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THE DETERMINANTS OF QUALITY FINANCIAL REPORTS: A CASE OF SELECTED BUSINESS FIRMS IN MBEYA CITY

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Abstract: The study motivated to assess the determinants of quality financial reports. This study employed the survey design to reveal the facts behind the assessment. Indeed the study used strata-multistage sampling to derive to 100 samples of respondents being business runners from 2 (20 respondents) public; 3(30 respondents) private; 30 respondents as SMEs and 20 respondents from large business firms. Data from this sample frame were collected by using questionnaire. Moreover the collected, coded and screened data were analyzed by applying inferential statistical tools including rotated component matrix, partial correlation and ordinary least square regression. The results from this assessment found that relevance, materiality and fair presentation were strong and significant determinants of quality financial reports to be presented. Despite of the positivism found but from the research area, the financial reporting standards found to be not effectively put into practice not to reveal the said three determinants of quality financial presentations. From this dilemma and the revealed determinants of quality financial reports , the study recommends the financial auditors to enforce accountants and other experts in Accounts and Finance department in business firms to be used to financial reporting standards both local and international ones.

Keywords: *Financial Reports, Relevance, Materiality, Fair presentation.*

1.0 Introduction

Following inventions over employment of financial reporting standards, the tendency of business firms treating un-relevant items into one group has not been the case. Apart from regulation abided to standards called substance over form, competence use over accounting standards has created relevance, materiality and fair representation of financial reports. Thus adhering to financial reporting standards has created special treatment of accounting items, which then has helped attain quality financial extracts. For instance treating fixed assets in different categories such that over IAS-16. Accounting for fixed rental assets; IFRS-4 –accounting for insurance Contract hold the meaning that fixed assets treated under IAS-16 are called production- depreciable assets which are then negotiable but the same fixed asset might be used as or securities in which in that case though they might be pledged but they should not be negotiable at the time when they are under lenders/ Bankers' lien or if already the insurance contract is formed.

The relevance treatment of accounting items is the reorganization of the same accounts of resemblances into one (Pavlopoulos, Magnis & Iatridis, 2019). Relevance does not mean reconstructions but treating similar accounting items fairly. The amortized assets are intangible assets which are grouped and treated the same in accordance to IAS-38. This treatment is different from PPE-production/rental/ administration/ depreciable assets which are treated under IAS-16 indeed which is also different from treatment of depleted mineral reserve assets–IAS39, the same difference as it is over treatment of investment assets, IAS-40.

Materiality over financial accounts is the non-biasness free from errors and omissions (Choudhary, Merkley & Schipper, 2019). Materiality creates reliability and neutrality over the figures regarding expenses, revenue, assets, liabilities and capital. The difference in treatment of provisions, contingent assets and Contingent Liabilities -IAS-37 differ from that over general reserve requirement capital-figure as under IAS 1-Statement of Financial Position; Disposable/ Depreciable/Impaired Assets as under IAS-16, IAS-36 and the adjusted Liabilities as defined under IAS-1. Normally Provisions are capital reserves which are non distributable profit and made so as to help the firm realize profit. Provisions are commonly known as revaluation on assets. Contingent assets are assets which its value is not deducted by depreciation figure. They are the fixed assets which are assumed to retain its value now and then without being undergone depreciation. Moreover the value of contingent assets taken at its historic not at Net Book Value as it is to depreciable/ disposable fixed assets. Furthermore contingent liabilities are non-adjusted/ non settled liabilities with debit (Dr) balance.

Fair representation of financial accounts is the treatment of financial items by regarding their similarities and differences (Dahiyat & Owais, 2021). Fair presentation entails aggregation of financial items basing on their similarities. Fair presentation is an exhaustive means of presenting financial reports by avoiding commitment over the errors and omissions (Safkaur, Afiah, Poulus & Dahlan, 2019). Fair representation is a neutral way of having financial items. It is a materiality system of keeping financial details (Hadiyanto, Puspitasari & Ghani, 2018).

