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Determinants of Financial Reporting Quality: Evidence from Large Manufacturing Share Companies of Addis Ababa

Kirubel Asegdew

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Statement of Declaration

I, Kirubel Asegdew, have carried out independently a research work on "The determinants of financial reporting quality evidence from large manufacturing share companies of Addis Ababa"in partial fulfillment of the requirement of the M.SC program in Accounting and Finance withthe guidance and support of the research advisor.

This study is my own work that has not been submitted for any degree or diploma program inthis or any other institution, and that all references materials contained therein have been dulyacknowledged.

Name Kirubel Asegdew Advisor's Name Dr. Wollela Y. Yesesgat

Signature---------- Signature----------

Addis Ababa University

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This is to certify that the thesis prepared by Kirubel Asegdew, entitled: The determinants offinancial reporting quality evidence from large manufacturing share companies of Addis Ababa and submitted in partial fulfillment of the requirements for the degree of Master of Science inAccounting and Finance complies with the regulations of the University and meets the acceptedstandards with respect to originality and quality.

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Abstract

Determinants of Financial Reporting Quality: Evidence from Large Manufacturing Share Companies of Addis Ababa

Kirubel Asegdew

Addis Ababa University, 2016

This study intends to assess the determinants of financial reporting quality in large manufacturing share company's in Addis Ababa. Accordingly, the study used documentary analysis of companies' audited financial statements and in depth interview with directors/officials of manufacturing firms. Using simple random sampling method, the study selected a sample of fourteen (14) companies to study them for the period of five years (2010-2014) with the total of 70 observations.

The results of panel least square regression analysis show that: Firm Profitability, Type of Auditor and Share Dispersion, have statistically significant and positive relationship with manufacturing share companies' financial reporting quality. On the other hand, Firm Size has a negative and statistically significant relationship with manufacturing share companies' financial reporting quality. The study suggests, stakeholdersto consider intensive investigation and internal control for low performance and large firm size respectively, further, employing large audit firms improve the quality of information produced.

Keywords: financial reporting quality, firm specific attributes, earning management,

discretionary (abnormal) accrual.

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List of Acronyms

ACCA	Association of Chartered Certified Accountants
AEO	African Economic Outlook
AICPA	American Institute of Certified Public Accountant
BOD	Board of Directors
CF	Cash Flow
CFO	Cash Flow from Operation
CLRM	Classical Linear Regression Mode
ERCA	Ethiopian Revenue and Custom Authority
FASB	Financial Accounting Standard Board
FRQ	Financial Reporting Quality
IASB	International Accounting Standard Board
PPE	Property Plant and Equipment
ROA	Return on Asset

Chapter One: Introduction

Management of a companyis solely responsible in preparing financial information that is capable of influencing decision makers by helping them to form predictions about the outcomes of present event or to confirm or correct prior expectations (Hassan and Bello, 2013).

Across the world, cases of inaccurate financial information have been witnessed with a view of hiding the financial loss, using or diverting funds and overestimating the value of assets with the company. The first decade of the 21st century has thrown up an impressive string of accounting and financial scandal. Most highly published case of the financial statement manipulation involves, starting from Enron, HealthSouth, Tyco and WorldCom to AIG, Lehman Bros., Bernie Madoff and Satyam (great finance and accounting scandal, 2015).

A company must prepare financial information with higher quality. Financial reporting quality (FRQ) is the faithfulness of the information conveyed by the financial reporting process. It is generally accepted that certain characteristics of the company have an impact on the level and the quality of financial information disclosed. However, what firm-specific characteristic is supposed to influence the level and the quality of financial information disclosed?

There are several underlying firm characteristics that differ across firms. Previous research has shown that firms engaging in earnings management activity are often with low leverage, less Board composition, lower performance, less liquidity, small firm size, small audit firm size and less share dispersion.

Agency theory argues that the information conveyed in the financial reportswill be at a better quality if agent relationship is in the corner. If a company have high long term loan, large audit firm and dispersed shareholder, it is likely to produce a better quality report. Signalling theory also indicate that a firm will be eager to signal its profit with a quality financial report and uses large size audit firm to signal it.

In the literature we find considerable research on determinants and consequences of FRQ.Since FRQ cannot easily be quantified or observed directly, this studies

suggestseveral proxies. As far as the case of Ethiopia is concerned the choice of FRQ measure robustly depends on the current economic structure of the country. Considering the absence of secondary capital market, the nature of research project at hand and the popularity of Earnings management model in the literature (see Hassan and Bello2013; Ferrero 2014; Madawaki and Amran 2013; Samaila2013; Ma Tao 2012; Hassan 2013), this research measured FRQ by abnormal earning management (modified Dechow and Dichev (2002) model).

The Ethiopian financial reporting environment have shown a remarkable development. Based on the recommendations of studies (Observance of Standards and Codes (ROSC), 2007; Ministry of Trade and Industry, 2005), the government has established Steering committees, passed financial reporting Proclamation and drafted the establishment of a professional body (Jember, 2014).

Several research has been conducted on FRQ in the reset of the world. Those studiesshow inconsistency and even difference result. Aboneh (2011) studied FRQ in Ethiopia. The study failed to fill the knowledge gap in the area by only focusing on private ownership and ignoring other firm related variables. This study brings insight for both managers, regulators and company stakeholders as to knowing what firm specific variables will influence FRQ.

Therefore,the study is centredon investigating whether financial reporting quality of large manufacturing share companies in Addis Ababa are likely to be influenced by their level of leverage, board composition, firm profitability, liquidity, size, type of auditor and shares dispersion.

The remainder of this chapter is organized as follows. Section 1.1 presents the statement of the problem. Section 1.2 presents objective and hypothesis of the study. Section 1.3 presents research methodology used. Section 1.4 presents the scope of the study. Section 1.5 presents significance of the study. Finally, Section 1.6 presents organization of the study.

1.1 Statement of the Problem

The goal of investors in a private, profit seeking enterprise is to maximize their wealth which means maximizing the present value of the future cash flows. For

more wealth maximizing Investors, investment decision requires information that would enable them predict the future cash flow from the investments and the associated risks volatility (Grace and Ambrose 2013). Investors receive the information they need to evaluate an investment's future cash flows and risks from financial reports. The quality of this reports will strongly influence the decision made by the investors.

FRQ requires companies to voluntarily expand the scope and quality of the information they report, to ensure that market participants are fully informed in order to make well-grounded decisions on investment, credit, etc. This high quality information facilitates greater transparency and this greater transparency reduces the information asymmetries and satisfies investors and stakeholders' needs.

Lambert, Leuz and Verrecchia (2007) obtained empirical evidence that the quality of accounting information can influence the cost of capital, both directly, by affecting market participants' perceptions about the distribution of future cash flows, and indirectly, by affecting real decisions that alter the distribution of future cash flows. Chen et al. (2011)found that FRQ positively affects private firm's investment efficiency in emerging markets and that this effect enhances bank financing and decreases incentives to minimise earnings for tax avoidance purposes.

It has been noted in different literatures that firms tend to manipulate financial information to meet investors expectation or to reduce other financial burdens from authorities. Hassan and Bello (2013) stated that when operating performance is poor, managers tend to increase earnings, however, if operating performance is extremely poor, some firms may decrease income further which is so called „taking bath" strategy. Studies like Hassan et.al. (2006) implied that firm's quality of financial statement will most likely be influenced by the capital structure choice they make. Adelopo (2010) stated that the more leveraged the manufacturing firms are the higher quality their earnings will be.

The other performance factor influencing FRQ is liquidity, Easley and O'Hara, 2004 noted that the more liquid the firm is the information presented will be at better quality. Another factor pointed out in the literature is board composition expressed

by independent directors. Hassan and Bello (2013) argued that independent directors are free from managerial influence and capable of monitoring them efficiently which improve the quality of financial information conveyed to the users of financial statement. Firm size, type of auditor and share dispersion are also among the determinant factors of higher reporting quality as noted by Surroca, Tribo and waddok (2010);Ali, Ahmed & Henry (2004); Ray & Gupta (1993).

Let alone Ethiopia, which had problematic accounting and reporting practice, countries with advanced practices couldn't stop their high profile companies from falling (Leilina, 2015).

IMF ranked Ethiopia as among one the five fastest growing economies signifying 11th consecutive year economic growthposting 10.3% growth in 2013/2014(AEO, 2015). Currently the government is promoting private investment and the economy is expected to shift from being agrarian to industrial at the end of the second GTP. In 2013/14 the industrial sector contributed 14% of the country's GDP, signifying the highest (21.2%) growth from other sectors (MoFED, 2014).

Considering this economic shift, huge investment is expected on the manufacturing sector. So to support and protect this huge investment in manufacturing sector the financial information in the sector must provide accurate, reliable and relevant facts to help the investors predict the future cash flow and risk associated with their investment.

The current financial reports produced by different institutions in Ethiopia are based on different standards, it mainly resulted from lack of professional bodies and regulatory institutions in charge of regulating the accounting and auditing profession. The financial reports provided by these companies is not accepted by government and banks (World Bank, 2007).

On the World Bank, (2007) report, it was noted that tax authorities and businesses do not easily agree on the financial statements for tax purposes. The Business people argue that tax authorities do not trust their financial statements. Whereas Tax authorities stated that they encounter financial statements prepared on a wide range

of bases and it is not in compliance with the tax law. This situation is inefficient and burdensome to both parties as there has to be a lot of vouching by the tax authorities and a lot of negotiations between the parties. Even the financial reports prepared are considered to some extent, secondly after collateral with bank authorities for credit purpose.

Therefore, given such a unique reporting environment characterized by regulatory laxities in the accounting profession, and lower reporting quality concern afforded in the country, it is imperative to investigate the factors that determine financial reporting quality and its implication in the Ethiopian manufacturing companies' context. Considering the inevitable and high need of financial statement quality in the Ethiopian economy, this study investigated the most important variables that can be considered when understanding the quality of financial statements.

