Firm Characteristics and Restatement of Financial Statement in Nigeria

Lodikero Olusola[1], Amodu Muhammed Abdulasisi[2]
[1,2]*Department of Accountancy, Rufus Giwa Polytechnic Owo, Ondo state, Nigeria*

Abstract: **Published accounting information in financial statements are required to provide various users; shareholders, employees, suppliers, creditors, financial analysts, stockbrokers and government agencies with timely and reliable information useful for making prudent, effective and efficient decisions. This paper examines firm characteristics and restatement of financial reports in Nigeria. Specifically, the study investigates the relationship that subsists between firm characteristics and restatement of financial statement. The corporate annual reports and website for the periods 2010-2019 were utilised as the main sources of secondary data. The study adopted correlation technique to analyse the data collected from annual reports and corporate website of the listed companies in Nigeria. The findings showed that restatement of financial reporting is related to: firm size, ROA, and leverage. The results also revealed that restatement of financial statements significantly influenced investors, potential investors' behaviour and serves as correcting and control yardsticks to check mate intentional material misstatements in financial records. The study recommended the effective execution of the restatement standard with integrity and independence of executors.**

Key Words: **Financial Statement; Firm Characteristics; Investors; Financial records; Restatement of financial report**.

I. INTRODUCTION

The issue of restatement of financial reports has become a matter of concern globally (…). This concern emerges mainly from the massive financial misstatement of companies' records. Various steps have been put forward towards correcting this deviation from excessive provision, extraordinary items, off financial position finance, capitalized costs, profit-sharing schemes to personnel, non-trading profit, depreciation rate change, foreign exchange mismatch, low tax charge, and brand accounting, due to the desire for transparent reporting and compliance with regulations. As a result, the public concern for the relationship between firm characteristics and restatement of financial statements has led to the emergence of this paper.

The emergence of restatement of financial statements in the developing countries has provided researchers with an opportunity to find out the benefits derivable by organisations from their connection with the firm characteristics (Norman, Rose & Suh, 2011). Rosner (2003) provides evidence that firms engage in financial misstatements when they need to report results more favourable than it would if it followed Generally Accepted Accounting Principles (GAAP), and when firm characteristics encourages a short-term orientation of financial reporting. Financial restatement has formed one of mechanisms of correcting material misstatements in financial statements (Idekwulim and Watts, 2014). Besides, it is a means of restoring integrity and independence of auditors, restoration of public confidence in reasonable assurance given by professional expert, check mating excesses of external auditors and reducing different kinds of threat to objectivity (Kalu, 2014).

Scholars have identified different factors that influence financial statements restatement such as characteristics of firm. However, much has not been extensively written on the correlation that exists between financial statements restatement and firm's characteristics most especially in the developing countries like Nigeria. Since listed companies in Nigeria have been mandated to comply with International Accounting Standard and with the adoption of the International Financial Reporting Standard (IFRS) by some companies in the country, it is imperative for the firms and those who are charged with responsibility not to only have the knowledge of the concepts of restatement of financial statements but to also understand the standards that guide it. The objective of the study is to investigate the association that exists between firm characteristics and financial statements restatements using positive accounting theory as theoretical framework. This study shall give responses to the following research questions: what is the relationship that exists between restatements of financial statements and firm size? What is the association between leverage and financial reporting restatement? Is there a significant association between return on asset and financial statement restatement?

II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Firm Characteristics and Restatement of Financial Statements

Abdullah, Yusof and Nor (2010), defined "financial statement restatement as the process of revising and correcting a previously issued financial statement to correct errors and non-compliance with Generally Accepted Accounting Principles (GAAP)". United State General Accountability Office (USGAO) (2002) opined that "financial restatement occurs when a company, either voluntarily or prompted by auditors or regulators, revises public financial information that was previously reported" and identified the following as the categories of financial restatement: reclassification; restructuring assets/ inventory; security related; acquisition and mergers; revenue recognition; cost or expenses; and in-process research and development. The International Financial Reporting Standard (IFRS 8) argues that financial restatement must be prepared when there are alteration in financial statements which occur after the reporting period but prior to the period when financial reports are authorized for issue, the computations earnings per share for the annual reports and the increase of any previous period should be determined by the new amount of share and should be unveiled.

