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FINANCIAL REPORTING QUALITY AND ITS EFFECT ON INVESTMENT DECISIONS BY NIGERIAN DEPOSIT MONEY BANKS

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ABSTRACT: *The study investigated the effects of financial reporting quality on investment decision making by Deposit Money Banks in reference to Zenith Bank Plc, Nigeria. Data obtained from the audited annual reports of Zenith Bank Plc that covered period of 2009 – 2016.The study utilised both Descriptive and Ordinary Least Square Regression method with the aid of using E-view 9 to analyse the data. The findings showed that, there was a significant effect of variables of (Financial Reporting Quality FRQ measures as profit after tax, cash used in/ from investing and cash and cash equivalent) on investment. The result also shows that, Financial Reporting Quality has significantly influenced on investment of Deposit Money Banks with (R^2 = 0.98; $P < 0.05$). The study concluded that, higher financial reporting quality increases investment decision by Deposit Money Banks in Nigeria.*

KEYWORDS: Financial Reporting Quality, Deposit Money Banks, Investment, Profit after Tax, Nigeria, Cash

INTRODUCTION

Financial institutions owe duty to fully disclose matters concerning strengths, weaknesses and prospects of their operations so as to aid in making investment decisions because information obtained from its financial reports use to predict future investment. Without the financial reporting quality, there will be a problem of how to invest and evaluation of performance of bank in general. Therefore, financial reporting quality relates to the accuracy with which reported financials of a bank reflects its operating performance and how useful they are in forecasting future cash flows (Nyor 2013). The ability to present a good and accurate figure for accrual is termed as financial reporting quality. Stergios and Michalis (2012) equally viewed the use of financial reporting quality in two general perspectives. The first is where the quality of financial reporting is determined on the basis of the usefulness of the financial information to its users. Secondly, financial reporting quality is focused on the notion of shareholder/investor protection**.** Therefore**,** financial reporting is the process of communicating economic measurement, obligation and accounting information about the resources and performance of reporting entity to those having reasonable rights to such information so as to facilitate informed judgments and decision making. It deals with the presentation of financial and other relevant statements to show the extent to which the objectives of the investors have been achieved. Financial reports prepared by the directors of Deposit Money Banks showing how well they have been able to manage the resources entrusted to them by the owners (shareholders) of the business.

Bolo and Hassani (2007) as cited in Nwaobia, Kwarbai, Jayeoba and Ajibade (2016) affirmed that financial reporting is one of the products of accounting system that provides the necessary information needed to take economic and investment decisions. This means that, any element(s) of ensuring the possibility of evaluating the past performance with the

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intention to effectively assess and predict the possible future profitability should be considered as a prerequisite for achieving a high volume of investment.

Financial reporting quality entails the standardization of preparation and presentation of both financial and non-financial information by the financial institution for effective planning and reliable decisions. However, the objective of financial reporting is to provide information that may be useful enough for evaluating management effectiveness in utilising resources under its control to satisfy its users' needs. Financial reports are used by investors and creditors in deciding where to in- vest their limited resources in a particular organisation or not (Akintoye 2002) cited (Muhammed, Abubakar & Danrim, 2016). Financial reports is a formal and comprehensive statement describing financial activities of a business organization such as the financial institutions. For such a business entity, is a statement that reports all relevant financial information presented in a structured manner and in a form easy to understand for managerial use for taking prompt and informed decision making related to investment (IASB, 2007a) and also to decision making pertaining to cost planning, investment planning, expected returns and performance evaluation. The financial reports comprises of statement of financial position, statement of comprehensive income, statement of equity changes and cash flow statements (reports on a company's cash flow activities, particularly its operating, investing and financing activities). In order for the financial reporting to be useful for decision maker, it must possess all aspects of qualitative characteristics such as understandable, comparability, consistence, relevant, reliable, objectivity, correctness and in time for the needs of the users.

Pandey (2005) investment decisions or analysis has to do with an efficient allocation of capital. It involves decision to commit the firm's funds to the long-term assets. Such decisions are of considerable importance to the firm since they tend to determine its value size by influencing its growths, profitability and risk.

