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ETHICAL PRINCIPLES AND FAITHFUL REPRESENTATION OF FINANCIAL REPORTS OF QUOTED COMPANIES IN NIGERIA

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ABSTRACT: *Business transaction records form the basis of financial statements which inform stewardship assessment and investment decisions. Good financial reports aid informed economic decisions which enhance efficiency in the allocation of resources. Allegations are rife of cases of deliberate falsification of financial statements even in the face of internal and external auditors, accounting standards and financial regulations. Using survey research design based on a population of 4893 accountants and auditors of 169 quoted companies and four regulatory bodies in Nigeria, the study investigated the relationship between ethical principles and faithful representation of financial reports. Four hundred copies of the research instrument with a reliability test coefficient of 0.830 using the Cronbach's alpha statistics were distributed with a 92.5% return rate. Data analysis employed the use of descriptive and inferential statistics. The results indicate that ethical principles influence financial reporting quality significantly ($F(4, 366) = 298.719$, Adj. $R^2 = 0.763$, $p = 0 .000$). The study recommends continuous ethical orientation for accountants, managers and auditors of Nigerian quoted companies.*

KEYWORDS: Ethics, Investment decisions, Quoted companies, Faithful representation, financial report.

INTRODUCTION

Financial reports are expected to be faithfully represented to make them qualitative and decision-useful. This supports the objective of financial reporting which explains the need to provide financial information about a reporting entity that is useful to investors, lenders and other creditors in making decisions about providing resources to the entity. Organisations, particularly those that are publicly listed, owe a duty to report adequately to stakeholders. This makes the activities of firms to be transparent, as well as make management to be accountable (IASB, 2010).

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The primary objectives of reporting finances center on the provision of financial information useful to investors, creditors, lenders and other stakeholders; for making well-reasoned financial decisions, for the assessment of certainty of future cash flows and also for reporting the economic resources and obligations of a business (Dyckman, Dukes & Davis, 2001). Sherman and Young (2016) note that if financial statements would fulfil their economic and social functions, they must reveal the economic truth underlying transactions and other events.

True financial reporting should be the soul of accounting, the more financial reports depict the truth, the more they are qualitative. High-quality accounting information is the life-blood of capital markets (IASB, 2010). Financial information should not just be any information, but information that is relevant, true, complete and error-free. Financial reports are also expected be comparable, understandable, timely and verifiable.

Financial reports present accounting information to various users (stakeholders); reflecting assets, equity, liabilities, expenses and income among other financial information. These reports are reported in the form of statements required for making economic decisions as well as required for appraising performance over defined time frame. Documenting financial transactions, which eventually leads to financial statements; has been identified as one of the most frequent business practices across departments (Laskin, 2009). Therefore, the need for quality financial reporting is significant to accounting.

However, the history of financial reporting across the globe has revealed cases of accounting scandals. Bakre (2007) states that investors in Nigeria lost billions of naira through the connivance of external auditors, accountants and managers of companies to manipulate financial statements. These scandals occurred in the face of accounting standards, accounting regulations, internal and external auditing. It is presumed that there should be no financial misreporting when these factors are in place, but they occurred. Kotharis, Mizik and Roychowdhury (2016) emphasize the role of management in providing financial information to investors, but the volume of literature on earnings management shows that managers misrepresent companies' financial performance.

Ethical principles have been examined with respect to faithful representation of financial reports of quoted companies in Nigeria, the result shows that the behavioural aspect of those responsible for the preparation and verification of financial reports has significant influence on the quality of financial reports of quoted companies. Unethical behaviour can be used by accountants, managers, and auditors to perpetrate financial reporting wrongs. The integrity of those responsible for the preparation and auditing of financial reports is a contributory factor to the quality of such reports. The management may choose to present an impressive financial result, the accountant would be coopted and the auditor may look away. Where this happens, there will be misrepresentation of facts. This is a product of the mindset of those in charge, despite the availability of accounting standards, regulations and auditors. Therefore, understanding the interactions between integrity, objectivity, diligence and financial reporting quality is important in adding value to accounting (Guragai, Hunt, Neri & Taylor, 2017).

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Objective/Hypothesis of the study

The objective of the study is to examine the relationship between ethical principles (integrity, objectivity, diligence and professional competence) and faithful representation of financial reports of quoted companies in Nigeria. Faithful representation is a fundamental attribute required of financial reports which makes them economic decision-useful. Good financial reports aid informed economic decisions which enhance efficiency in the allocation of resources. Allegations are rife of cases of deliberate falsification of financial statements even in the face of internal and external auditors, accounting standards and financial regulations. Thus the study evaluated the influence of ethical principles on faithful representation of financial reports of quoted companies in Nigeria. Then the hypothesis formulated for the study is that ethical principles do not have significant influence on faithful representation of financial reports of quoted companies in Nigeria.