Several scholars have pointed out the effect of firm characteristics on restatements of financial records on the reputation of firm and its performance. For example, Akhigbe, Kudla and Madura (2005) argue that restatement creates a negative market reaction after the declaration of earnings restatements (Richardson, Tuna & Wu, 2002). Also, Levitt (1998); Palmrose and Scholz (2000) assert that restatements have effect on the quality of financial statements after its announcement. Moore and Pfeiffer (2004) are of opinion that restating entities' financial records do not show a more conservative accounting reporting stratagem after restatement. Wilson (2008) argues that restating financial exercise leads to a decline in financiers' confidence aftermath and that it only shows for short-term; but distrust concerning the information of loss of post-restatement income in the long-term is baseless.

On this backdrop, this study observes that the burdens of presentation of financial restatement are majorly on firm's characteristics such as: size structure, profitability (ROA), leverage, industry type, composition of board of directors. For instance, Nikbakht and Rafiee (2011) study on evaluation of effective factors pattern on financial reporting restatements, argue that financial restatement in Iranian stock market reveals firm's characteristics such as: firm size, financial leverage, profitability, management period, management change and accountant replacement, influence financial restatement. Gleason, Jenkins and Johnson (2008) also argue that financial statements restatement has not only negatively influenced shareholders wealth but also affect share price.

III. THEORETICAL FRAMEWORK

The theory underpinning this study is hinged on agency theory and positive accounting theory.

Agency Theory

Agency Theory assumes that the interest of the principal and agent varies and that the principal can control or reduce this by giving incentives to the agent and incurring expenses from activities designed to monitor and limit the self- interest activities of the agent (Jensen & Meckling, 1976; Fama & Jensen, 1983; Hull & Jones, 1992). According to Jensen and Meckling (1976), the principal will ensure that the agent acts in the interest of the principal by giving him the incentives and by monitoring his activities as his absence may lead to scandals.

In this study, management motives and poor corporate governance mechanisms are used as indicators of financial misstatements. We argue that the decision to engage in accounting misstatement requires the firm to first rationalize its actions to commit accounting misstatement as acceptable management behavior.

Positive Accounting Theory

Restatement of financial statements is a topic that has received interest by many scholars from different theoretical views. Positive accounting emerges as a result of Jensen's search for positive accounting theory. Jensen and Meckling (1976) theorize the institution of positive accounting theory. This elucidates why directors react and the intention of their reaction. This is done by evaluating the cost and benefit of financial disclosure in relation with different stakeholders and allotment of relative scare resources within the financial system (Belkaoui, 2014).

The theory is founded on the scheme that shareholders, managers, as well as regulators are logical. They make effort to maximize their efficacy which is directly connected to their wealth and compensation.

Reviews of Empirical Studies

This section covers the relationship that exists between firm characteristics and financial statements restatement as advanced in existing literature.

Firm size and restatement of financial statements

Firm size can be measured as total assets of a given company Farzin and Mostafa (2013); Nikbakht and Rafiee (2011). Farahnaz and Alireza (2012) opined that there are several methods of carrying out firm size measurement and conclude that it can be done via employees' size, sales, assets, and values add features. Studies by Farzin and Mostafa (2013) examine relationship between firm characteristics and financial restatements, and found that there is a significant negative relationship between the firm size and financial restatements. They conclude that small firms are frequent in rendering financial restatement as a result of inadequate expertise and facilities. Sajadi and Ghorbani (2004) researched on relationship between annual adjusting of companies statements to stock price, size and life span of companies adopted by Tehran stock exchange, and are of the opinion that the large firms have more intellectual assets and facilities to reduce material misstatements in financial statements and conclude that firm size inversely related to occurrence of financial restatement, the higher the size, the lower the occurrence of financial records restatement. Therefore, the following hypothesis shall be examined.

H_1: Firm size has no significant association with financial statements restatement

Firm leverage and restatement of financial statements

Okwoli (2009) sees firm leverage as the proportion of debt investment in firm's capital structure. It is obtained by dividing long term debt by fixed asset (Kalu, 2014). From extant literature, different scholars reacted to relationship that exists between firm leverage and financial restatement. For instance, Defond and Jiambalvo (1991) examined incidence and circumstances of accounting errors; argue that an increase in firm's debts level may likely increase the proportion of restating its financial statements. Richardsons, Tuna and Wu (2002) argue that most firms with higher degree of outstanding debt often engage in restatement of financial records. Hence, the following hypothesis is examined:

H_2: Firm's leverage has no significant correlation with financial statements restatement.