The investment decisions of a firm are generally known as the capital budgeting decision. This may be defined as the firm's decision to invest its current funds most efficiently in the long-term assets in anticipated of an expected flow of benefits over a series of years. The two importance aspects of investment decisions are; evaluation of the prospective profitability of new investments and the measurement of a cut-off rate against that the prospective return of new investment could be compared (Anaja & Emmanuel 2015)

Statement of the Problem

It has obviously seen in practice by Nigerian Deposit Money Banks to adopt creative accounting in anticipation of sourcing for equity capital from the capital firms. Although, this approach in financial reporting process often leads to over-valuation of assets and bank's net worth in the views of prospective investors invariably affect investments decision of banks. The problem of financial reporting disclosure is the non-compliance to industry corporate governance, ethics, and a regulatory standard which is prevalent in the Deposit Money Banks of Nigeria. Also, financial statements do not reflect many factors that affect financial condition because they cannot be stated in monetary terms such as business model, competitive advantage, reputation and prestige of banks with the public, the credit rating of the banking, the efficiency, loyalty and integrity of management and board of directors. It was observed that the roles of financial reporting on investment decision making of Deposit Money Banks in Nigeria has some problems to management of banks

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The observed shortcomings of financial reporting have led to enhance and expand the scope of the generally accepted accounting principles and now the international financial reporting standards. Kariuki and Jagongo (2013) posited that, these shortcomings have paved way for the new reporting standards now released by International Accounting Standards Board (IASB) to reflect the changes in either the reporting environment or business complexities so has to have uniformity in financial reporting. It can be deduced from the above assertions that, the idea of the recent policies and standards is to minimize information asymmetry by providing adequate information on the value of the profitability and performance, growth and stability of the banks, thereby reducing adverse selection at the issuance of securities (Bushman and Smith, 2001) and or mitigate the attendant moral hazard (Healy and Palepu, 2001; Santhosh *et al.*, 2013) as cited (Nwaobia et al 2016). Several studies have been carried out in the past on this subject but the review of previous empirical literature revealed a lack of established effects of financial reporting quality on investment decision making by Deposit Money Banks in Nigeria, in the research findings of past researchers in which indicates the existence of a research gap. Nwaobia, et al (2016) studied financial reporting quality on investors' decisions using annual time series data for the period 2010-2014.Other research works focused directly or indirectly on related topic in Nigeria and /or in other countries includes, Anaja & Emmanuel (2015), Kapellas & Siougle (2017), Muhammed, et al (2016), Vestine, Kule & Mbabazi (2016), Muhamoud (2017), Muhammedi (2014), Verdi (2016) and Afolabi (2013), Zayol, Agaregh and Eneji, (2017), Adebiyi (2017), Chan-jane, Tawei and Chao-jung (2015). It is observed that, none of research works dealt with effects of financial reporting quality on investment decision making by Deposit Money Banks in Nigeria for period of 2009-2016. The omissions of this in literature, therefore, will form major gap in this study. The study, therefore, seeks to answer the following fundamental question: What are the effects of financial reporting quality on investment decision making by listed Deposit Money Banks in Nigeria?

Research Objective

The main objective of this study is to ascertain the effect of financial reporting quality on investment decisions

Research Hypothesis

$Ho_{1:}$ Financial reporting quality has no significant effect on investment decisions

Significance of the Study

This study would be of benefit by improving the performance of deposit money banks because it intends to help the banks in investment decisions. The study would help in widening knowledge of financial reporting quality in investment decisions; it will also make the banks to appreciate the importance of financial reporting quality in the provision of information necessary for investment decisions. Additionally, this study helps banks prepare financial statement under similar accounting principles. It also creates awareness with respect to the great impact account reporting quality has on investment decisions. It shows how finance has been raised and how it has been deployed, how relationships between wealth generated and wealth invested can be important and helpful indicators of business effectiveness. Finally, it will serve as a reference document for future researchers who may be interested to embark on study of this nature.