1.2 Research Objective and Hypotheses Development

The major objective of this study was to assess the determinants of financial reporting quality in Addis Ababa large manufacturing share companies. Based on the firm specific factors that are found to significantly influence financial report quality in prior studies, the study assessed factors that manufacturing companies must consider in determining the quality of financial reports.

Specifically, the study assessed whether financial reporting quality is influenced by level of leverage, board composition, firm profitability, liquidity, firm size, type of auditor and shares dispersion.

Hypotheses Development

To achieve the objectives of this study the following hypotheses are derived from the literature to give comprehensive factors that explain the variations of financial reporting quality in Addis Ababa manufacturing share companies.

FRQ Vs Firm Leverage

Agency theory has largely been used also to explain the relationship between firm leverage and financial reporting quality. According to the agency theory (Jensen and

Meckling, 1976), a company with a higher debt ratio has an incentive to disclose more information. Empirical evidence appears to be inconclusive for some cases. While Hossain, tan and Adams (1994), Naser, Al-Khatib and Karbhari (2002), Hassan, Percy and Stewart (2006)and Adelopo (2010) have all found a positive relationship between leverage and financial reporting quality, many researchers have not found the positive relationship (Camfferman and Cooke, 2002; Ali, Ahmed & Henry 2004; AlSaeed, 2006). On the other hand, Zarzeski (1996) and Ahmed (2012) found a negative relationship between leverage and disclosure, suggesting that highly leveraged companies tend to disclose private information to their creditors which may not be reflected in their annual reports. These conflicting results provide genuine incentives for further investigation of this relationship. From the above theoretical explanations, we anticipate that the relationship between the quality of financial reporting and leverage is positive.

H1: Financial reporting quality is positively related to firm leverage.

RFQ Vs Board Composition

Independent directors can be officers of others companies or representatives of financial institutions. Based on their experience, independent directors can contest decisions made by managers and therefore exercise more effective control. The relationship between the proportion of independent directors on the board and financial disclosure quality within the company was provided by Haniffa and Cooke (2002) and Hassan and Bello, (2013). They found a positive effect of the existence of independent directors on the disclosure of financial information. Based on these explanations, our hypothesis is as follow:

H2: Financial reporting quality is positively related to board composition.

FRQ Vs Profitability

The signalling theory suggests that if a company is profitable, it could disclose more information to indicate the credibility of its reported earnings, to increase its reputation and to avoid undervaluation of its equity (Inchausti 1997). Firms‟ profitability has also been argued to have an influence on the quality of financial

reporting. Alsaeed (2006) argued that a profitable firm may feel proud of its achievements and therefore would wish to disclose more information to the public in order to promote positive impressions of its performance. However, even though studies by Raffournier (1995) and Patton & Zelenka (1997) did find a significant positive relationship, a study by Alsaeed (2006) on the other hand, had found insignificant relationships. The above arguments lead us to predict a positive relationship between profitability and financial disclosure.

H3: Financial reporting quality is positively related to firm profitability.

FRQ Vs Liquidity

Economic theory suggests that voluntary disclosures and increased information quality reduce information asymmetries. This reduction in information asymmetries increases the firm's liquidity (Hassan and Bello, 2013; Easley and O'Hara, 2004). Overall, the empirical evidence suggests that disclosures and accounting information of higher quality are related to improved liquidity. This variable, which is widely associated with the accounting result, allows companies to enjoy a higher liquidity when better financial performance is achieved.

H4: Financial reporting quality is positively related to firm liquidity.

FRQ Vs Firm Size

Positive accounting theory provides arguments in respect of the size of entities and its relevance for disclosures in financial statements. According to Leftwich, Watts and Zimmerman (1981) political costs are higher for large companies, disclosing more information in order to increase confidence in their affairs. Large companies have superior information systems providing them with additional information at no cost. According to the proprietary cost theory developed by Verrecchia (1983) and Dye (1985) the management quantifies the costs and benefits of disclosing information and decides not to disclose if the costs exceed the benefits. Larger firms are incentive to show a positive effect on reporting quality (Prior, Surroca and Tribó, 2008; Surroca, Tribo and waddok 2010).

H5: Financial reporting quality is positively related to firm size.

FRQ Vs Type of Auditor

Audit function has a key role in the control of the management of companies where the owners do not provide stewardship. An external audit can significantly influence the amount of information disclosed. This relationship is consistent with agency theory; an audit firm with large size has a strong incentive to maintain their independence and to impose more stringent disclosure standards because they have more to lose from damage to their reputation. The large audit firms invest more to maintain their reputation as providers of effective control that small audit firms (DeAngelo, 1981).

Signal theory suggests that the choice of an external auditor can serve as a signal of the value of the company. In general, entrepreneurs are likely to choose a large audit firm size (eg, Big 4) because it is a signal to investors. The choice of audit firm has been found to be a signal of firm value. The presence of big audit firm is considered as a signal quality of the disclosure of the company and the integrity of financial information (Datar, Feltham and Hughes, 1991). However, the empirical researches of associations between the size of engaged audit firms and the quality of disclosures in financial statements for different authors provide different results. Ahmed and Nicholls (1994) and Wallace and Naser (1995), find a positive relationship between the size of the audit firm and the quality of disclosures in financial statements, however Firth (1979), Malone, Fries and Jones (1993), Ali, Ahmed & Henry(2004) in their research find no evidence of statistically significant relationship.

H6: Financial reporting quality is positively related to type of auditor.

FRQ Vs Share Dispersion

The agency theory suggests that in a modern society, due to the separation of ownership and control, there is a possibility of agency conflicts (Jensen and Meckling, 1976). This conflict may be more important when shares are widely distributed than when they are held by one person (Fama and Jensen, 1983). Managers can therefore voluntarily disclose information as a means to reduce agency conflicts with the shareholders. According to the agency theory (Leftwich,

Watts and Zimmerman, 1981) or transaction costs theory (Ray & Gupta, 1993), annual reports is a main source of information for shareholders who cannot incur large expenditures in order to ascertain manager's opportunistic behaviours. Managers of firms whose ownership is diffuse have thus an incentive to increase disclosure quality in order to help shareholders in monitoring their behaviour. A stronger ownership diffusion should weaken secrecy traditions. so it is assumed that higher owner diffusion will improve reporting quality.

H7: Financial reporting quality is positively related to share dispersion.

1.3 Significance of the Study

The central purpose of this research study is to find out the determinants of financial reporting by gathering evidence from manufacturing share companies found in Addis Ababa with deeply investigating large tax payers. In turn, the findings of the research add to the existing knowledge on the area of reporting quality. Specifically, this study is significant in the sense that:

- ✓ Create meaningful awareness among the concerned body such as the finance managers of firms in manufacturing industry about financial reporting for optimal reporting quality.
- ✓ The study finding helps scholars to seek more knowledge about the reporting quality in many other industries in order to shot light on reporting quality for sound financial reporting.
- ✓ The findings are also helpful in building on the already existing literature about determinants of financial reporting quality and it shows the ability of the model used to capture financial reporting quality.
- ✓ The policy makers and the government can use the study findings in building and widening the awareness of financial reporting quality. Further, since the country is adopting the first accounting and reporting standard, it will be helpful in identifying the company specific factors influencing the reporting quality when monitoring its implementation.

1.4 Scope and limitation of the study

The scope of this study was limited to the relationship between FRQ and determinants of FRQ of large manufacturing share companies in Addis Ababa. The study focused on manufacturing companies because the sector is showing high growth and the government is giving special attention to the sector. Further unlike financial institution the sector was receiving low regulatory provision on the preparation of financial statements. The study used a seven year (2009-2015) data to predict financial reporting quality for five years (2010-2014) using modified Dechow and Dichev (2002) model (the model use cash flow(CF) from prior, current and future period, change in revenue and property, plant and equipment (PPE) to predict FRQ for one period). The conclusion was on five-year period because the sector was on a tremendous growth during that period. The growth rate of this sector was 13.4% on average from 2009 to 2013 (MoFED Report, 2009 to 2013). The major limitations that hamper the study were resource constraint, lack of organized database for manufacturing share companies financial report and unavailability of active secondary market to measure the dependent variable.

1.5 Structure of the Study

The Final paper is organized into five chapters. The first Chapter presents introduction of the study. The literature review part of the study is presented in the second chapter. The review of the literature includes the theoretical review in its first section which is followed by the review of the previous studies related to the area and conclusion and knowledge gap finally. The third Chapter presents the research design and methodology. This is followed by an analysis of the results and discussion part of the paper in the fourth chapter. Finally, the fifth chapter presents the conclusions and recommendations.

Chapter Two: Literature Review

Introduction

The first chapter introduced the problem to be investigated in this study along with purpose and research hypothesis. In order to put the study within the context of the existing literature, the subsequent sections of this chapter present the theoretical review, empirical review and gap identification.

2.1 Theoretical Review

The theoretical review aims at giving the meaning of a basic terminologies, theories and creating a comprehensive theoretical framework for the study. The following sub sections will present definition of financial reporting quality, objectives of financial reporting and review these theories that help in defining and understanding determinants of financial reporting quality.

2.1.1 Definition of Financial Accounting Quality

The value of financial accounting is generally determined by its quality (Pounder, 2013). The central concept of financial accounting quality is that some accounting information is better and more reliable than other accounting information in relation to its characteristic of communicating what it purports to communicate. That is why,accounting quality is of great interest to several types of users involved in the financial reporting chain.

The term of financial accounting quality has no single, widely accepted definition. We can find a large amount of definitions, which vary significantly across individuals, projects, companies and organizations, depending also on the purpose for which the financial information is to be used.