Significance of the study

Faithful representation of financial reports is depicted by truthfulness, completeness and error-free attributes possessed by the reports. Therefore, reporting of faithfully represented accounting information is of ethical significance. The study of how ethics affect financial reporting quality in terms of faithful representation is necessary in assisting managements, accountants, auditors, regulatory bodies, policy makers and investors. And the finding of this study adds to the existing literature on ethics and its relationship with faithful representation of financial reports of Nigeria quoted companies. The study is to remind professional accountants who provide the technical expertise in financial reporting to remember and apply their profession's code of ethics in the course of preparing and presenting financial reports.

REVIEW OF LITERATURE

Integrity

Kaptein and Wempe (2002) refer to integrity as integrative judgment, control of character, conduct and consequences. Integrity requires that words and deeds conform to a substantive, coherent and relatively stable set of qualities, principles and ideals to which a person is freely and genuinely committed. Integrity regulates the connection between intentions, deeds and consequences. Integrity requires consistency in thought and action. In addition, it requires sincere dedication to convictions. In consequentialist ethics, moral judgment is based on the consequence or effect of an action; in deontological ethics, the nature of the action is evaluated in making moral judgment; in virtue ethics, the character of the actor, his motive and intention are evaluated. The integrity approach emphasises the "whole". Integrity explains "working on wholeness" from three perspectives: First, by aligning value, norms and ideals: striving for coherence between words and deeds is the second. Third, by making a contribution to the greater whole (Kaptein et al., 2002). One of the characteristics of a person of integrity is the willingness to contribute to the greater whole. Willigenburg (2000) posits that it is the "whole" aspect of meaning that the 'moral character' of the concept of integrity lies. Integrity also extends to accepting responsibility for fulfilling a given role. It involves the willingness to account for actions and loyalty to those principles that can be consented to on legitimate grounds. Integrity is a commitment to a morally

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justifiable set of values and principles. It is also a way of acting in accordance with legitimate expectations. Solomon (1999) argues that cooperative relationships and conformity to legitimate norms remain of primary importance. Also, Integrity implies independence and may sometimes require disobedience and disloyalty. Integrity requires flexibility while holding onto ones value and norms.

Benjamin (1990) describes three characteristics of integrity: a state of autonomy, a state of internal integration and a state of external integration. First, a person of integrity is autonomous and authentic, he possesses a stable set of values, and he stands and strives for something; and is true to his ideals. Persons of integrity have set of beliefs that define them and define what they stand for. Unlike the moral chameleon, external forces do not make them sway. Erikson (1950) notes that integrity encompasses 'wholeness' and it is the highest stages of personal development; thus, the values of a person of integrity are autonomous and authentic. Integrity requires an integration of intentions deeds and effects. Persons of integrity match their intentions with actions. Williams (2000) states that a person who displays integrity, is the one who acts in accordance with his motive and has the virtues that enable him to do that. A person of integrity acts from a sense of what is right not from impulse or out of habit. A person of integrity endeavors to harmonize principle with practice, and acts from a sense of what is right.

A person of integrity does not act on the basis of expectation of a gain, but on the conviction that the right thing must be done. Integrity as a state of external integration, requires a person to be an integral part of something larger than the individual. A person of integrity is integrated into sensitive social issues, integrated into his environment and he is willing to be accountable. According to Willigenburg (2000) this third characteristics of integrity is found in the voluntary willingness of a person to contribute to the society. A person of integrity is willing to take other views on proper conduct seriously. The concept of integrity is an integration of consequentialist, deontological and virtue ethics. In theory, a person who fulfils a role according to the rule could be viewed as a person of integrity, but certain situations may arise that cannot be simply resolved by following the rules, wisdom is needed to sort out the situation. Also, appropriate values and principle must be internalized to enable a person to assess a situation and determine a sound course of action in the context of the role and its moral dimensions.

Objectivity

Objectivity describes the condition of neutrality, independence and no-bias in our behavior. It requires the avoidance of undue influence and conflict of interest in rendering accounting services. IFAC (2006) states that objectivity requires professional accountants not to compromise their professional judgment because of undue influence, bias or conflicting interest. Reasonable steps must be taken by professional accountants to identify situations that could bring about conflict of interest. Threats that could give rise to non-compliance with ethical principles must be avoided.

Diligence

Diligence is a virtue that explains the carefulness, conscientiousness and the thoroughness of action. Diligence brings about increase in qualities and it is also essential for success (Gampopa,

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1994). Due diligence is the required level of diligence necessary to carry out a professional activity. This is to avoid being negligent of taking the appropriate action at the right time.

