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ACCRUALS QUALITY AND RETURN ON ASSETS OF OIL COMPANIES IN NIGERIA

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ABSTRACT

*The study examines the relationship between Accruals Quality (AQ) and Return on Assets of Oil companies in Nigeria. The cross sectional research design was adopted for the study. Data collected were analysed using the Pearson Product Moment Correlation Coefficient and Regression Techniques with the aid of the Statistical Package for the Social Sciences (SPSS) version 22. Further data analysis was supported with the Guilford Model and tests of normality were duly carried out. Results indicate that there is no correlation and an insignificant relationship between accruals quality and return on assets. Members of oil firms (Management and Directors) should not be absolved of improved scrutiny as it is their responsibility to avail users of financial statements with adequate disclosures. This can be ensured through the enforcement of appropriate retributive measures on defaulting firms.
Keywords: Accruals Quality, Return on Assets, Financial Reporting.*

INTRODUCTION

The importance of financial reporting cannot be over-emphasized, even in cross-border capital transfer. "Creditors decide whether to lend or not and establish contractual terms, namely interest rates, considering accounting figures" (Gopalakrishan, 1994; Weber & Beatty, 2003). In addition, better and improved performance, financial condition and internal control are of paramount importance to management hence, the review of the organization's financial

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Performance can help them achieve this goal. On the one hand “higher accounting quality mitigates financial information asymmetry through increase in investment efficiency” (Verdi, 2006) also, “through earnings effectively representing future cash flows” (Garcia-Teruel, Martinez-Solano & Sanchez- Ballesta, 2009). Lopes, Antonio and Brandao (2011) studied the impact of accounting quality on firm performance in the form of Return on Assets (ROA). However, using abnormal earnings methodology to evaluate only ROA does not effectively evaluate the firm performance phenomenon. Adeyemi & Asaolu (2013) examined financial reporting in relation to organizational stability which was also defined by both ROA and liquidity as conducted by Lopes et al (2011) and Nwanyanwu (2013).

STATEMENT OF THE PROBLEM

Financial information quality in Nigeria has been established as weak compared to other developed and developing countries. This has ultimately hampered the development of equity market that can be described as efficient. “A usual complaint among Nigerian investors is that financial reporting on firm’s performance is usually unavailable or, when published, lacks reliability” (Shehu, 2011). Due to the critical nature of financial performance, it behoves on us to analyse the extent to which financial performance can be enhanced in the oil sector through the province of accruals quality.

The aim of the study is to examine the influence of Financial Reporting Quality (FRQ) in terms of accruals quality; on Financial Performance of Oil Companies in Nigeria. However, the specific objective include to: Ascertain the impact of Accruals Quality on Return on Asset

RESEARCH HYPOTHESES

The research hypothesis to be tested for the purpose of the study includes the following:

H₀ Accruals Quality does not make a significant contribution to the Return on Asset of Oil Companies in Nigeria.

LITERATURE SURVEY

Theoretical Framework

Opportunistic Theory

The firm performance variables could have an effect on quality of financial reports as explained by the opportunist theory. By definition, opportunistic earnings management is a term that is used to refer to self-interested managerial reporting behaviour that is undesirable from a shareholder’s perspective. A widely held belief in the literature is that earnings management is primarily opportunistic and it hampers earnings quality. Indeed, many studies have used discretionary accrual measures of earnings quality as negative proxies of earnings quality (Myers, Myers & Omer 2003; Defond and Park 2004; Schipper and Vincent, 2003). If earnings management were primarily opportunistic, it is reasonable to posit that such behavior would adversely affect both relevance and reliability. In this case, constraining earnings management behavior via effective internal reporting controls and auditing should benefit

Shareholders. To the extent that opportunistic earnings management impairs predictive ability, less of it should arguably increase the predictive ability of earnings components.

EFFICIENT CONTRACTING THEORY

Bowen, Rajagopal and Venkatachalam (2008) asserted that “the efficient contracting theory associates managers to exercising accounting discretion in an efficient manner such that in the long run, firm value is maximized”. The earlier discussed theory (opportunistic), suggests that “managers have a short-term self-interest as an incentive to form poor firm structure to manage earnings for their own benefit” (Klein (2002). On the other hand, agency theory stresses that the independence of directors and institutional shareholding have a positive correlation in relation to adequate quality of earnings. The efficient contracting theory establishes a positive correlation between financial reporting discretion; future organizational performance and financial reporting quality.