Studying the literature, we can see that on the one hand, accounting quality can be seen as the precision with which the financial reports convey information to equity investors about the firms expected cash-flows (Biddle, Hilary and Verdi 2009). On the other hand, reporting quality refers to the extent to which financial reports of a

company communicate its underlying economic state and its performance during the period of measurement. (Elbannan, 2010).

Biddle, Hilary and Verdi (2009) defines financial accounting quality as the precision with which financial reports convey information about the firm's operations, in particular its cash flows, in order to inform the equity investors. Tang, Chen and Zhijun (2008) define financial reporting quality as the extent to which the financial statements provide true and fair information about the underlying performance and financial position. Anyway, a commonly accepted definition is provided by Jonas and Blanchet (2000), who argue that quality financial reporting is full and transparent financial information that is not designed to obfuscate or mislead users.

The role of financial reporting is complex and, according to financial accounting standard board (FASB), it aims to provide even handed financial and other information that together with information of other sources facilitates the efficient functioning of capital and other markets and assists the efficient allocation of the scarce resources in the economy. Therefore, the concept of financial accounting quality is broad and includes financial information, disclosures and non-financial information useful for decision making(Tasios and Bekiaris, 2012).

Many times, accounting quality is defined using its characteristics. In this context, prior literature research shows that key determinants of financial reporting quality include legal system, source of financing, characteristics of the tax system, involvement of the accounting profession, economic development and accounting education. The quality of financial reporting is a broad concept which has a series of diverse measurable attributes. Anyway, one property of accounting which is frequently mentioned in support of harmonization is comparability. It cannot be clearly concluded if harmonization results in significantly greater comparability across countries. That is why, this aspect is intensively studied and the results are still very different, causing diverse points of view upon this subject. We will try to clarify what are the characteristics of financial accounting information that makes it of good quality.

In order to have a certain degree of quality, financial statements should meet certain qualitative criteria. These criteria are stated by both boards of IASB and FASB in their conceptual frameworks, where they conclude that high quality is achieved by adherence to the objective and the qualitative characteristics of financial reporting information (IASB, 2008).

2.1.2 The Objectives of Financial Reporting

FASB on its Statement of Financial Accounting Concepts (2008) have stated the objectives of financial reporting. The objectives of financial reporting underlie judgments about the qualities of financial information, for only when those objectives have been established can a start be made on defining the characteristics of the information needed to attain them. In Concepts Statement 1, the Board set out the objectives of financial reporting for business enterprises that will guide it. The information covered by that Statement was not limited to the contents of financial statements. "Financial reporting," the Statement said, "includes not only financial statements but also other means of communicating information that relates, directly or indirectly, to the information provided by the accounting system—that is, information about an enterprise's resources, obligations, earnings, etc."

The objectives of financial reporting are summarized in the following excerpts from the Statement:

- ✓ Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.
- ✓ Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. The

prospects for those cash receipts are affected by an enterprise's ability to generate enough cash to meet its obligations when due and its other cash operating needs, to reinvest in operations, and to pay cash dividends and may also be affected by perceptions of investors and creditors generally about that ability, which affect market prices of the enterprise's securities. Thus, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.

- ✓ Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change resources and claims to those resources.
- ✓ Financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' and creditors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance.
- ✓ The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components.
- ✓ Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distributions of enterprise resources to owners, and about other factors that may affect an enterprise's liquidity or solvency.
- ✓ Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it.

- ✓ Financial reporting should provide information that is useful to managers and directors in making decisions in the interests of owners.

2.1.3 Related Theories

This section presents theories that help in understanding determinants of financial reporting. The existence of a theory requires us also to use our reasonable expectations about objects. Hendriksen (1970) defines theory as a coherent set of theoretical, conceptual and pragmatic principles forming the general framework of reference for a field of inquiry. Theory is not considered just a simple 'hunch' and it is not a ready concept to be used on demand or when exceptional scenarios exist.

A review of the literature indicates that five main theoretical frameworks have been used to explain and analyse the association between financial reporting quality and its determinants. These are Agency theory, Signalling theory, Legitimacy theory, Proprietary costs theoryand Positive Accounting Theory: Political Costs.

Thus, each of the aforementioned theories related to financial reporting quality and its determinants are discussed in detail in this particular section in an orderly.

2.1.3.1 Agency Theory

Agency theory is considered to be a contract between shareholders (principals) and external auditors to control the work of other agents (management). Shareholders (principals) delegate tasks to be performed by management (agents). Tasks cover mainly operating the organization on behalf of shareholders to meet their objectives. The most important basis of agency theory is that the managers are usually motivated by their own personal gains and work to exploit their own personal interests rather than considering shareholders' interests and maximizing shareholder value. Whereas stakeholders act in a relational way to maximize their personal utility (**Toukabri, Ben and Julani, 2014**).

The agency relationship leads to the information asymmetry problem due to the fact that managers can access information more than shareholders (Nermeen, 2014). This will allow pursuit of self-interest which increases costs to the firm, which could

include the costs of the formation of contracts, loss due to decisions being taken by the agents and the costs of observing and controlling the actions of the agents. Leuz, Nanda and Wysocki (2003) assert that the effects of such behavior ultimately reflect in the company earnings.

Consequently, management has an incentive to manage the company's reported earnings in order to meet or beat earnings targets and, thus, to receive any bonuses that may be tied to the company's earnings (performance-related pay). This creates an information asymmetry in that managers can exercise the discretion they have on accruals, which in turn reduces the relevance and reliability of reported earnings, and the whole financial statements. (Leilina, 2015)

Davidson, Goodwin and Kent (2005) argues that when management provides inaccurate financial reporting information, it introduces earnings management as a type of agency cost. As a result, managers cannot be fully trusted. Therefore, strict monitoring of managers by the principals or external auditors is seen as fundamental to protecting shareholders' interest from being compromised when managers maximize their self-interest at the expense of the organization's profitability. Thus, the key predicament indicated by agency theory is ensuring that managers pursue the interests of shareholders and not only their own interests.

Most of researchers that examine the determinants between financial reporting quality relied upon agency theory (Ahmed, 2012; Hassan and Bello, 2013; Michailesco, 2010; Fathi, 2012; Dechow, Ge and Schrand, 2010)

Disclosure literature theoretically hypothesises and empirically examines agency cost. Some authors apply firm size as a proxy for agency costs and assume a positive association between disclosure and firm size. The ownership structure variable is also examined widely in the literature as a proxy for agency cost. The literature hypotheses there is a positive association between the ownership diffusion pattern and agency cost. They assume that shareholders will put more pressure on the managers in order to disclose more information. Another proxy for agency cost is audit type. Some authors argue that the monitoring role is fulfilled by the auditing role. They assume that the better the quality of auditor, the more adequate and

increased the information will be. A company's financial leverage is also applied as a proxy for agency cost in the disclosure literature. Some authors argue that leverage represents the agency cost between debtholders and managers or shareholders and therefore such association will be reflected in disclosure practice (Abdulla, 2011).

2.1.3.2 Signalling Theory

The signalling theory argues that the existence of information asymmetry can also be taken as a reason for good companies to use financial information to send signals to the market (Ross 1977). Information disclosed by managers to the market reduces information asymmetry and is interpreted as a good signal by the market (Teixeira and Lima). Although the signalling theory was originally developed to clarify the information asymmetry in the labour market (Spence, 1973), it has been used to explain voluntary disclosure in corporate reporting (Ross, 1977).

Empirically, several studies have studied signalling influence on disclosure: Watson, Shrives and Marston (2002) and Haniffa and Cooke (2002).

The disclosure literature identifies several variables as a proxy for signalling theory including profitability, liquidity and leverage. The theory argues that directors who believe their company can perform better than other companies will want to signal this to shareholders in order to attract more investments. Directors may do this in a sort of disclosure in excess of any information that is required by regulations. Signalling theory suggests that when a corporation's performance is good, managers will signal companies' performance to their investors, stakeholders and the market by making disclosures that poorer companies cannot make. By enhancing disclosures, directors wish to receive more benefits: a better reputation and the firm's value will increase (Abdulla, 2011). In contrast, firms with poor performance may choose to keep silent rather than reveal unflavoured performance. However, investors may misinterpret this silence as withholding the worst possible information (Verrecchia, 1983).

2.1.3.3 Legitimacy Theory

According to Toukabri, Ben and Julani (2014) the theory of legitimacy is based on two fundamental ideas; companies need to legitimize their activities, and the process of legitimacy that confers benefits to businesses. Thus, the first element is compatible with the idea that social disclosure is related to the social pressure. In this context, we say that the need for legitimacy is not the same for all companies due to the degree of social pressure to which the company is exposed, and the level of response to this pressure.

There are a number of factors that determine the degree of social pressure on companies, and responses to that pressure. These factors are potential determinants of corporate social disclosure. The second component is based on the idea that companies can expect to benefit by a legitimate behavior based on the social responsibility activity.

Since the objective of accounting is providing users with information that help in decision-making, i.e., satisfy social interests, the theory has been integrated in accounting studies as a "means of explaining what, why, when and how certain items are addressed by corporate management in their communication with outside audiences" (Magness, 2006). Those external perceptions about companies could be ways by the management of corporate disclosure policies (Deegan, 2002). Then the companies could have a strategy legitimacy and choice and change their legitimacy status and consequently the external perceptions (Aerts and Cormier, 2009).

Normally the legitimacy theory is used to explain social and environmental reports disclosure. But the legitimacy theory can be used in corporate report, suggested by Woodward, Edwards and Birkin (1996), as one possible legitimacy/accountability reporting framework, to communicate with the shareholders and clarify the importance of this relationship. Damaso and Lourenco (2011), has concluded that the organizational legitimacy is a useful concept to explain corporate report behaviour.