Amahalu, Okeke and Chinyere (2018) revealed that improper adopting of financial reporting standards by SMEs in Nigeria lead into exaggeration of revenue reports. Indeed grouping of unrelated items such that over gain disposal of fixed asset being treated as revenue found on to incorrect figure for operating profit (Rahman & Hasan, 2019). Improper transfers over the fixed assets held for sale as per IFRS-5 to the named property, plant and equipment (PPE) in accordance to IAS-16 by most of accounting entities in Uganda was found to be a root cause of over unlawful representation of financial accounts (Bananuka, Tumwebaze, Musimenta & Nuwagaba, 2019).

From the field area it was revealed that accounting personnel adhere to accounting standards with the major aim of adhering to substance over form indeed when it comes to the time when financial auditing is to be carried out. But being the focus of this study, it was revealed that adhering to accounting standards help achieving qualities of financial reports. To contemporate this fact, three issues were addressed including relevance, materiality and not fair representation. Thus it is from the these three variables in which three research objectives were formulated ie to assess the effects of adhering to relevance principles in producing quality financial accounts; to investigate the impacts of adhering to materiality concept in coming up with quality financial reports and to reveal the impacts of adhering to fair representations principle in extracting the quality financial accounts.

Thus being the focus of this study assessment , the issue is not being a good memorizer of accounting principles and standards or sustaining the so called substance over form but quality realization of the prepared and presented financial reports. Either to meet this situation, then three issues were discussed i.e. the relevance, materiality and fairness. To uncover these three issues towards sustaining quality of financial reports presented, the study adopted the “Relevance Theory” (Everest & Weber, 1977). This theory proposes on treating accounts basing on the extent to which they are related /relevant. The relevance theory proposes on accounting and finance section adopts and use financial reporting standards both the local and international ones. Use of accounting standards foster for distinctive treatment of accounts basing on the situation for final reports appear fairly presented. Accounting standards are principles and basis of classification of items/accounts (Garcia-Sanchez, Hussain, Martínez-Ferrero & Ruiz-Barbadillo, 2019). Fair presentation ascertain for grouping of related accounting items, thus the final reports provide for fair comparability of the firms say items of performance or liquidity (Dhliwayo, 2018). For instance if one firm account for profit when interest and tax is deducted and the other one account for profit before deducting the two parameters stated, then with this comparability can-not be conducted fairly. Moreover if say one firm account for adjusting entries (IAS10)-Accounting for events after the balance sheet date and the other one does not , then the final reports i.e. statement of income or comprehensive income statement or statement of financial position won’t be fair to be used as a comparative tool. Furthermore relevance theory did not recognize the quality ingredients paid into the final report financial accounts due to materiality, neutrality unbiases and reliability ascertained (Al-Dmour, 2019). These are the issues; this study under discussion has concretely addressed them.

2.0 Methodology

The study was conducted in Mbeya City. The area was chosen because of the reason of being reachable, accessible and it was a fast growing city in which using surveys over population census 2012, the population of Mbeya City was at 300,000 while in the year 2020, the projection was at 700,000–800,000 people of which most of them are traders. It is from this fast population growth, then the areas such as Mwanjelwa has becoming a commercial area but to realize that most of private trading firms were not used to effective financial recording indeed by not adhering to financial reporting standards. Though in large extent, private firms were the ones involved to reveal the facts on hand but the study investigation also included public firms. Using a survey design, indeed with private firms about 80 respondents were researched while from public firms 20 respondents were consulted. Derivation of 100 sample was fostered through the use of stratified sampling technique from 500,000, the recent population of Mbeya City (Mbeya Regional Office, 2020) at a level of confidence =10%. Data from 100 drafted sample frames were collected using questionnaire and observation. The collected and processed data were analyzed by employing the rotated component matrix, partial correlation and Ordinary Least Square Regression being guided by the following structural equations:-

$Q_{FR} = \alpha_1\sum R_E + \alpha_2\sum M_R + \alpha_3\sum F_P$ ……………………………………………………1)

where Q_{FR} = quality of financial reports; R_E = Relevance; M_R =Materiality; F_P =fair representation.