For the purpose of this study, the opportunistic theory is selected to link structure variables with financial reporting quality and agency theory to frame monitoring variables with financial reporting quality, while the financial reporting quality and performance variables will be anchored on efficiency contracting theory.

EMPIRICAL FRAMEWORK

Jensen (1986) investigated the financial reporting quality and found that financial reporting quality correlates with the firms’ characteristics in the form of investment, financial structures, auditing quality and financial leverage. Lambert et al., (2007) and Bushman and Smith (2001) studied the relationship between FRQ and investments. They concluded that increase in the FRQ improves the efficiency of investments. Li Feng (2010) examined the impact of financial reporting quality on investment costs, information uncertainty and agency and found that high-quality financial reporting reduced investment and agency costs (Fengchen et al., 2010). Stiglitz (1981) is of the view that “due to economic facilities used to produce and store information, large firms tend to pay more on information acquisition”. He further revealed that information disclosure in large organizations were more than in small firms.

ACCRUALS QUALITY

Accruals Quality has been identified as the accuracy with which financial reporting portrays information about a company’s operations, particularly in terms of its expected cash flows. Accruals quality for this study is estimated using the Jones (1991) model as adjusted by Dechow and Dichev (2002). This procedure was as put forward by McNichols (2002). It is expressed as follows:

$$\text{Accruals}_{i,t} = \text{CashFlow}_{i,t-1} + \text{CashFlow}_{i,t} + \text{CashFlow}_{i,t+1} +$$

$$\Delta \text{Revenue}_{i,t} + \text{PPE}_{i,t} + \varepsilon_{i,t}$$

Where Accruals = $(\Delta \text{CA} - \Delta \text{Cash}) - (\Delta \text{CL} - \Delta \text{STD}) - \text{Dep}$,

ΔCA = Change in current assets,

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Δ Cash = Change in cash/cash equivalents,

Δ CL = Change in current liabilities,

Δ STD = Change in short-term debt,

Dep = Depreciation and amortization expense,

CashFlow = Net income before extraordinary items minus Accruals

Δ Revenue= Change in revenue, and

PPE = Gross property, plant, and equipment.

Return on Assets

Return on assets has elicited huge interest from researchers over time. Thus, David Lindo believes that "Return on Assets (ROA) is the general purpose financial ratio used to measure the relationship of profit earned to the investment in assets required to earn that profit. The ROA percent is a baseline that can be used to measure the profit contribution required from new investments. As such, it identifies the rate of return needed to at least maintain current performance and can be used to establish the hurdle rates all new investments must meet for approval" (Lindo, 2008). Gallinger (2001) asserted that "indicators such as the return on sales, financial leverage, interest expenses and return on equity allows for analyzing a company's asset management and the opportunity to redeploy the assets in the future". He stressed that "the return of a firm is influenced by many factors. Knowing these factors is important primarily for the company management, to adopt appropriate measures of growth, and to perform short or long term forecasts. Also, knowing the relationship of dependence between the return and the factors of influence is important for investors, creditors and for other categories of stakeholders who have different interests about the firm".

RESEARCH METHODS

Trochim (2006) regards research design as "the blueprint for the collection, measurement and analysis of data". This study adopts the cross sectional field survey of the quasi-experimental research design. This is because it intends to study the interaction of the variables in the study population (Baridam, 2001).

POPULATION OF THE STUDY

Population of the study is the collection of the elements from which the sample of that population is drawn (Anyanwu, 2000). Consequently, the population of study includes companies engaged in the oil and gas sectors based on the classification of the Nigerian Stock Exchange (NSE). The population includes 14 firms in the oil sub-sector of the oil and gas sector quoted on the Stock Exchange as at 31st December, 2014. The 2014 financial year was adopted because this study covers a period of 5 years beginning from 2010. Thus, since the firms are 12 in number and less than 30 (that is, $n < 30$, the census approach is used to select the identified firms). Therefore, there is no need for sampling procedure and sample size determination

SAMPLE AND SAMPLING TECHNIQUES

The period chosen for this study is 5 years beginning from 2010 to 2014? As stated earlier, the population includes the fourteen (14) Oil & Gas companies listed on the Nigerian

Stock Exchange. However, twelve (12) were selected for the study covering the five years period. The twelve companies selected met the following selection criteria:

1. Availability of all required data for computation of financial reporting quality (FRQ)
2. Complete audited financial statements for the required period of five years beginning from 2010.