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LITERATURE REVIEW

Several studies have investigated the effect of financial reporting quality /financial statements on investment or investors' decision making in Nigeria, and in different part of the countries with diverse opinions and techniques. The outcomes of the investigations, however, have shown that, financial reporting quality has a significant relationship with investors' decisions making. For instance, Fariba and Mehran (2016) examined the effect of financial reporting quality and investment opportunities and dividend based on decision making of Insurance companies in Iran. They found that, investment opportunities and quality of corporate financial reporting has a significant relationship with dividend policy and investment decisions

Nwaobia, et al (2016) explored financial reporting quality on investors' decisions using 10 selected manufacturing companies listed on the Nigerian Stock Exchange Market covered period of 2010-2014. Correlation matrix, Vector auto regressive estimation and Pooled OLS model were employed for the analysis. Data used proxied as accrual quality, volume of investment, Size, age and growth rate and earnings per share. They found that there was a positive association between investors' decision and financial reporting quality.

Chan-jane , Tawei and Chao-jung (2015) investigated the association between investment decisions and financial reporting quality in the context of family firms versus non-family firms using a sample of listed firms in Taiwan from 1996 to 2011. Their findings suggested that, family firms are more likely to under-invest than non-family firms in order to protect their socio emotional wealth, and financial reporting quality is more negatively associated with family firms' under-investment behavior. The existence of internal financing channels attenuates this negative association and the study does not find a significant role on such association when a family member serves as the chief executive officer. They contributed to the literature on the relation between financial reporting quality and investment decisions by highlighting the unique characteristics of family firms.

Other studies use the expected investment model to estimate the magnitude of the deviation from the expected level of investment to proxy for investment inefficiency.

The deviation is captured by the positive or negative residuals from the expected investment model and is denoted as the level of over-investment or under-investment. For example, McNichols and Stubben (2008) used publicly-traded firms alleged to have manipulated earnings and demonstrate that those firms over-invest substantially in capital expenditure during misreporting period but no longer do so after the misreporting period and used all publicly-traded firms (except financial institutions) in the US. Biddle, Hilary and Verdit (2009) showed a negative association between financial reporting quality (proxied by the standard deviations of discretionary accruals) and both underinvestment and over-investment in R&D, capital expenditure and acquisition, suggesting financial reporting quality can mitigate both under-investment and over-investment.

In a setting of private firms in emerging markets ,Chen, Hope and Wang (2011) observed a negative, association between financial reporting quality (proxied by discretionary accrual) and investment inefficiency of capital expenditure and R&D expenditure. Such association is affected by bank financing and the incentives to minimize earnings for tax purposes.

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In a related study, Anaja and Emmanuel (2015) analysed the role of financial statements on investment decision making in reference to United Bank for Africa Plc in Nigeria covered the period of 10 years. They revealed that, the transparency of financial statements of the bank has significant influence on the investment decision making of the users of financial statements. All the parameter estimates employed in the regression equation were statistically significant via the test of hypotheses. They also agreed that, profitability, assets, liabilities and equities of banks have significant ways of evaluating the performance of a bank report on investment decision making

Muhammadi (2014) investigated the relationship between financial reporting quality and investment efficiency and the factors affecting the firms listed in Tehran Stock Exchange from 2009 to 2012. His results of statistical analyses on 93 firms in Tehran Stock Exchange showed that, the financial reporting quality had a significant positive correlation with the investment efficiency. He also found that, there was a direct link between firm size, growth opportunities and cash holdings as well as tangibility of assets with investment efficiency. Kapellas et al (2017) summarized evidence on literature about the effect of financial reporting practices on investment decisions. They discussed existing literature regarding the effects of financial reporting practices firstly on the cost of equity capital and effect of financial reporting practices on investment decisions as documented in the literature in the areas of earnings management; information asymmetry effects; accounting quality; the effects of the information environment; investment efficiency; over investment –under investment and cash flow sensitivity as well as stock market efficiency. Zayol et al (2017) studied the effect of financial information on investment decision of shareholders of five selected banks in Nigeria from 2009 to 2015. They discovered that, there was a positive relationship dividend per share and investment decision of shareholders of banks in Nigeria. They recommended that, both existing and prospective investors can factor financial information relating to dividend paid per share while making investment decision in shares of Nigerian banks; as dividend per share is positively correlated with investment decisions of shareholders. Adebiyi (2017) evaluated board composition and financial reporting quality of 15 Deposit Money Banks listed on the Nigeria Stock Exchange between 2005 and 2015. He explored the extent at which the board composition (measured with three variables: Board size, board meeting and board independence) influence the financial reporting quality of Banks in Nigeria. He found that, discretionary accrual as a proxy for financial reporting quality is positively related to Board size and board independence but relate negatively to board meeting. He established the fact that, board composition is a key component of the quality of financial reporting quality of the listed Deposit Money Banks in Nigeria. Mahmoud (2017) investigated the relevance of financial reporting quality reported by oil Listed firms in Nigeria covered (2011- 2016). He employed Ohlson Model to establish the degree to which the accounting information of oil firms influences the share price valuation of the listed firms in Nigeria under relative to share prices, market values, and earnings per share of the firms are used. He discovered that financial reporting quality of listed oil firms in Nigeria has significant relevance to the users of the information.. He also contributed to the theory by validating financial reporting quality and Ohlson Model of share valuation using Nigerian data