2.1.3.4 Proprietary Costs Theory

Teixeira and Lima (2007), stated that proprietary costs theory considers the costs of disclosures as well as its benefits. Managers take into account the costs of disclosing information and do not disclose when costs outweigh the benefits. These costs include not only those of preparing and disseminating the information, but also costs of appropriation of the information by competitors. Investors know this and do not apply adverse selection. Proprietary cost theory applied to disclosure is analytically developed by Verrecchia (1983), Dye (1985), Darrough and Stoughton (1990) and Wagenhofer (1990).

2.1.3.5 Positive Accounting Theory: Political Costs

PAT is concerned with predicting actions such as the choices of accounting policies by firm managers and how managers will respond to proposed new accounting standards. The term "positive" refers to a theory that attempts to make good predictions of real world events (Scott, 2003). Watts and Zimmerman (1978) develop a positive theory of the determination of accounting standards. This theory was developed in a deductive and normative interaction, and considers that the choice of accounting methods by companies is a reflection of agency relationships within the enterprise, and political costs they may incur.

The main results presented by Watts and Zimmerman showed that the accounting disclosures published by companies have information content for the financial markets. Thus, the results unanticipated by the market produce abnormal returns in the same direction and with variations connected. However, Watts and Zimmerman point out that financial and extrafinancial disclosure have no informational content to the extent that they provide information about the cash flows of companies.

Hassan (2008) argues that PAT helps to explain how a conflict of interest between managers, shareholders and debtholders influences the corporation's accounting practices.

According to the politico-contractual theory highly leveraged firms adopt accounting methods that increase their profits. In the same line of ideas, Toukabri,

Ben and Julani (2014) argue that firms that undertake specific expenditures putting out their commitment in social responsibilities, have a primary objective of change in accounting period results and clauses in their contract debt.

2.2. Empirical Review

Ahmed (2012) conducted a study on disclosure of financial reporting by focusing on Firm Structure as a Determinant of Bangladesh quoted manufacturing firms. The study used Firm size (measured by logarithm of total asset), leverage (measured as the ratio of total non-current liabilities to owners' equity and long term liabilities) and share dispersion (logarithms of number of shareholders) as independent variable. Whereas financial reporting quality is measured by modified EBO. The data is extracted from 12 sample firms representing the all quoted manufacturing companies in Bangladesh as the population of the study. Multiple regressions are used as a tool of analysis for the study.

The result reveals a positive strong relationship between firm structure and financial reporting quality of quoted manufacturing firms in Bangladesh. And also the study found significant positive relationship between quality of financial reporting and firm size and significant relationship between share dispersion and quality of transparency in the annual reports.

It is therefore, recommended among others that the regulators should enforce more on the financial statements disclosure and transparency among companies quoted on the DSE as to ensure a higher quality of financial reporting.

Hassan and Bello, (2013) have studied the effect of firm characteristics on financial reporting quality of listed manufacturing firms in Nigeria. This study investigated firms' characteristics from perspective of structure (using firm size and leverage as proxies), monitoring (using board composition and institutional shareholding as proxies) and performance elements (using profitability, liquidity and growth as proxies). The quality of financial reporting measured by modified model of Dechew and Dechev (2002) of listed manufacturing firms in Nigeria. The study adopted

correlational research design with pooled balanced panel data of 24 firms served as sample of the study using multiple regression as a tool of analysis.

The result reveals that larger and more leveraged firms in Nigerian manufacturing sector are less likely to manage earnings and increase in sales as well as institutional

investors serve as a monitoring tool of preventing managers from opportunistic behaviour in managing earnings. In addition, profitability and independent directors are positively associated with earnings quality while liquidity is inversely related with quality of financial reporting despite significant at 1% level of significance. In sum, firm characteristics of listed manufacturing firms in Nigeria have impacted significantly on their financial reporting quality.

Therefore, it is recommended among others that the shareholders of Nigerian listed manufacturing firms should ensure all the seven firm characteristics used in this study keep on improving to decrease manipulative accounting and increase the quality of financial reporting.

Michailesco (1999) conducted a study aiming to relate the quality of disclosure in the annual reports of French listed companies to possible determinants representing agency theory. The sample includes 100 industrial and commercial companies whose corporate reporting have been studied from 1991 to 1995. The quality of disclosure is measured by an index based on the expectations and opinions of French financial analysts concerning the information disclosed today. Independent variables are measures of ownership diffusion, use of external financing, domestic share listing, multiple share listing and profitability. Relations are assessed using univariate analyses and multiple regressions.

Only domestic and multiple listing status play a significant role in the disclosure quality over the 1991 1995 period. As disclosure requirements justify this influence, it suggests that compliance with those requirements is considered to be enough to solve agency problems. Ownership diffusion has no influence on disclosure quality and leverage has a significant influence only in 1995. Nevertheless, since 1993, as the influence of these variables is getting stronger, it indicates a trend toward a better

transparency in French companies' reporting practices. Profitability has no influence on disclosure quality. So the results provide new insight into French reporting practices and suggest topics for additional research.

Mensah and Deajeon (2013) studied the quality of financial reports before and after adopting IFRSs in Ghana, and also the influence of firm-specific characteristics. The firm specific variables used in the study are firm size, profitability, debt equity ratio, liquidity and audit firm size on the quality of financial information disclosed by firms listed on the Ghana Stock Exchange. The research was conducted through detailed analysis of the pre-official adoption period, (2006) and post adoption period, (2008) financial statements of the listed firms. This study used regression analysis which forms the main data analysis.

The results of the quality of financial information for the two years indicate that the quality of financial reports has improved significantly after adopting IFRSs. The study thus confirms that the implementation of IFRSs generally reinforce accounting disclosure quality. It also indicates listed firms' overwhelming compliance with the IASB's IFRS Framework. The results of the multiple regression analysis show that company size, represented by net assets and Auditor type were found to be associated at a statistically significant level with the quality of financial information disclosed. With the improvement in the quality of the financial reports after adopting IFRS users are assured of useful information for financial decision-making.

Fathi (2013) examined the relationship between the quality of financial information disclosed and governance mechanisms. The measures of governance used are certain features of the board, ownership structure and control system. The study used French companies listed on the SBF 250 for a period of five years from 2004 to 2008. The quality of financial information is approximated by the discretionary accruals and with a disclosure index with 78 items.

The results show that the size of the Board, attendance of members at meetings of the Board, the presence of the auditors belonging to the big 4 and the presence of a double listing have a positive impact on the quality of information financial disclosed.

Atanasko (2013) studied to examine the degree and quality of disclosures of financial information related to fair value by Macedonian listed entities and associations with several corporate attributes. An un-weighted disclosure index comprising 51 disclosed information in audited financial statements of 32 listed entities for 2010 was composed. The association between the disclosure index of each company and various corporate characteristics have been considered. The study used multiple regression analysis to capture the effect of size, industry, ownership concentration, type of auditor, internationalization, and leverage on disclosure index.

Based on the results of the two regression analysis, three of the hypothesis can be statistically confirmed. The first hypothesis H1 according to which there is positive relationship between the degree of disclosures of fair value in financial statements and the size of the company, audit firm part of international network and leverage. The research also reveals areas of improvement for listed companies reporting of fair value information in financial statements.

2.3 Conclusions and Knowledge Gap

Financial reporting quality has been the focus of theoretical and empirical auditing research. Plenty of studies investigated the determinants of a financial report quality in different countries only a limited study had been conducted in the area from developing countries as far as the researcher knowledge is concerned e.g. Nigeria, Ghana. Again, prior researches have documented inconsistent results on the evidence of the linkage between financial reporting quality and its proxy.

In the context of Ethiopia, the related study conducted by Mekonnen (2011) assessed the impact of private ownership on financial reporting quality in privately owned companies in Addis Ababa-Ethiopia. This study limits its scope only on investigating financial reporting quality based on the qualitative characteristics of financial reporting information on an improved conceptual framework for financial reporting of the FASB and the IASB (2008) from the point view of auditors' perceptions. Besides, the study of Mekonnen (2011) fails to disclose the impact of some very important variables on Ethiopian privately owned companies' financial

reporting quality such as company size, leverage and audit firm related factors among others.

That means this study clearly fails to fill the knowledge gap that exists in the area as far as it considers only one variable (private ownership) and ignores other firm related variables affecting financial reporting quality.

Researches in the area is very useful in giving an insight for both managers and company stakeholders as to knowing the determinant factors affecting financial reporting quality. It will also help regulatory and professional bodies to properly monitor the accounting profession and to maintain trust among the various stakeholders. Therefore; it would be worthwhile to ask the firm related attributes that are considered to be the determinant factors affecting financial reporting quality in Ethiopia. Besides, the relationship between firm determinant factors and financial reporting quality (measured by earning management) has not been empirically researched for the Ethiopian. Thus, this paper speaks directly to such issues using manufacturing share companies in Addis Ababa-Ethiopia.

Chapter Three: Methodology

Introduction

This chapter specifically gives a brief description of the research method that is employed to capture determinant factors of financial reporting quality. This include research approach, research approach adopted andrelation between research hypotheses and data sources. A detail description of mixed research design tools with their sample and sampling procedure, sources of data and the data collection procedures, type of data analysis, model specification and variable description are also discussed.

3.1 Research Approaches

As noted by (Zikmund and Griffin 2009) research design is a master plan that specifies the methods and procedures for collecting and analysing the needed information. As well, research design provides a framework or plan of action for the research. Research design is classified into: quantitative research design, qualitative research design and mixed research design.

Quantitative research is the systematic and scientific investigation of quantitative properties and phenomena and their relationships. As noted by (Greener 2008) quantitative research is associated with a deductive approach to testing theory, often using number or fact. Jonker and Pennink (2010) contended that the essence of quantitative research is to use a 'theory' to frame and thus understand the problem at hand. It is grounded in the basic attitude that knowledge about reality can also be obtained 'through the eyes of the researcher'. It is he who elaborates theory based on findings. In order to make thishappen, theory is most often translated into a conceptual model and elaborated predominantly by means of hypotheses. For the researcher conducting quantitative research it implies the need to carefully operationalizing a theory and subsequently measuring it by means of variables and questions.