$R_E = \Delta_1 C_{EF} + \Delta_2 C_{RF} + \Delta_3 C_{AV} + \Delta_4 C_{LV} + \Delta_5 C_{CF}$ ……………………………………2)

where R_E = Relevance; C_{EF} = Correctness of expenses figure; C_{RF} = correctness of revenue figure; C_{AV} = correctness of asset value; C_{LV} = correctness of liabilities value; C_{CF} = correctness of capital figure.

$M_R = \lambda_1 C_{GI} + \lambda_2 F_{ERR} + \lambda_3 N_E$……………………………………………………..3)

where MR = Materiality; C_{GI} = Correct grouping of accounting items; F_{ERR} = Free from error; N_E = Neutral financial accounts

$p\,\frac{t+1}{3} = \beta_0 + \beta_1 F_P + \varepsilon$ ……………………………………………………4)

Where p= probability; F_P = Fair presentation; ε = error term

$FP = \beta_0 + \beta_1 FRp + \beta_2 Co + \beta_3 Ne + \varepsilon$ ………………………………………...5)

Where FP =fair presentation; FRp= faithful representation; Co= completeness and Ne=neutrality.

3.0 Results and Discussion

3.1 Relevance and quality of financial reports

In here the study aimed at assessing the impacts of adhering to relevance accounting principle and presentation of quality financial reports. It is with relevance consideration in which the problem of setting items/ accounts in different category is overcomed. It is

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through treatment of account/items in which the final answer say the net profit/loss become bias though in some extent it might happen the debit (Dr) and credit (Cr) sums to agree. For instance treatment of revaluation in land as a revenue pile up the revenue figure which might exaggerate the final profit of the year.

Table 1: Rotated Component Matrix

S/N	Constructs	1	2	3	4	5
1.	Correctness of expenses figure		0.4			
2.	Correctness of revenue figure					0.35
3.	Correctness of asset value				0.26	
4.	Correctness of liabilities value			0.34		
5.	Correctness of capital figure	0.20				

Source: Author's computations (2022)

With construct correctness of expenses figure =0.4 in relation to quality of financial reports shows a discrepancy to exist from the financial firms invested what was revealed was over in- correctness over the expenses figure. Normally in accordance to IAS 1 over presentation of financial statements, the expenses are those fall under the category of operating expenses and not those over capital expenditures. Payment over bills and more other administrative and distribution expenses as well as purchases and carriages and not payment over capital/fixed assets say as motor Van, premises and non-current assets. What was revealed over wrong treatment was the expenditure incurred is acquiring motor vehicle (non-current assets) treated as purchases accounts. The effects with this wrong recording were that the figure for operating expenses become greater (exaggerated) and at the end the final result might become a Net loss. This is because of irrelevant treatment of accounts.

The same dilemma revealed over incorrectness of expenses figure was that which was found with irrelevant treatment of revenues, assets, liabilities and capital equals to 0.35, 0.26, 0.34 and 0.20 respectively. For instance and indeed in accordance to IAS-18, all the so called revenues are recognized and disclosed. In here or according to IAS-18 not all incomes are revenues but all revenues are incomes. Either it should be known that revenues are incomes from operations such as sales revenue, dividend, interest revenue and commission. The income/loss from sale of PPE-IAS-16 (assets which depreciate) are not revenue but revaluations and they are recommended as other income gain (loss) in the statement of comprehensive income. Revaluation gain/loss incomes are recorded as Revaluation in Statement of Changes in Equity and Capital Reserves (specifically Provisions in accordance to IAS 37) in the Statement of Financial Position in accordance to IAS-1.

Assets which are used as securities/collaterals called Insurance Contract assets-IFRS4 were revealed to be treated the same as those presented in accordance to IAS-16 (classified as PPE) , IAS-36 (Impaired assets), IFRS-5 while in actual fact they are forms of assets which are to be treated differently. Associating the PPE-IAS-16 assets into insurance contract –IFRS 4 assets is wrong treatment which revealed to be the cause of incorrectness over the assets figure as presented under insurance financial report contracts as refers to IFRS-4.

