesis. This result confirms our priori expectations. This so because postage of financial reports to shareholders is mostly what is obtainable. More so, very few companies reported informing and communicating with employees, through briefs, meetings, and circulars. Also very few companies organize business forum to interact with stakeholders. NSELII do not have a communication committee, instances where the companies have a general purpose committee the activities of the committee do not include information and communication.

This is an indication that IC component of NSELII function is inadequate not well designed, lacks an enabling environment and adequate operational communication and information condition. However, the size and growth of the companies in the NSELII explains why the association between IC and FRQ is positive. This in line with the study of Hashim, (2012) who found financial reporting quality to be strongly and positively associated and influenced by an entity's age or growth, and contrary to the study of Hope, Thomas & Vyas, 2011 who found a large and a negative correlation between an entity size and the financial reporting quality. On the whole

5. Conclusion This study achieved the singular objective of examining the extent to which internal control system ICS’s control environment CE, control activity CA, risk assessment RA, monitoring MO, information and communication IC influences the financial reporting quality FRQ of the Nigerian stock exchange lotus Islamic index NSELII. This study

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did not include other index of the NSE and so the findings cannot be generalized, rather it is an area for future or further research. Based on the findings, the study concludes that the CE, CA & MO aspect of ICS significantly relates to FRQ. The implication of the findings is that these components were well designed and were given an enabling environment to perform adequately in producing quality financial reports. On the other hand, RA has a positively insignificant association with FRQ; IC has a negatively significant association with FRQ. The implication of these findings is that these components did not
receive adequate attention towards producing quality financial reports. The study recommends that the management of these companies should sustain their business approaches and policy framework. They should make the internal audit unit as core monitor of the ICS. Secondly, the security and exchange commission SEC should consider issuing directives on mandating companies to have an information and communication committee and include in the corporate governance report a detailed risk assessment, information and communication reports. These will address the inadequacies of RA and IC components of the ICS identified by this study.


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