Qualitative research is an inquiry process of understanding" where the researcher develops a "complex, holistic picture, analyses words, reports detailed views of informants, and conducts the study in a natural setting (Creswell 2009). It involves studies that do not attempt to quantify their results through statistical summary or analysis. Qualitative research seeks to describe various aspects about behaviour and other factors studied in the social science. In this approach, the bottom up or inductive exploratory method is used; it is used primarily for the purposes of description and exploration and to gain an understanding of how people think and experience their lives. In qualitative research, data is collected from those immersed in everyday life of the setting in which the study is framed. It is based on qualitative data which during analysis are examined for patterns, themes, and holistic features. A narrative report is presented and generalization is usually not a goal because the focus is on the local, the personal, and the subjective.

Mixed research: is the third and newest research methodology paradigm. It tries to mix the best of qualitative and quantitative research into research studies. Philosophically, mixed research takes an eclectic, pragmatic, and common sense approach, suggesting that the researcher mix quantitative and qualitative in a way that works best for the given research question being studied in a particular context.

Mixed research uses both deductive and inductive methods, obtains both quantitative and qualitative data, attempts to corroborate and complement findings, and takes a balanced approach to research. A mixed methods approach is one in which the researcher tends to base knowledge claims on pragmatic grounds (e.g., consequence-oriented, problem-centred, and pluralistic).

3.2 Research Approach Adopted

The major objective of this panel study was to assess the financial reporting quality determinants in Ethiopian manufacturing firms based on factors which are found to significantly influence financial reporting quality in prior studies. The research problem tends to be explanatory which seeks to explain the relationship between financial reporting quality and firm level factors. Therefore, the research used a

mixed research approach. Mixing quantitative and qualitative data sequentially helped the study, to understand a research problem more completely (Creswell, 2009).

By using the mix of qualitative and quantitative approach, the study followed explanatory design. Explanatory research aims at establishing the cause and effect relationship between variables. The researcher used the facts or information already available to analyse and make a critical evaluation of the data. These research designs were appealing for this study to achieve the objectives of the study and to test the hypothesis.

The study employed strategies of inquiry that involve collecting data sequentially to best understand research problem. The data collection also involved gathering both numeric information (document review) as well as text information (e.g., on interviews) finally the database represented both quantitative and qualitative information.

3.2.1 Research Design

The study adopted a mixed research design which is a combination of qualitative and quantitative design. The following section will present a detail of each methods with their data type, data source, data collection method, Sampling frame, sample size and sample selection methods employed.

3.2.1.1 Quantitative Design

The study used both primary and secondary data, for the purpose of the quantitative analysis secondary data is used. The secondary data is collected from manufacturing share companies in Addis Ababa, Ethiopia with audited financial statements. For this study, 7 years' data (2009-2015 inclusively) is considered. The data related to manufacturing share companies, which is necessary to undertake the study, is gathered by directly approaching the respective companies'. The criterion for inclusion in the study unit was holding 7 consecutive years (from 2009-2015) financial report.

Sampling design

As noted in Jonker and Pennink (2010) it is obvious that researchers are typically unable to study the entire population. Therefore, researchers typically study a subset of the population which known as a sample. A sample is a portion of the population that infer about the population. However, it is important that the sample be representative of the population from which it was selected.

The population of this study was manufacturing share companies in Addis Ababa, Ethiopia classified under large tax payers (i.e. companies with annual turnover of more than Ethiopian Birr (ETB) 37 million), with audited financial statements from 2009 to 2015. According to the records held by ERCA, there are 29 manufacturing share companies categorized under large tax payer. To be included in the research analysis, the firms had to have available balance sheets and income statement for at least seven consecutive years (2009 to 2015), to allow the researcher to obtain sufficient data for calculating the representative data from each firm.

Based on the formula of Yamane (1967) the sample size will be:

$$n = N/(1+N(e^2)$$

$$= 29/ (1+29(0.05^2)$$

$$= 27.03$$

In circumstance, where there are small population elements the sample will be equal to the population in such case we can adjust the sample calculated by the formula:

$$n = n / (1+(n/N))$$

$$= 27/ (1+(27/29))$$

$$= 13.98 \approx 14$$

Therefore, out of the 29 companies the researcher randomly selected 14 manufacturing share companies as sample size because the researcher believed that given the nature of the study taking sample size more than this will become unmanageable.

In addition, random sampling technique was used in order to give equal chance for each manufacturing share company and the observations of the sample can be used for inferential purpose as stated in Jonker and Pennink (2010).

3.2.1.2 Qualitative Design

Qualitative research approach is a means for exploring and understanding individuals or groups scribe to a social or human problem (Creswell, 2009). Qualitative research is typically used to answer questions of complex phenomena on which data can be collected using instruments like structured and unstructured interviews, group discussions, observation and reflection field notes, various texts like reflexive Journals, pictures, and analysis of documents and literature. Thus, in the current study to gather the qualitative data, in- depth interviews with finance managers of seven selected banks were employed. The next section presents the in-depth interviews.

In – Depth Interview

In-depth interviews with seven selected Ethiopian large manufacturing share company finance managers were utilized to gain a greater insight into the findings from documentary analysis. The interviews were conducted with seven finance managers. The finance managers were chosen as they are believed to be the most knowledgeable parties about the determinants of financial reporting quality. Besides, the respondents were contacted once and each respondent was contacted at different times. This allowed the interview time to be utilized effectively and improved the efficiency of the interview process by helping the interviewees to save time. Generally, based on the objective and research hypothesis presented in the preceding section a number of unstructured interview questions were asked to better understand the determinants of financial reporting quality.

3.3.2 Data Analysis

To achieve the objective of the study the researcher analysed the raw data collected from the manufacturing companies. The financial statements of sampled

manufacturing companies for the period of 2010- 2014 were analysed using panel data model. As noted on Brooks (2008) panel data embody information across both time and space. Importantly, a panel keeps the same individuals or objects and measures some quantity about them over time.

The quantitative data analysis was undertaken by using Eveiws 8 software and it incorporated the descriptive statistics, Correlation Matrix analysis and panel data regression.

First, descriptive statistics is used to highlight the nature of data and describe the variables used in the study, in terms of average and variation among the cross-section. The descriptive statistics include mean, maximum, minimum and standard deviation for all study variables. Second, correlation analysis is conducted to see the relationship among the dependent and independent variables. This would help to get an initial picture as to the nature of the relationship among the variables before proceeding to regression analysis.

Finally, panel least square regression analysis is used to determine the significant relationships between manufacturing share companies' financial reporting quality and the identified independent firm specific variables

The panel data regression is undertaken by using random effect model, by checking fitness of the methods using Hausman Test. Then before running panel data regression, the necessary diagnoses test such as heteroscedastic, autocorrelation, normality, and multicollinearity are made to proof the validity of the model. The objective of this analysis was to make a prediction about the dependent variable based on its relationship with all the concerned independent variables.

3.3.2.1 Definition of Variables and Model Specification

I. Dependent variable (FRQ)

The most frequently used proxy for earnings and accrual quality in financial reporting quality literature is the modified Dechow and Dichev (2002). The model developed a way of combining Dechow and Dichev (2002) and Jones model. The

Dechow and Dichev (2002) model developed a way of mapping cash flows in estimating accrual quality. This measure defines accrual quality as the error variance from a regression of working capital accruals on past, current, and lagged cash flows. The modified model will add to the model of Dechow and Dichev (2002) the essential variables present in the model of Jones, as the annual revenue variation and the value of gross property, plant and equipment as proposed by McNichols (2002).

The modified Dechow and Dichev's (2002) model is specified as:

$$\Delta WCit = \beta 0 + \beta 1 CFO_{it-1} + \beta 2 CFO_{it} + \beta 3 CFO_{it+1} + \beta 4 \Delta REV_{it} + \beta 5 PPE_{it} + \varepsilon$$

Where: ΔDW is the change in working capital accruals or current accruals from the statement of cash flows, CFO denotes the cash flows from operating activities, ΔREV is change in revenue and PPE is property, plant and equipment.

The residuals for the modified DD model, after inserting the sampled firms' data represented financial reporting quality in the second regression model specified for the study. However, the residual determines the accrual quality, the larger the residuals, the lower the quality of accruals vice versa as in McNichols (2002). To mitigate this problem, multiplied the absolute values of the modified Dechow-Dichev measure by −1 (DD). Thus, higher values of DD represent higher FRQ.

II. Independent variables

Firm Size: is measured as the logarithms total assets that refer to the sum of current and non-current assets at the end of firm's reporting year.

Leverage: is measured as the ratio of total non-current liabilities to owners' equity and long term liabilities.

Shares dispersion: which is obtained from analysis of shareholding parts in the note to account, measured by the number of shareholders.

Liquidity: refers to a firm's ability to meet its short-term obligations when they fall due. Cooke (1989) argued that the soundness of the firm as portrayed by high

liquidity is associated with greater disclosure level. Liquidity is defined by the ratio of current assets and current liabilities.

Board Composition: The presence of independent directors in the board of directors is measured by the proportion of independent (outside) directors on the board.

Profitability: the profitability of the firm is measured by return on asset.

Type of Auditor: The proxy for audit firm size applied in this study is the audit firm grade given by OFAG to classify audit firm's size in to Big Versus Non-Big. The type of engaged audit firm is considered as dummy variable, 1 if the audit firm belongs to the big group or 0 if it is another audit firm.