Indeed while the construction assets (parts and components) were to be treated different from other assets such that over IAS-16, IAS-36, IAS-2, IAS-32, IFRS-4 and IFRS-5 AND IFRS-2. The difference between construction contract assets ascertained under IAS-11 and other assets as they have identified above what the same was revealed from the field was that while IAS-2 was accounting for inventories (assets recognized at market value ie purchase price; the IAS-16 was (is) accounting for rental/production assets recognized at fair value and not at its purchase (acquisition) cost.

Moreover, while the assets accounted under IFRS-5 are non-current assets but they are held for sale and not for production as those under IAS16 or construction as fixed assets under IAS11. The same while assets treated under IAS 32 are specifically financial assets (instruments) recognized at market price, price per earning, and dividend per market price those which are under IAS11 are construction metal parts and components which are fixed business assets. These forms of assets are indeed not recognized at its fair value but at its purchase price. This is from the fact that despite of being noncurrent assets but they are non depreciable assets as because once they are bought they are direct subjected to construction. Construction assets are non rental assets of which in its secky of operation or production they expect to undertake depreciation from which the depreciation amount, annual depreciation , impairment, carrying value, purchase price, disposal values are parameters needed to be disclose. But with reference to construction assets that fall under IAS-11 then the issues (parameters) regarding depreciation are not disclosed at all as its disclosures will be counted irrelevant. But as it has noted above these standards were revealed to be not mastered by most of financial firms indeed with those operating under informal and private sector. Either the knowledge gap of not adhering to relevance financial accounting principles with the said informal and private sector. This is then what this study calls for private and informal entities recruit and being used to professional and qualified accounts. Either much emphasizes what the study is putting to the runners/owners or regulators/professional Boards such as National Board of Accountants and Auditors (NBAA) in Tanzania, is that all business firms are to be registered and being used to professional (public) accountants. In Tanzania, for instance the study recommend to adhere to most of principle that anyone to be recruited to the position of accountant or financial manager should be certified and revealed competent and viable towards use of financial reporting standards.

3.2 Materiality and quality of financial reports

With this subtitle, the study motivated to reveal the effects of adhering to materiality accounting principle on preparation and presentation of financial reports. The material accounting items are accounts or records which are free from errors, omissions and biases. Simply material items are items which are neutral and they are stand as they are. Immateriality is the for-secky against wrong or bias financial figures or reports. Moreover material items in accounting are those entries which are relevant and therefore they can be aggregated or grouped together.

Table 2: Partial Correlation

S/N Constructs	1	2	3
1. Correct grouping of accounting items	1		
2. Free from errors/omissions/missing values	0.24**	1	
3. Neutral financial reports	0.29**	0.22**	1

***p<0.01; **p<0.05; *p<0.1

Source: Author's computations (2022)

With r=0.24 for the construct free from errors/omissions/missing values show in-appropriateness the accounting section is used to. It is with this response (results) as it was with other construct i.e. correct grouping of accounting items, r=0.29 and neutrality of financial reports presented, r=0.22 which are all <0.3 what revealed immateriality during recording. This is from the same facts revealed in subtitle 3.1 where the item which was to be recorded as capital expenditure was found to be recorded as revenue purchase expenditure. This then shows the extent to which most of persons in accounting and finance section were not competent over use of financial reporting standards, both local and international ones.

The provisions which were to be treated as non distributable income of which were recorded as revaluations in Statement of changes in equity and recorded as provisions, contingent assets and contingent liabilities in accordance to IAS37 were found recorded as general reserve or simply distributable income called profit for the year. While financial reports accounting for all employees' benefits in accordance to IAS29 was to include all employees' welfare such as maternity leave, paternity leave, sabbatical leave, holiday leave allowance and more others such as rental benefits, transport allowance, medical allowance but to find in most cases private firms were not used to provide these employees' benefits. Moreover for those found to be provided were revealed inadequate where some welfares were found missing.