Theoretical Review

Several economic theories have been proposed in order to rationale investment decisions in an organization and is generally classified under different theories such as sequential

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decision- making theory, capital asset pricing theory, signaling theory, dividend decision-walter model, The study is, however, guided by these two “Agency theory and capital needs theory

Agency theory: This suggests that the firm can be viewed as a nexus of contracts (loosely defined) between resource holders. An agency relationship arises whenever one or more individuals, called principals, hire one or more other individuals, called agents, to perform some services and then delegate decision-making authority to the agents. The primary agency relationships in business are those (1) between stockholders and managers and (2) between debt-holders and stockholders. These relationships are not necessarily harmonious; indeed, agency theory is concerned with so-called agency conflicts, or conflicts of interest between agents and principals. This has implications among other things, corporate governance and business ethics. When agency occurs, it also tends to give rise to agency costs, which are expenses incurred in order to sustain an effective agency relationship (e.g., offering management performance bonuses to encourage managers to act in the shareholders' interests). Accordingly, agency theory has emerged as a dominant model in the financial economics literature and is widely discussed in business ethics texts. Sheikh, Kahn, Iqbal and Ahmed (2012) affirmed that, conflict of interest may arise in firms when managers’ personal interests override their obligations to comply with principal-agent contract of maximizing shareholders wealth. Due to the need to present a better result to the owners and potential owners of the firm, managers tend to engage in earnings management and subsequently reduce the overall quality of earnings reported. Also, the constant need for capital via investor’s decision is one reason why managers present a better picture of the financial position of the company.

Agency theory suggests that, imperfect labour and capital markets, managers will seek to maximize their own utility at the expense of corporate shareholders. Agents have the ability to operate in their own self-interest rather than in the best interests of the firm because of asymmetric information (e.g., managers know better than shareholders whether they are capable of meeting the shareholders' objectives) and uncertainty (e.g., myriad factors contribute to final outcomes, and it may not be evident whether the agent directly caused a given outcome, positive or negative). Evidence of self-interested managerial behaviour includes the consumption of some corporate resources in the form of perquisites and the avoidance of optimal risk positions, whereby risk-averse managers bypass profitable opportunities in which the firm's shareholders would prefer they invest. Outside investors recognize that the firm will make decisions contrary to their best interests. Accordingly, investors will discount the prices they are willing to pay for the firm's securities.

A potential agency conflict arises whenever the manager of a firm owns less than 100 percent of the firm's common stock. If a firm is a sole proprietorship managed by the owner, the owner-manager will undertake actions to maximize his or her own welfare. The owner-manager will probably measure utility by personal wealth but may trade off other considerations, such as leisure and perquisites, against personal wealth. If the owner-manager forgoes a portion of his or her ownership by selling some of the firm's stock to outside investors, a potential conflict of interest, called an agency conflict, arises.