Model Specification

The research paper used the data from manufacturing companies of Addis Ababa that include financial statement from 2010 to 2014 for analysis. The nature of data that will be used in this study enabled the researcher to use panel data model, which is deemed to have advantages over cross sectional and time series data methodology. The study tested the two most important panel data techniques, Random Effects Model (REM) is selected as appropriate model for the study.

The model consists of dependent and independent variable. The researcher used major dependent variable of financial reporting quality measured by modified Dechow and Dichev (2002) model (Hassan and Bello, 2013; Ferrero, 2014; Madawaki and Amran, 2013; Samaila, 2013; Ma Tao, 2012; Hassan, 2013). The independent variables used are level of leverage, board composition, firm profitability, liquidity, firm size, type of auditor and shares dispersion.

To examine the determinants of financial reporting quality in manufacturing share companies in Addis Ababa the following general empirical research model is developed from empirical studies (Ahmed, 2012; Hassan and Bello, 2013; Michailesco, 1999; Fathi, 2012; Dechow, Ge and Schrand2010; Atanasko, 2013; Ole, Wayne and Dushyantkumar, 2011;Ferrero, 2014).

$$FRQ_{it} = \beta 0 + \beta 1(LEV_{it}) + \beta 2(COMP_{it}) + \beta 3(PROF_{it}) + \beta 4(LIQ_{it}) + \beta 5(SIZE_{it}) + \beta 6(AUD_{it}) + \beta 7(DISP_{it}) + \varepsilon_{it}$$

Where:

FRQ_{it} = Financial Reporting Quality of Company i at time t

β0 = Intercept

LEV_{it}= Firm Leverage of Company i at time t

$COMP_{it}$ = Board Composition of Company i at time t

$PROF_{it}$ = Profitability of Company i at time t

LIQ_{it} = Liquidity Ratio of Company i at time t

$SIZE_{it}$ = Firm Size of Company i at time t

AUD_{it} = Type of Auditor of Company i at time t

$DISP_{it}$ = Share Dispersion of Company i at time t

β 1- β7= Coefficients parameters

ε_{it} = Error term where i is cross sectional and t time identifier

After analysing the quantitative data in a second phase the qualitative data was analysed. It will be used when the researcher wishes to use qualitative findings to help interpret or contextualize quantitative results (Creswell, 2009).

The data collected from deep interview was used in the qualitative component of the study. The qualitative data was first reduced based on information needed to answer research problem by coding, summarizing and writing up. The organized and condensed layout of the data was displayed to support conclusion drawn from quantitative analysis and finally interpreting and drawing meaning from the data was made to explain the conclusions.

3.3 Relation between research hypotheses and Data Sources

This chapter presented the research method adopted to address the research problem. A detail description of the quantitative, qualitative and mixed research approach with the method adopted for this study is presented. In connection to this, based on the underlying principles of research methods and the research problem

mixed methods approach has been chosen as appropriate to this research. Finally, this chapter puts the procedures and methods used in the study. The next table will illustrate how the research hypothesis is addressed by the data collected.

Table 3.1 relationship between research hypothesis and data source

Research Hypotheses	Nature of data and Source
HP 1: Financial reporting quality is positivelyrelated to firm leverage.	Long term debt and capital. How does the creditors influence the quality of financial information produced?
HP 2: Financial reporting quality is positivelyrelated to board composition.	Number of independent directors.how does the independent directors influence the quality of financial information produced?
HP 3: Financial reporting quality is positivelyrelated to firm profitability.	Total asset and net income. How does profitability influence the quality of financial information produced?
HP 4: Financial reporting quality is positivelyrelated to firm liquidity.	Current asset and current liability. How does the firm liquidity influence the quality of financial information produced?
HP 5: Financial reporting quality is positivelyrelated to firm size.	Total asset. How does the size of the firm influence the quality of financial information produced?
HP 6: Financial reporting quality is positivelyrelated to type of auditor.	Name of the audit firm.How does big size audit firm influence the quality of financial information produced?
HP 7: Financial reporting quality is positivelyrelated to share dispersion.	Number of shareholders. How does the shareholders influence the quality of financial information produced?

Chapter Four: Results and Discussion

Introduction

In the preceding chapters, the review of relevant literature helped this study to understand the problem and design an appropriate research approach to deal with. The previous chapter also discussed the research design employed to achieve the objectives of the study and to test the research hypotheses there on. In this chapter, the study analyses the collected data using various statistical tools and presents the results and discussion accordingly. This chapter is organized in two sections. The first sub section presents the result which includes descriptive statistics, CLRM Assumptions and Diagnostic tests, correlation analysis, the regression results and interview result. The second section is dedicated to the discussion of results.

4.1. Results

In order to achieve the study objective, the researcher adopted various statistical tools to analyse the collected data. Section 4.1.1 presents the descriptive statistics which focuses on the distribution the data, mean, maximum and standard deviation. Section 4.1.2 presents tests for the classical linear regression model assumptionsfollowed by the correlation analysis among the dependent and independent variables in section 4.1.3. The model selection test and outcomes of the regression result with discussion are presented in section 4.1.4 and 4.1.5 respectively and the last section (4.1.6) presents the result from in depth interview.

4.1.1. Descriptive statistics

This section essentially present descriptive statistics of dependent and explanatory variables included in this study. The dependent variable of this study is financial reporting quality and explanatory variable are non-performing loan ratio, capital adequacy ratio, cost per loan asset and liquidity ratio. The total observation for each dependent and independent variable was 70 (data for 14 manufacturing share companies for the period from the year 2010 to 2014). The descriptive statistics include mean, median, maximum, minimum and standard deviation of all study variable (see table 4.1).

Table 4.1: Summary of descriptive statistics

	Mean	Maximum	Minimum	Std. Dev.	Observations
FRQ	-7.121	-5.893	-8	0.523	70
LEV	0.141	0.718	0	0.193	70
COMP	0.302	0.833	0	0.308	70
PROF	0.103	0.299	-0.135	0.080	70
LIQ	2.092	5.395	0.131	1.017	70
LOG_SIZE	8.216	9.153	7.641	0.357	70
AUD	0.443	1	0	0.500	70
DISP	5.100	10	1	2.788	70

Source: Output of Eviews 8

As shown in table 4.1 above, the dependent variable of this study, financial reporting quality (FRQ), have a mean value of -7.121 and standard deviation of 0.523. This implies that during the study period the sampled manufacturing companies have abnormal accrual, on average, with log value of -7.121. On the other hand, the minimum and maximum value of -5.893 and -8 indicate that form the sampled manufacturing companies a manufacturing company with -5.893 have maximum have the highest financial reporting quality while a manufacturing company with -8 have a minimum financial reporting quality. The entire figure shows that the Ethiopian manufacturing companies have averagely negative log 7.121 0f abnormal accrual, that implicate financial reporting quality.

The first explanatory variable of the study, leverage, as demonstrated in table 4.1 has a minimum value and maximum value of 0 and 0.718 respectively. These imply that there is a manufacturing company out of the selected manufacturing companies with the maximum leverage or the ratio of total non-current liabilities to owners' equity and long term liabilities is 0.718 and a manufacturing company with as minimum as 0 ratio of total non-current liabilities to owners' equity and long term liabilities during the review period. Yet, ratio of total non-current liabilities to owners' equity and long term liabilities has 0.193 standard deviation from its mean value with 0.141. The average ratio is reported to be 14.1% during the review period. According to this the manufacturing companies finance their long term 14.1% from long term loan.

The composition of board of directors, another explanatory variable of the study, as shown on the table 4.1 has average value of 30.2% that clearly displays in this study period the sample manufacturing companies have composed, on average, 30.2% of their board of directors from independent directors. The minimum and maximum independent board of director's value for this manufacturing companies is reported to be 0 percent and 83.3 percent respectively, where 0% implies no independent board of director and 83.3% means the at least one company have 83.3% independent board of directors in its company. Standard deviation value of 30.8 reveals the average spread from the mean value of manufacturing companies board of director's composition.

Profitability measure, return on asset shows, how much return the company have generated from the asset employed. In this case, return on asset has a mean value of 10.3 percent and standard deviation of 8 percent. Thus, the management of the manufacturing companies have generated on average 10.3% return for each asset employed and the deviation from the mean value was 8%. Besides, the minimum and maximum amount of return on asset of the sampled companies is -13.5 percent and 29.9 percent respectively. This indicates that there is a manufacturing company with a maximum return on asset ratio of 29.9 percent and a company with a minimum return on asset ratio of -13.3 percent.

Liquidity ratio is another indicator of financial reporting quality in this study. It is computed by dividing current assets and current liability. As reported in table 4.1 its mean value and standard deviation is 2.092 and 1.017 respectively. The maximum and minimum value for liquidity ratio is 5.395 and 0.131respectively. This implies that the manufacturing companies' management use on average double reserve of current asset to cover their current liability.

As shown in table 4.1 above, the independent variable, size have a mean value of 8.216 and standard deviation of 0.357. This implies that during the study period the sampled manufacturing companies have total asset, on average, with log value of 8.216. On the other hand, the minimum and maximum value of 7.641and 9.15 indicate that form the sampled manufacturing companies a manufacturing company

with 9.15 have the highest total asset while a manufacturing company with 7.641 have a minimum total asset. The entire figure shows that the Ethiopian manufacturing companies have averagely log 7.121 total asset, that implicate size of the companies.

Audit Firm Size shows the audit firm grade given by OFAG to classify audit firm's size in to Big (as represented by one) versus non-Big (as represented by zero) while providing external audit service. The mean of this variable for the selected manufacturing share companies stands at 0.443 and the minimum and maximum value for the variable is 0 and 1 respectively with a standard deviation of 0.5.

Share dispersion, furthermore, another observation is that there was average share dispersion of 5.1share holders in the manufacturing share companies. somewhat a higher variation in the number of shareholders range between 10 and 1 with standard deviation of 2.788.