Profitability and restatement of financial statements

Peterburgskey (2012) confirms that firm which experiences low returns is more prone to restatement of financial statements compared with profitable firms. Kinney and McDaniel (1989) researched on the consequences to managers for financial misrepresentation and argue that company with less profit is prone in restating its financial statements. This is also constant with the study of Farzin and Mostafa (2013) who assert that firms with negative returns in the preceding years are prone in restating their financial statements in current year. Sajadi and Ghorbani (2004) find a positive relationship between entity's losses a year before financial restatement and financial statement restatements. As a result of this, the following hypothesis shall be examined:

H_3: Firm's profitability has no significant relationship with financial statements restatements

IV. METHODOLOGY

The study is descriptive and secondary data were utilized. The study covers the three key sectors within the economy (i.e. banking, manufacturing, service). Data were sourced from the annual reports and corporate website of listed companies in Nigeria. This is as a result of the fact that annual reports are audited, reliable and regular medium to communicate with stakeholders. The population of this research consists of all listed companies on the Nigerian Stock Exchange within the study periods (i.e. ten years, 2010-2019). The research purposive sampling method were use to select 5 organizations spread across the three key sector of the country's economy (i.e. banking, manufacturing, service). Based on disclosure index, the items of financial statement restatements were numerically scored on occurrence procedure. Therefore, the weighted disclosure approach were used for scoring, a company is scored (1) when it engages in restatement of financial records once within cut off periods, while (2) if it restates its financial records more than once and (0) if it is not involved in restatement within the periods at all. The entire restatement disclosure index is computed for each sample company. The study embraces the use of panel regression system as tool of analysis.

Model Specification

In order to analyze firm characteristics and financial statements restatement, Karl Pearson Correlation was designed to analysis the research.

Where FSR = Financial Statement Restatement measured using FSR disclosure index

Fsize = Firm size measured as the log of total asset

Lev = Leverage measured as ratio of debt to equity

ROA = Return on asset measured as profit after tax divided by number of ordinary shares

β_1 - $\beta_{3\,=}$ are the coefficient of the parameter estimate

ε = Error term

V. DISCUSSION OF FINDINGS

Table 1: Descriptive Statistics

Variables	FSR	F-size	LEV	ROA
Mean	1.600	53634107.4000	.7103	.0563
Maximum	2.00	121060621.00	.88	.10
Minimum	1.00	9376225.00	.60	.01
Std. Dev	.54772	42944289.55473	.12328	.12328
Skewness	-.609	1.080	.725	-.011
Kurtosis	-3.33333	1.158	-1.1992	0.038
Probability	0.000002	0.000000	0.019362	0.000000

Source: Author's Computation

The descriptive statistics of the analysis is presented in Table 1 above showed that FSR is at a mean value of 1.60, therefore demonstrating that on the 80% (1.600) of sample companies restating their financial statements more than once. The Skewness and kurtosis statistics of total FSR and its firm characteristics are within the range of ±1.96 and ±3 showing that such data are normally distributed (Haniffa & Hudaib 2006), and they are close to zero. In addition, the data showed high consistency as the mean and median fell within the minimum and maximum scores. As a result, the data exhibited normality of the distribution. The standard deviation measuring the spread of the distribution stood at a value of 0.54772 with an associated probability of 0.00. Therefore, it denotes that the variables are normally distributed variable when evaluate at critical level. This implies that the likelihood of outlier does not subsist in the distribution. An additional examination is analyzed at 5% critical level.

Table 4.2: Correlations Matrix

Pearson Correlations Table						
			FSR	F-size	Lev	ROA
Spearman's rho	FSR	Correlation Coefficient	1.000	-.866	.289	-.289
		Sig. (2-tailed)	.	.058	.638	.638
		N	5	5	5	5
	F-size	Correlation Coefficient	-.866	1.000	-.700	.600
		Sig. (2-tailed)	.058	.	.188	.285
		N	5	5	5	5
	Lev	Correlation Coefficient	.289	-.700	1.000	-.500
		Sig. (2-tailed)	.638	.188	.	.391
		N	5	5	5	5
	ROA	Correlation Coefficient	-.289	.600	-.500	1.000
		Sig. (2-tailed)	.638	.285	.391	.
		N	5	5	5	5

Source: Authors Compilation

H_1: Financial statements restatement does not significantly influence firm's size.