TEST OF VALIDITY AND RELIABILITY

The study used secondary sources from the Financial Database of 2015 from quoted companies of the Nigerian Stock Exchange (NSE). These records are audited and validated. Thus, there is no need for validity and reliability tests.

MODEL SPECIFICATIONS

The functional and operational relationship of the criterion and predictor variables of the study is as expressed below:

$$\begin{aligned} \text{ROA} &= f(\text{AQ}) \\ \text{AQ} &= \text{Accruals Quality} \\ \text{ROA} &= \text{Return on Assets} \end{aligned}$$

$$\lambda_1 = \beta_0 + \beta_1 \text{AQ} + u_t \dots\dots\dots 1$$

Where;

λ_1 = Return on Assets (ROA); (Criterion Variable)

β_0 = Constant

β_1 = Coefficient of Accruals Quality (AQ); (Predictor Variable)

u_t = Error term.

The tests for normality include the test for Collinearity and test for the presence of heterostadasticity. Detection of heterostadasticity was done through the observation of the scatter plot of the standardized residuals; the Breusch-Pagan test and the White's Test.

DATA ANALYSIS TECHNIQUES

The hypothesis propounded in the present study was tested by the use of the regression analysis and Pearson's product moment correlation coefficient (PPMC) statistical tool. According to Dana, (2001), the PPMC measures the strength of relationship or going togetherness of the two sets of data with coefficient of correlation that ranges between -1 and +1, and it is symbolized as r.

The regression model specification will be used to assess the relationships between variables, and examine how changes in levels of X (predictor variable) relate to change in levels of Y (criterion variable) (Baridam, 2001).

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The values for calculations will be done using either t-test or z-test. In sampling analysis, if the values for calculation are more than 30, the z-test statistical tool is used. However, if the values are below 30, the t-test statistical tool is applied. The coefficient of correlation is denoted as r. The study adopted the use of version 22.0 of the statistical package for social sciences (SPSS) as an aid to test the hypothesis.

RESULTS AND DISCUSSIONS

The outcomes of the tested hypothesis in the research were interpreted based on Guilford (1954) correlation decision framework, to pad up the SPSS output on the test of hypotheses. Under the model, we have:

- 0.01 - 0.20 Neural Significance
- 0.21 - 0.30 Slight Significance
- 0.31 - 0.40 Moderate Significance
- 0.41 - 0.60 Very Significant
- 0.61 - 1.00 Perfect Significance

The hypothesis is tested so as to empirically assess the correlation between the predictor variable and criterion variable (Baridam, 2001).

TEST OF HYPOTHESIS

H0: Accruals quality does not have a significant relationship with Return on Assets.

Table 4.2A: Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std. Deviation
Accruals Quality	-40.75	854.99	96.8063	178.94570
ROA	-1.27	28.16	.4665	3.64295

Table 4.2A gave the outcomes of the descriptive statistics of the mean and standard deviation for each variable of Accruals Quality and Return on Assets. Table 4.2A further reveals that Return on Assets has a mean of .4665; and it also has a standard deviation of 3.64295. In addition, Return on Assets figures range from a maximum of 28.16 to a minimum of -1.27.

Accruals Quality reported a mean of 96.8063 and 178.94570 was reported as standard deviation with maximum and minimum figures of 854.99 and -40.75 respectively.

TABLE 4.2B: CORRELATION

		Accruals	ROA
		Quality	
Accruals	Pearson Correlation	1	-.066
Quality	Sig. (2-tailed)		.615
	N	60	60
ROA	Pearson Correlation	-.066	1
	Sig. (2-tailed)	.615	
	N	60	60

Table 4.2B above indicated a negative and insignificant relationship between Accruals Quality and Return on Assets

TABLE 4.2C: REGRESSION ANALYSIS

Model		Unstandardized		t	Sig.
		Coefficients			
		B	Std. Error		
1	Constant	.597	.539	1.107	.273
	Accruals Quality	-.001	.003	-.505	.615

a. Dependent Variable: Return on assets

OTHER VALUES OF REGRESSION ANALYSIS

Statistic	Value
R	.066 ^a
R ²	.004
Adjusted R ²	-.013
Values Explained by other variables	99.6%
Std. Error of the Estimate	3.66617
F-Statistics	.255
Sig.	.615 ^b

The above regression analysis result reveals the effect of Accruals Quality on Return on Assets. R² reveals that 0.4% of variations in criterion variable of Return on Assets are explained by the variations in the predictor variable of Accruals Quality. The implication of this outcome

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Is that the remaining 99.6% is explained by other variables not included in the model. The adjusted R² value of -1.3% is slightly below the R² of 0.4%.