4.1.2 CLRM Assumptions and Diagnostic tests

Diagnostic test is made to make sure that the classical linear regression model assumption is violated or not. In this study an attempt is made to test Heteroscedasticity, Autocorrelation, normality and Multicollinearity the result of which are presented and discussed as follows.

4.1.2.1 Heteroscedasticity

It is a test made to check whether error terms variance is constant (homoscedasticity) or not (heteroscedasticity). To test for the presence of heteroscedasticity, the popular white test was employed (Brooks 2008).

One of the important assumptions of the multiple regression reveals that the variance of the disturbance term is constant. This is called the assumption of homoscedasticity. If disturbance terms (errors) do not have constant variance, they are said to be heteroscedasticity (Gujarati, 2004).

In this case as presented in table 4.2, both the F-statistic and Chi-Square versions of the test statistic gave the same conclusion that there is no evidence for the presence

of heteroscedasticity in this particular study, since the p-values are considerably in excess of 0.05. Therefore, the null hypothesis that the variance of the errors is constant (homoscedasticity) should not be rejected.

Table 4.2: Heteroscedasticity test: White test

Heteroskedasticity Test: White			
F-statistic	1.253219	Prob. F(34,35)	0.2548
Obs*R-squared	38.43168	Prob. Chi-Square(34)	0.2756
Scaled explained SS	18.66744	Prob. Chi-Square(34)	0.9847

Source: Output of Eviews 8

4.1.2.2 Autocorrelation

The other Assumption of classical linear regression model is Autocorrelation. The diagnostic test for CLRM assumption of no autocorrelation was tested by this study. According to Gujarati, (2004) the assumption of no autocorrelation between the disturbances assumes that given any two X values, Xi and Xj (i≠j), the correlation between any two ui and uj(i≠j), is zero. According to Chris Brooks (2008) it is assumed that the errors are uncorrelated with one another. If the errors are not uncorrelated with one another, it would be stated that they are 'autocorrelated' or that they are 'serially correlated'. This assumption was tested by Durbin Watson (DW) test of autocorrelation. Durbin--Watson (DW) is a test for first order autocorrelation -- i.e. it tests for a relationship between an error and its immediate previous value. One way to motivate the test and to interpret the test statistic would be in the context of a regression of the time *t* error on its previous value

$$ut = \rho ut-1 + vt$$

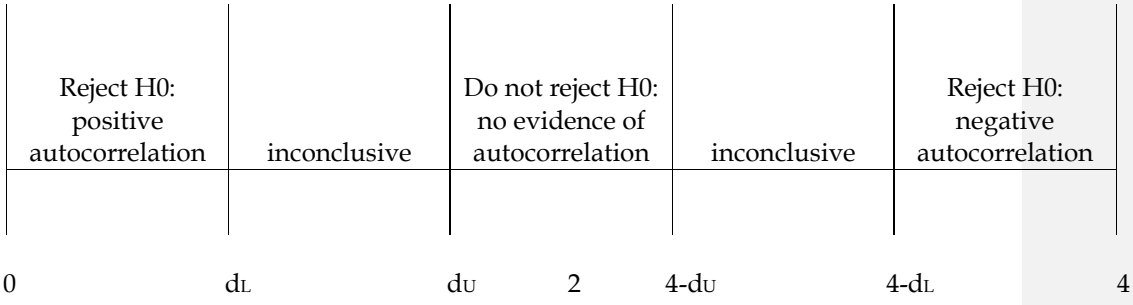
Where $vt \sim N(0, \sigma^2 v)$ and ρ is the coefficient of autocorrelation. The DW test statistic has as its null and alternative hypotheses. Under the null hypothesis, the errors at time *t −1* and *t* are independent of one another (the errors at time *t −1* and *t* are uncorrelated), and the alternative hypothesis says the errors at time *t −1* and *t* are independent (the errors at time *t −1* and *t* are serially correlated). Therefore

$$H_0: \rho = 0 \text{ (no autocorrelation)}$$

H_1: $\rho \neq 0$ (autocorrelation)

DW has 2 critical values: an upper critical value (dU) and a lower critical value (dL), and there is also an intermediate region where the null hypothesis of no autocorrelation can neither be rejected nor not rejected! The rejection, non-rejection, and inconclusive regions are shown on the number line in figure 4.1

Figure 4.1 Rejection, non-rejection, and inconclusive regions for DW test



According to Brooks (2008) the following is the decision rule to reject and not to reject the null hypothesis

- null hypothesis is rejected and the existence of positive autocorrelation presumed if DW is less than the lower critical value d_L; the null hypothesis is also rejected and the existence of negative autocorrelation presumed if DW is greater than 4 minus the lower critical value d_L;
- The null hypothesis is not rejected and no significant residual autocorrelation is presumed if DW is between the upper critical value d_U and 4 minus the upper critical value d_U.
- The null hypothesis is neither rejected or fails to be rejected if DW is between lower critical value d_L and the upper critical value d_U or if DW is in between4 minus the upper critical value $d_U$and4 minus the lower critical value D_L.

The DW test table value of d_L, d_U, 4-d_U and 4-d_L at N 70, and K 7 for this study is presented graphically below.

Figure 4.2 DW test result

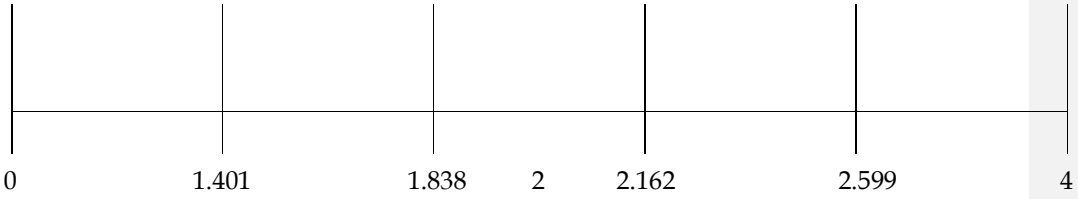


Table 4.3: DW test result test of autocorrelation

Test	DW test statistics
DW result	1.78

Source: Output of Eviews 8

The DW test statistic value for models was 1.78 for a total observation of 70(5*14) were used in the model with 7 regressors. Thus the decision values for the test are d_L= 1.401, d_u = 1.838, 4-d_U = 2.162 and 4-d_L = 2.599. The DW test statistics for the model is 1.78 lies between d_L which is 1.401 and d_u which is 1.838er critical value. So, the null hypothesis of no autocorrelation is within the inconclusive region. Therefore, there is no significance evidence for the existence of autocorrelation in the study.

4.1.2.3 Normality

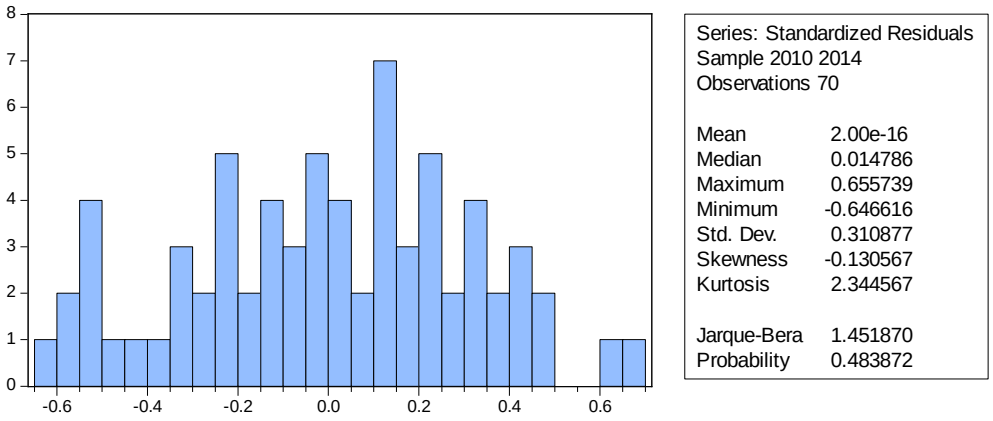
The other classical linear regression model assumption is normally distribution of the residual. The classical normal linear regression model assumes that each ui is distributed normally with mean and standard deviation values are near to 0 and 1 respectively Gujarati (2004).

To test the normality assumption in this study the researcher applied the Jarque-Bera (JB) test. As noted by Brooks (2008) JB uses the property of a normally distributed random variable that the entire distribution is characterized by the first two moments -- the mean and the variance.

The standardized third and fourth moments of a distribution are known as its skewness and kurtosis. Skewness measures the extent to which a distribution is not symmetric about its mean value and kurtosis measures how fat the tails of the distributed. If the residuals are normally distributed, the histogram should be bell-shaped and the Jarque-Bera statistic would not be significant. This means that the p-value given at the bottom of the normality test screen should be bigger than 0.05 to not reject the null of normality at the 5% level.

As clearly plotted in figure 4.1 the normality test for this study shows a p-value of Jarque-Bera 0.48 which is greater than 0.05 and the histogram is also bell-shaped implying that the residuals of this study is normally distributed.

Figure 4.3 Normality Test: Residual



Source: Output of Eviews 8

4.1.2.4 Multicollinearity

The other very important assumption of the classical linear regression model is multicollinearity. According to Guajarati (2004) one of the assumptions of the classical linear regression model is that there is no multicollinearity among the explanatory variables, the X's. Broadly interpreted, multicollinearity refers to the situation where there is either an exact or approximately exact linear relationship among the explanatory variable. To test the multicollinearity problem the current study used correlation matrix between the explanatory variables.

According to Kennedy (2008) multicollinearity problem exists when the correlation coefficient among the variables are greater than 0.70. Table 4.4 below shows the correlation coefficient among explanatory variables in this study. The highest correlation coefficient for this study explanatory variable is -2.7 that is between PROF and LEV, which is less than 0.7. Therefore, there is no evidence for presence of multicollinearity problem in this study model.