The first hypothesis states that firm's size does not significantly influence financial statements restatement, which has negative correlation coefficient value of -.866 with sig. (2-tailed) of 0.058 that is equivalent to 0.05 level of significance, showing that there is a negative relationship between financial statements restatements and firm size. The null hypothesis is rejected at 0.05. Thus financial statements restatement does negatively influence organization's size as feature of a firm.

H_2: Financial statements restatement does not significantly influence firm leverage.

The second hypothesis posits that financial statements restatement does not significantly enhance leverage as one of the firm characteristics factor to be considered. The result, correlation coefficient of 0.289 with 0.638 sig. (2-tailed) level of significance, indicates that there is no significant relationship between financial reporting restatement and leverage. Hence the alternative hypothesis is being rejected. The result then indicates that financial statements restatement influences level or degree of leverage cannot be determined.

H_3: Financial statements restatement does not significantly influence firm profitability**.**

The third hypothesis states that financial audited report restatement does not significantly affect return on asset-proxy for profitability- as one of firm characteristics. The result reveals correlation coefficient of negative relationship of -.289 with sig. (2-tailed), indicating that there is a negative significant relationship between financial statements restatement and returns on assets and hence alternative hypothesis was rejected. The null hypothesis is therefore accepted.

VI. FINDINGS

This study has appraised the impact of financial statements restatement in influencing firm characteristics. The key findings are summarized as follows:

(1) The analysis on our first hypothesis revealed that there is significant but a negative relationship between financial statements restatement and firm size. This collaborates with Farzin and Mostafa (2013); Nikbakht and Rafiee (2011); Waweru and Riro (2013) argue that restatement of financial statements is frequent with small firm (Kinney & McDaniel, 1989; Kim & Liu, 2003)).

(2) The second hypothesis reveals that there is a positive association between financial statements restatement and level of firm leverage and hence agrees with (Defond and Jiambalvo (1991; Richardson, 2002)).

(3) The evaluation on the third hypothesis depicts a negative correlation between financial statements restatements collaborated by (Anderson &Yohn, 2002; Peterburgskey, 2012; Kinney & McDaniel, 1989; Farzin & Mostafa, 2013).

VII. CONCLUSION AND RECOMMENDATIONS

The paper concludes that the users of financial statements should be meticulous and take the advantages of experts to determine the relevance, reliability and sufficiency of financial statement before making economic decision. They should be aware that small firms are more prone to provide financial restatement and that the users of restated financial statements should consider losses in financial statements while making economic decision

Therefore, the paper recommends that small firms should engage the service of professionals in set up their accounting systems and internal control mechanism in order to mitigate against material misstatements and human errors which may necessitate preparation and presentation of financial restatement as stipulated by the International Accounting Standards. Besides, firms are encouraged to institute sound corporate governance and ensure sound elements of internal control system especially sound control environment. The users of restated financial statements should consider losses in financial statements while making economic decision since previous studies and this paper's analysis revealed that those firms with loss in previous years are prone to restatements in coming year.

Suggestion for Further Research

There are several areas for further research that arise from the limitations addressed in the previous section. Firstly, the data collection could be extended to include even the unhealthy quoted companies on the Nigeria Stock Exchange. This would help to determine if the results from this study also hold for unhealthy companies as well.

Secondly, a number of case studies of financial restatement in Nigeria companies could be undertaken to obtain a more detailed understanding of the inner workings of the corporate governance.

Finally, other measure of firm's characteristics could also be exploited. Some prior studies suggest that a firm characteristic is an effective corporate governance mechanism, which can improve the quality of companies' financial reporting practices. This research found similar support for this notion based on our findings; however, there are others who found otherwise. Therefore, the relationship between firm characteristics and financial restatement appears divergent and foundations have been set for further research about this relationship especially among the Nigerian corporate entities.

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