Capital needs theory: This upholds that companies that have growth opportunities in the capital market strive to present qualitative financial reports with adequate disclosures that will enhance their opportunities for external financing. Thus, financial reporting is the appropriate tool to attract more capital from investors (Core,2001) as cited in (Nwaobia, et al

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,2016). Furthermore, the goal of shareholders is to maximize their wealth which means maximizing the present value of the future cash flows. Their economic decision is a proxy of quality financial information. Hence, investors require information that would enable them predict the future cash flow from the investments and the associated risks volatility (Kariuki & Jagongo, 2013).

METHODOLOGY

This section discusses the methodological issues of the study. Precisely, this deals with source of data collection, model specification, and estimation techniques as well as data description. This study employed secondary source of data. Data obtained from the audited annual reports of Zenith Bank Plc that covered period 2009 - 2016. This period was chosen so as to determine the trend in which the financial reporting quality has affected investment decision by banks .This study used estimated technique of both descriptive and Ordinary Least Square regression method with the aid of using E- view 9 to analyse the data. The statistical test for the measurement of the parameter estimate includes the co-efficient of determination r, the t-test. The significance level at which the hypothesis is accepted is 5% (0.05).

Model Specification

The model of the study established the relationship betweens the dependent variable of investments (investments in subsidiaries, associate, properties, other assets held for sales and maturity as well as due from other banks) and independent variable of Financial Reporting Quality measured by Profit After Tax , Cash and Cash equivalents and Cash used in / from investing , through the empirical model developed from the work of Asaolu (2004) adopted by Odetayo (2016). The model specification is as stated below:

$$INV = f\,(FRQ) \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots..(1)$$

Where;

INV represents Investments

FRQ represents Financial Reporting Quality

Equation (1) presents the functional relationship between investment and Financial Reporting Quality (FRQ) measured by Profit After Tax (PAT), Cash and Cash Equivalent (CCE), Cash used in / from investing (CUI)**.**The above equation can be re-specified in an explicit form as shown below;

$$INV_t = \beta_0 + \sum_{it=i}^{n} \beta_{1\,FRQ} + e \text{--}(2)$$

$$INV_t = \beta_0 + \sum_{it=i}^{n} \beta_1 PAT_t + \beta_2\, CCE_t + \beta_3\, CUI_t + \varepsilon \text{---------------------------------}(3)$$

Where;

INV = Investments

FRQ **=** is a vector of financial reporting quality variables which include Profit After Tax (PAT), Cash and Cash Equivalent (CCE) and Cash used in / from investing (CUI); β_0 = Constant Parameter

β_1 -β_3 = Coefficient of explanatory variables

$\sum$ = Summation

e = Error Term

t = Time series

EMPIRICAL RESULTS AND DISCUSSION

Table 1: Descriptive Statistics of the model

	INV	CUI	PAT	CCE
Mean	2790391.	10252.13	73164.88	634289.8
Median	2659290.	7051.000	87954.00	589879.0
Maximum	4283736.	24443.00	119285.0	871853.0
Minimum	1578912.	3792.000	21933.00	456890.0
Std. Dev.	965153.4	7377.653	36023.98	150562.8
Skewness	0.243481	1.127857	-0.327404	0.628628
Kurtosis	1.743958	2.696755	1.558465	2.001107
Jarque-Bera	0.604925	1.726734	0.835599	0.859493
Probability	0.738996	0.421740	0.658494	0.650674
Sum	22323126	82017.00	585319.0	5074318.
Sum Sq. Dev.	6.52E+12	3.81E+08	9.08E+09	1.59E+11
Observations	8	8	8	8

Source: Author's computation Using E-view 9

Table 1 presents the summary of descriptive statistics of INV, CUI, PAT and CCE for the study. Given the scope of the study (2009-2016) and the frequency of the annual data, all the variables have 8 observations. As shown in Table 1, the sum, range, mean, maximum and minimum, standard deviation and variance as well as the skewness and kurtosis of our variables of interest are evident. The various statistics indicate that the variables have different distributions. The skewness and kurtosis statistics provide useful information about the symmetry of the probability distribution of various data series as well as the thickness of the tails of these distributions respectively. These two statistics are particularly of great importance since they are used in the computation of Jarque-Bera statistics which is used in testing for the normality or asymptotic property of a particular series. Most of the variables in the study are positively skewed showing that they have a long right tail and PAT which is negatively skewed indicates a long left tail. Kurtosis statistics of the all variables are less than 3 implying the extent of flatness of the distribution of the data series relative to normal.