The p-value associated with the F-value (0.615) is higher than the alpha level (0.05) thereby indicating the fact that Accruals quality cannot reliably predict ROA. Furthermore, comparing the t-value to the p-value (sig), the p-value is more than the alpha (0.05) thereby indicating that the coefficients are statistically insignificant?

Collinearity Diagnostics^a

Model	Dimension	Eigenvalue	Condition Index
1	1	1.479	1.000
	2	.521	1.685

In addition, the collinearity diagnostic confirms the absence of serious collinearity problems. The Eigenvalues are not close to 0 indicating that the standardized and unstandardized predictors are not highly inter-correlated. Hence small changes in the data values will not lead to large changes in the coefficients of ROA estimates. In addition, the condition indices reveal that values are less than 15 thereby indicating no problem with collinearity.

Test of Heterostadasticity

		Breusch-Pagan
	F-statistic	0.301
	Sig	0.585

Furthermore, the scatter plot of residuals against accruals quality (for normality) reveals the absence of heterostadasticity deduced by the non-identification of any pattern. A formal check was done using the Breusch-Pagan test which reveals that the F-statistic (0.301) is less than the significant value (0.585); hence we accept the null hypothesis that there is no heterostadasticity problem in the model formulated.

Thus, the hypothesis of the present study states that Accruals Quality does not have a significant relationship with Return on Assets. The correlation result of -0.66 indicates a negative but insignificant correlation, which entails that Accruals Quality cannot influence Return on Assets in oil sub-sector of the Oil and Gas Industry. Consequently, the null hypothesis is not rejected, while the alternative hypothesis is rejected. Therefore, we could state that Accruals Quality has no significant relationship with Return on Assets.

CORRELATION BETWEEN ACCRUALS QUALITY (AQ) AND RETURN ON ASSETS (ROA)

H0: Accruals Quality does not have a significant relationship with Return on Assets. The above hypothesis sought to examine the correlation between Accruals Quality and Return on Assets. The regression analysis predicted a negative relationship between Accruals Quality and Return on Assets (see tables 4.2A, 4.2B and 4.2C). The outcome of the R-squared shows that

0.4% of variations in criterion variable of Return on Assets are explained by the differences in the predictor variable of Accruals Quality.

Therefore, because the explanation variable is grossly less than 50%, it reveals that the model does not have a good fit. Also, the tested hypothesis using the Pearson's Product Moment correlation coefficient statistical tool gave a value of 0.066 to show that no correlation exist between accruals quality and return on assets. Consequently, it was stated that Accruals Quality does not have a significant relationship with Return on Assets.

This finding is in line with the views of McDermott (2011) who examined the relationship between financial reporting quality and return on assets. He realized a negative association between the variables for firms operating in settings with higher likelihood of over-investments. Furthermore, Lopes et al (2011) examined the mechanical relationship between accounting quality (measured through abnormal accruals) and financial performance (measured through Return on Assets). The research revealed a negative but insignificant relationship between abnormal accruals and return on assets for two consecutive years studied.

CONCLUDING REMARKS

Conclusively, the study has provided both empirical as well as statistical evidence on the utility of accruals quality in explaining and predicting the return on assets of the Nigerian listed oil firms.

POLICY IMPLICATION

The significant gap between the research knowledge and current policy is due to the fact that policy-makers and practitioners may not know about important research findings and they tend to apply only findings that agree with their preferred policies. We hope that our empirical findings will be of interest to researchers, standard setters and other regulators, government officials in emerging markets, managers, and others involved in improving economic conditions of Nigeria through the oil and gas sector.

LIMITATION OF THE STUDY

The research is limited to the study of Financial Reporting Quality in terms of Accruals Quality and Financial Performance in the Oil Sector of the Nigerian Economy instead of an economy-wide research. A broad research of the phenomena should include the Financial, Manufacturing, Agricultural, Construction/Real Estates, Conglomerates, Consumer Goods, Healthcare, ICT, Industrial Goods, Natural resources and Service Sectors. However, maximum care was deployed in drawing inferences from the research and results were concluded with ease in line with the purpose of the study.

SUGGESTIONS FOR FURTHER STUDIES

Further studies should be carried out in the following areas:

1. Financial reporting quality and efficiency of Government Agencies in Nigeria.
2. Financial reporting quality and corporate stability of manufacturing firms in Nigeria.
3. Qualitative characteristics of financial reporting and corporate performance of listed firms in Nigeria.

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