Professional Competence/Behaviour

The distinguishing feature between a professional and others is the special skill he possesses. He is expected to be competent to enable him render professional service. And he has to ensure continuity in maintaining his professional knowledge. The principle of professional competence/behaviour requires that professional accountants should ensure that their clients receive quality professional service. This also extends to their employers. They are expected to act in a diligent manner and in compliance with relevant technical and professional standards. This principle also requires that accountants should be up to date in terms of accounting knowledge through the process of continuing professional development (IFAC, 2006). The principle of professional behavior requires that professional accountants should do away with conducts that may bring the profession into disrepute.

Qualities Required of Financial Information

Financial information by nature, are expressed both in figures and words as they represent economic phenomena that have both qualitative and quantitative values.Consequently, these figures must be faithfully represented and be decision-useful. This is because financial reports provide information regarding an entity's economic resources, effects of transactions that change these resources and claims against the entity. The conceptual framework for financial reporting identities fundamental qualitative characteristics and enhancing qualitative characteristics. The fundamental qualitative characteristics are faithful representation and relevance, while the enhancing qualitative characteristics are understandability, verifiability, comparability and timeliness (IASB, 2010).

Relevance

The conceptual framework for financial reporting describes relevance of financial reports in terms of its predictive and confirmatory values. (IASB, 2010). If financial information is to be valuable, it must be capable of influencing or making a difference in the decisions made by users. A financial report may possess either predictive or confirmatory value or both. The predictive value of a financial report is found in its ability to aid the processes used by users to predict future outcomes, while confirmatory value of a financial report is found in its ability to confirm previous evaluations. However, the predictive and confirmatory values of financial information are interwoven, while materiality is an aspect of relevance that is entity-specific. Materiality is a relative concept expressed in terms of the nature or magnitude of the items to which the information relates.

Power (2010) suggests that the relevance of financial information is in its ability to provide options in terms of decision making. This points to the capacity of financial reports in influencing its users towards arriving at economic decisions in terms of providing resources to a reporting entity. Potential and existing investors, lenders and other creditors expect to find financial reports that provide promising and forward-looking accounting information that suggests beneficial future

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cash inflows. Barth, Beaver, and Landsman (2001) explain that the extent or how well accounting amounts convey information that equity investors use is its relevance. An accounting amount is considered value relevant if it reflects a predicted association with market worth of equity. That is, the relevance of financial reports is measured in terms of its significant association with share prices.

Barth, et al. (2001) distinguish relevance from reliability. Relevance is expressed in the correlation between accounting amounts and equity values, while reliability is expressed in the correlation between accounting amounts and faithful representation (accounting amount representing what it purports to represent). Further distinction is also drawn between value-relevance and decision-relevance: Timeliness of information makes the difference. That is, an accounting information may be relevant in value but not relevant in decision making because of the timelines in information supply. Relevance of accounting information has significant relationship with fair value estimates. The study of bank loans by Barth et al. (1996) shows that fair values of bank loans are perceived by investors to reflect underlying values with more relevance and reliability than historical cost figures. Erin, Olojede and Ogundele (2017) note that the relevance of financial information is its power to effectively impact the decision of investors on investment issues. Financial information is relevant in determining the value of share prices and subsequently relevant in decision making in the capital market (Sutopo, Kot, Adiati & Ardila, 2018).

Faithful Representation

Financial reports expressed in numbers and words depict economic phenomena. Since useful financial report represent relevant phenomena, it is expected that it should be a faithful representation of such economic phenomena, and nothing less. Thus, the faithful representation of financial report is found in its completeness, neutrality and freedom-from-error (IASB, 2010). A financial report is considered complete, if it reflects all the information it ought to reflect. These are financial information arising from transactions and other activities of an entity. Completeness of a financial report also extends to the description and explanation of significant facts about transactions and other events. Neutral depiction of financial reports is expressed in the objectivity and fairness in the preparation of financial reports. A neutral financial information is devoid of bias nor any form of manipulation. Error-free depiction of financial report points to the absence of errors or omissions in the description of the economic phenomena.

Enhancing Qualitative Characteristics

The enhancing qualitative characteristics, as the name suggests, are those qualities that improve the fundamental qualitative characteristics of financial reports. These factors enhance the ‘relevance’ and ‘faithful representation’ of financial reports. These factors are comparability, understandability, timeliness and verifiability (IASB, 2010).

Comparability

Comparability is the quality that enables users to compare financial reports of an entity through time, and financial reports of entities through time in order to identify trends in its financial performance and financial position (Cheung, Evans & Wright, 2010). It enables users to compare

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entity to entity in order assess their performances. It is necessary for users of accounting information to relate financial reports with one another, to allow them make sound and informed decisions arising from financial information that has been prepared to enable comparisons within the same entity over time and between entities (Tootell, 1963; Dunn, 1975; Bell, 1982; Van der Tas 1992; Sharpe, 1998) When companies operate in a comparable manner, they make the same choice between alternative accounting methods.