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Correlation Analysis

Table 2: Correlation Matrix

	INV	CUI	PAT	CCE
INV	1.000000			
CUI	0.819947	1.000000		
PAT	0.908309	0.599263	1.000000	
CCE	0.481977	-0.039728	0.543138	1.000000

Source: Author's computation Using E-view 9

The results from table 2 shows the independent variables (Profit After Tax, Cash and Cash Equivalent and Cash used in / from investing**)** were strongly positive correlated and hence multi-colinearity in the result with the dependent variable (INV) constant with 1, Profit After Tax (PAT) at 0.908, Cash and Cash Equivalent, (CCE) at 0.482, and Cash used in / from investing (CUI) at 0.819, all at 0.05 significant level. The interpretation was that the level of multi-colinearity between the independent variable was not very high which meant that the influence of each variable in the regression equation could be isolated easily

Table 3: Summary of Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CONSTANT	30337.61	286692.4	0.105819	0.9208
PAT	10.48004	2.776580	3.774443	0.0195
CUI	78.12476	11.39256	6.857522	0.0024
CCE	1.879799	0.532251	3.531790	0.0242
R-squared	0.986298			
Adjusted R-squared	0.976021			
R-squared	0.986298			
S.E. of regression	149455.1			
F-statistic	95.97457			
Prob(F-statistic)	0.000350			

Source: Author's computation Using E-view 9

Table 3: presents summary of the estimated regression model:

INV= 30337.61 + 78.125CUI+ 10.480PAT+ 1.880CCE

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From the table 3 , it was observed that, the coefficient of determination for the regression as depicted by the R^2 value of 0.98 suggest that about 98 percent of the systematic variation of the dependent variable is accounted for by the explanatory variable. The remaining 2 percent is caused by variable that are not included in the model which is accounted for by the stochastic error term. The F-statistics of 95.97 shows that the model of the study is well fitted; this can be confirmed by the significant value of 0.0003 which shows that null hypothesis is rejected, this implies that there is significant effects of some variables of (Profit After Tax , Cash and Cash equivalents and Cash used in / from investing) on investments. This means that Profit After Tax , Cash and Cash equivalents and Cash used in / from investing has influence on investment decision by Deposit Money Banks in Nigeria.

The results also revealed that the predictor variables significantly predicted investment decisions in Nigerian Deposit Money Banks as shown Cash and Cash equivalents (β= 1.88, t = 3.53), Profit After Tax (β= 10.48, t = 3.77) and Cash used in / from investing (β= 78.12, t = 6.86), all at 5% level of significant. This also signifies that the Cash used in / from investing has highest influence on investment The Durbin Watson statistics of 2.49 which fall within the value of 1.5 to 3.5 shows absence of serial correlation in the model

CONCLUSION AND RECOMMENDATIONS

Based on our findings, we concluded that, there was a great level of interactions between Financial Reporting Quality measures as profit after tax, cash used in/ from investing and cash and cash equivalent on investment proxy as total assets. This study has equally revealed that, FRQ has a very positive impact on investment decision by Deposit Money Banks in Nigeria in reference to Zenith Bank Plc, Nigeria for period of 8 years (2009- 2016)

The results obtained in this study confirm that, a positive and strong correlation exists between as profit after tax, cash used in/ from investing and cash and cash equivalent and the level of investments The result also indicates that, higher reporting quality increases investment decision by Deposit Money Banks in Nigeria. It was therefore recommended that, DMBs should voluntarily produce quality report as this is shown to create positive market reaction and enhance investments.

Contributions

This study contributes to the existing literature on how financial reporting quality (profit after tax, cash used in/ from investing and cash and cash equivalent) can be catalyst to investment decisions. This study is one of very few studies that established how Deposit Money Banks in Nigeria invest the resources of its investors on profitable businesses.

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