3.3 Fair presentation and quality of financial reports

In here the study motivated at revealing the strength of association between fair presentation and quality of financial accounts. Fair presentation considers use of principles, accounting guidelines and standards in grouping items. Fair presentation is the constitutionalization of the accounting items into its similarities and differences (Vitolla, Raimo & Rubino, 2019). This either has revealed to create a truth basis for undertaking financial comparative analysis between one and another or between one firm and the other. Fair presentation proves for neutrality of the financial information extracted (Wadesango & Ncube, 2020). This then has found to minimize the problem of exaggeration. More facts revealed from the field were extracted and presented in Table 3.

Table 3: Ordinary least square regression analysis results

	Model 1	Model 2
1. Faithful representation	0.024 (0.01)**	0.010 (0.04)**
2. Completeness	0.050 (0.34)**	0.302 (0.13)**
3. Neutrality	0.070 (0.02)**	0.061 (0.12)***
Constant	0.050 (0.07)**	0.010 (0.20)**
N	100	95
UNDUMMY	NO	YES
R	**0.24**	

Note: *p<0.001; **p<0.05 and *p<0.1
Source: Author's computations (2022)

With R=0.024, β =0.01 from model 1 and R=0.010, β=0.04, it shows that faithful representations positively define the quality of financial reports. Faithfull representation creates usefulness of the presented financial accounts. This is from the fact that faithful representation is the disclosure of the economic and other phenomenon that it purports to represent. A faithful representation adheres to substance over form (legal way of accounting). From the shown positivism between the construct faithful representation and production of quality financial reports but the association was not strong showing unfaithful representation committed by most of financial accountants. This is the same what revealed with other constructs i.e. completeness and neutrality of financial accounts/reports.

Given R=0.050, β =0.34 from model 1 and R=0.302, β =0.13, this shows a positive results over completeness of financial information and enrichment of quality of financial reports presented. Completeness entails inclusion of all information that is necessary for fair representation of the phenomenon that it purports to depict. An omission of some information can cause the representation to be false or misleading, and thus not useful to users of general principles of financial reporting.

With R=0.070, β =0.02 from model 1 and R=0.061, β =0.12 from model 2, this indicates that neutrality of financial information define the quality of financial reports. In practice it might be not possible to know or confirm whether information presented is free from material error. However, the information should be neutral and free from errors and missing values (omissions) for it to become useful for users of such information depend on for their concrete and correct decision making. There is no presented financial reports that may become dependable, understandable and use them (it) for undertaking comparative study analysis if it contain bias/wrong items are aggregated or simply the financial figures are exaggerated or prudented.

4.0 Conclusion and Recommendations

Grouping of accounting items into similarities and differences has been a relevant and material approach in realizing optimal use of firms' resources. From the field it was revealed that distinctive treatment of capital expenditures and revenue expenditures lead into appropriate allocation of financial resources. But despite of these goodness of fit but it was revealed that pitfalls over transfers of the items where while the item was to be recorded under capital expenditure account it was found recorded as revenue expenditure and vice versa.

From the revealed discrepancies, then the study suggests the following to different target groups such that the government should enforce adhering to accounting standards, principles and basis when presenting financial reports indeed with public institutions. Indeed, the government should emphasize or enforce the business or financial firms being used to financial reporting standards. Also, the financial/business units should be registered and subjected to statutory operations and financial auditing and the financial/business firms should be emphasized to be used to certified accountants.

Moreover, employers should hire professional and certified accountants. Either it is recommended that employers from statutory public firms should be conducting statutory internal and external auditing for strengths and weakness in treatment of accounting items to be disclosed. Furthermore, employers from private accounting/business firms should be used to effective non-statutory auditing by hiring independent auditor in case of external auditing who also not known or have close family, friend relationship with anyone in the organization especially those in accounting and finance unit/department. To employees indeed those working in accounting unit should be adopted and used to financial accounting standards in presenting financial accounts.

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