IASB (2010) states that comparability is an enhancing qualitative characteristic that helps users to understand and identify the similarities and differences that exist among items. Information is more valuable if it can be compared with information about the same entity and about other entities with similar information. However, comparability is not the same with consistency, nor with uniformity, although consistency relates to comparability.

Understandability

Understanding financial reports is required to make informed decisions. A financial report that is not understandable is not worth its content. IASB (2010) states that the process of classifying characterizing and presenting financial information concisely and clearly makes it understandable.

Timeliness

Timeliness of financial information points to the need for timely rendition of accounting report as required by law or guideline. IASB (2010) states that making information available in time to makers of decisions to be capable of influencing their decisions means timeliness. Information is more useful and decision-relevant when it is fresh. When information is old, it becomes less useful. Johnson and Zhang (2018) opine that information technology enhances the speed of the production of financial reports. It is also required for the efficiency of auditing of the reports. In Nigeria for instance, Okougbo and Efobi (2014) observe that the fastest reporting company takes an average of 122 days, some take as much as 304days. This is in contrast to the requirement of security and exchange commission of 90days. The study shows that size, leverage and performance are negatively correlated with the timeliness of corporate financial reporting while age is positively correlated with the timeliness of financial reporting.

Verifiability

Verifiability implies that knowledgeable and independent observers could arrive at a consensus. This does not imply that the different knowledgeable and independent observers are in complete agreement (IASB, 2010). Verifiability is an assurance quality of financial reports that helps to assure the users that the accounting information is faithfully represented with respect to the economic phenomena it purports to represent. Verifiability helps to confirm, through the examination of report in a direct or indirect manner. Directly, there could be an investigation of the physical existence of assets or the verification of the carrying amount of inventory by checking the quantities and costs and recalculating the inventory as at a given date.

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METHODOLOGY

The survey research design was adopted for the study; involving the collection of data through the administration of structured questionnaire on accountants and auditors of quoted companies in Nigeria, as well as accountants and auditors of quoted companies' regulatory agencies in Nigeria. The questionnaire was sectionalised to reflect demographic information, independent variables and dependent variables. Responses were rated using the five-point Likert scale. Internal consistency (reliability test) was carried out on the research instrument; using Cronbach Alpha reliability test, with the aid of Statistical Package for Social Sciences (SPSS). The result of the test shows coefficient of 0.830. Given these results, it is concluded that the instrument is reliable and capable of producing consistent results. The population of the study comprised 4893 accountants and auditors of 169 quoted companies and four regulatory bodies in Nigeria. A sample of 369 was determined using Taro Yamani sampling technique. 400 copies of the questionnaire were distributed and 370 were returned and analysed using associational and inferential statistics. The associational statistics tested the correlation between the variables, while the inferential statistics was meant to draw inferences.

Findings

Table 1: Faithful Representation and Ethical Principles

	Coefficient	(t-stat)	[p-value]
(Constant)	-0.165	(-1.541)	[0.124]
INT	0.458	(5.497)	[0.000]
OBJ	0.287	(3.009)	[0.003]
PC	0.53	(5.072)	[0.000]
DIL	0.541	(7.349)	[0.000]
Observation	370		
F-stat[p-value]	298.719		[0.000]
R^2	0.766		
Adj. R^2	0.763		

Source: Author's computation, underlying data from field survey 2018.

From the result in Table 1, F- statistics value of 298.719 [p-value = 0.000] shows that the ethical principle indicators are jointly statistically significant at 1% alpha level. The result also indicate that the Adj. R^2 value of 0.763 means that the independent variables jointly explain 76.3% of variations in faithful representation of financial reports. Financial reports are sources of economic information needed by those who make resource allocation decisions that bother on investment and credit transactions. To be useful in making resource allocation decisions, financial information must faithfully represent the economic phenomena that gave rise to it. Here, it means that financial information must be true, complete and neutral; devoid of untrue or self-motivated figures.

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CONCLUSION AND RECOMMENDATION

The study concludes that it takes the application of ethical principles to financial reporting process to achieve faithfully represented financial reports. However, how to achieve quality financial reporting has often been addressed from the technical side of financial reporting rather than from the behavioural side of the preparers of financial reports. The mindset of accountants, managers, auditors and regulators constitute a strong influence on the decisions they take, whether to write the right figures or write the wrong figures. The level of focus on accounting standards, regulations and auditing should be extended to the behavior of managers, accountants and auditors, including regulators. The study calls for ethical orientation and reorientation of accountants, managers, auditors and regulators.

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