Table 4.4 Correlation Matrix for independent variables

	LEV	COMP	PROF	LIQ	LOG_SIZE	AUD	DISP
LEV	1.00						
COMP	-0.19	1.00					
PROF	-0.27	-0.06	1.00				
LIQ	-0.14	-0.19	0.02	1.00			
LOG_SIZE	0.30	-0.08	0.01	-0.22	1.00		
AUD	-0.11	0.19	0.06	0.23	-0.08	1.00	
DISP	0.15	-0.01	-0.20	-0.22	0.21	-0.09	1.00

Source: Output of Eviews 8

4.1.3 Correlation Analysis

The purpose of correlation matrix in this particular study was to show the linear association between the dependent and independent variables. As noted in Brooks (2008), correlationbetween two variables measures the degree of linear association between them. Values of the correlation coefficient are always range between positive one and negative one.

A correlation coefficient of positive one indicates that a perfect positive association between the two variables; while a correlation coefficient of negative one indicates that a perfect negative association between the two variables. A correlation coefficient of zero, on the other hand, indicates that there is no linear relationship between the two variables.

Table 4.5 presents the correlation coefficients for the variables used in the financial reporting quality model. As exhibited in table 4.5, almost all the variables correlated with financial reporting quality except audit firm size (AUD, 0.61) are with the lowest correlation coefficient.

This relationship suggests initial picture as to the nature of the relationship between explanatory variables and financial reporting quality. As the correlation matrix indicates, audit firm size is the most dominant determinant of financial reporting quality, which is reflected in the table by the very strong positive correlation between AUD and the dependent variable (i.e. FRQ). This correlation clearly shows that, as the number of certified auditors in a given audit firm increases, Financial reporting quality also moves to the same direction. Besides, the variables PROF and LIQ show a weak correlation with financial reporting quality.

Table 4.5 also reported COMP and DISP have a very weak correlation with the explanatory variables. The coefficient of correlation between firm size and leverage with the dependent variable financial reporting quality was -0.4 and -0.32, respectively. This shows that weak and negative relationship.

Table 4.5: Correlation matrix of dependent and independent variables

	FRQ	LEV	COMP	PROF	LIQ	LOG_SIZE	AUD	DISP
FRQ	1.00							
LEV	-0.32	1.00						
COMP	0.05	-0.19	1.00					
PROF	0.27	-0.27	-0.06	1.00				
LIQ	0.39	-0.14	-0.19	0.02	1.00			
LOG_SIZE	-0.40	0.30	-0.08	0.01	-0.22	1.00		
AUD	0.61	-0.11	0.19	0.06	0.23	-0.08	1.00	
DISP	0.05	0.15	-0.01	-0.20	-0.22	0.21	-0.09	1.00

Source: Output of Eviews 8

4.1.4 Model Selection Test: Random Verses Fixed Effect Model

In order, achieve the objective of the study the researcher-employed panel Data model. As far as the Data is concerned, comprising both time series and cross-sectional elements panel model is appropriate. In order, achieve the objective of the study the researcher-employed panel Data model. As far as the Data, comprising both time series and cross-sectional elements panel model is appropriate. The choice of this methods are comparing time series and cross-sectional units and by using Hausman specification test.

As noted by Gujarati (2004) if T (the number of time series data) is large and N (the number of cross-sectional units) is small, there is likely to be little difference in the values of the parameters estimated by fixed effect model and random effect model. Hence, the choice here is based on computational convenience. On this score, random effect model may be preferable.

The best alternative to make a choice between fixed effects and random effects model is conducting Hausman specification test. In this study the Hausman specification tests is utilized to decide which model is appropriate to fit the sample data. Hausman specification test is the classical test of whether the fixed or random effects model should have used.

Running a Hausman specification test at five percent level enables the researcher to choose between fixed effects and random effects models (Hausman, 1978). The hypothesis for Hausman specification test is:

Null hypothesis: Random- effect model is more appropriate
Alternative hypothesis: Fixed-effect model is more appropriate

Decision rule: if the P-value from the Hausman test is statistically significant (less than five percent) the fixed-effect model is preferred in favour of random effect, otherwise the random effect model is selected.

The result from Hausman test in table allow as to not reject the null hypothesis that random model is better in this regression analysis. This implies that a random effect model is more appropriate than fixed effect model to undertake the panel regression estimation for this study.

Table 4. 6 Correlated Random Effect-Hausman Test

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	5.805875	7	0.5626

Source: Output of Eviews 8

4.1.5 Fixed Effect Regression result

This section presents a fixed effect model regression result to examine the impact of explanatory variables (LEV, COMP, PROF, LIQ, LOG_SIZE, AUD and DIS) on the financial reporting quality proxy FRQ of large manufacturing companies. Table 4.7 displays random effect model regression estimation result.

Table 4. 7 FRQ Model Fixed Effect Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-3.306623	1.285821	-2.571605	0.0125
LEV	-0.044148	0.239418	-0.184399	0.8543***
COMP	-0.168776	0.227408	-0.742172	0.4608***
PROF	2.292755	0.672806	3.407751	0.0012*
LIQ	0.063389	0.044768	1.415937	0.1618***
LOG_SIZE	-0.565998	0.156763	-3.610539	0.0006*
AUD	0.616052	0.072820	8.459981	0.0000*
DISP	0.049462	0.019621	2.520884	0.0143
R-squared	0.691602			
Adjusted R-squared	0.656783			
Prob (F-statistic)	0.000000			
Durbin Watson stat	1.783644			

Source: Output of Eviews 8

Note: * significant at 1% and *** insignificant

The estimated model is the following:

FRQ = -3.306 - 0.044LEV -0.168COMP + 2.292PROF +0.063LIQ -0.565LOG_SIZE +0.616AUD + 0.049DISP

(1.2858) (0.2394) (0.2274) (0.6728) (0.0447) (0.1567) (0.0728) (0.0196)

R2 = 0.691 Adjusted R2 = 0.656 Prob (F-statistic) = 0.000 DW = 1.783

Note: values in parentheses are standard errors

The estimation result of the panel regression model used in this study is reported in table 4.7. Accordingly, the R-squared statistics and the Adjusted-R squared statistics of the model are 0.691 and .656 respectively. These indicate that explanatory variables included in this model could explain variation in the dependent variable by about 69 percent and 65 percent respectively. The remaining 53percent can be

taken as the role of explanatory variables that are not included in this model but that have impact on the financial reporting quality.

The null hypothesis of F-statistic (the overall test of significance) that the R2 is equal to zero is rejected at 1% as the p-value is sufficiently low. F-probability of 0.000 indicates that the model fit the sample data well and the explanatory variables are jointly significant. All the independent variables jointly have statistically significant impact on financial reporting quality of large manufacturing share companies. As shown in the above table leverage, board composition and liquidity have no statistical significance on financial reporting quality at 0.1 significance level. by their ROAA with the exception of liquidity ratio which is in contrary to the expectation of the researcher. Whereas all the other variables with exception to total asset have significant positive impact on financial reporting quality. Size implicated by total asset have negative significance impact on financial reporting quality.

4.1.6 In-Depth Interview Results

In order to deeply understand how financial reporting quality is influenced by firm specific variables, unstructured interview was utilized with some selected Ethiopian large manufacturing company finance managers. The interviews were conducted with seven finance managers of large manufacturing companies The finance managers were chosen as they are believed to be the most knowledgeable parties about the determinants of financial reporting quality. Besides, the interviews were conducted independently with the officials. They were asked unstructured interview questions in relation to the financial reporting practice of their company. These interview questions were designed to find out the main factors that determine the financial reporting quality of large manufacturing share companies.

The practitioners argued that the sector used to practices financial reporting from its tax laws and fragmented accountingpractices acquired from the country's institutions of higher learning, without a nationwide conceptual framework to guide the teachingprocess and the practical application by companies.

It is also marked that, the Commercial Code makes directors of companies responsible for preparation of financial statements and for ensuring that an audit of thefinancial statements is conducted. Consequently,selection and application of an accounting principle formeasurement and disclosure of financial transactions is left to thecompany's management and its auditor.

The government is currently implementing the first national accounting standard, unlike other sectors like financial institutions who marked their way first, this sector is on the verge of implementing international financial reporting standard. The practitioners argued that, the current practice will relief the professionals and decision makers since it provides guides in selection of appropriate accounting policies by companies. In the previous practice it is notsurprising to see companies employ different accounting rules orprinciples that ultimately lead to production of different sets of financial statements. Different financial statements with differentbases for recognition, measurement presentation and disclosure offinancial transactions do not assist users of financial statements ineconomic decision-making.

They argued that they prepare financial statements for creditors, by assuming good financial reporting facilitates access to borrowing. The problem stated to this regard is lack of consistency in the information produced, because of the absence of mandatory disclosures and widespreaduse of 'creative accounting,' in Ethiopia, financial statements depictlimited information on companies' financial positions, performanceand cash flows. Under the circumstances, creditors find itdifficult to compare financial statements produced by differentcompanies in giving priority for loan. So companies prepare financial information by considering the information required by credit giving companies when in need of borrowing.

Further in the interview with financial managers of the companies, the factors that can determine the financial reporting quality of large manufacturing companies in Ethiopia were; firm leverage, firm profitability, type of auditor and share dispersion.

As per the interview with the financial managers, leverage increases the level of relevant financial report of large manufacturing share companies. According, to the

official's leverage, profitability, type of auditor and share dispersion increases the ability of the firm to produce high quality financial report.

4.2 Discussion of the Result

Under this section, specifically the researcher analysis in detail the regression result of random effect model and the data collected through interview. The current study shows that all variables in the model except the liquidity, leverage and board composition affects financial reporting quality of large manufacturing share companies in Ethiopia. More specifically, the regression result indicates that profitability, size, type of auditor and share dispersion have significant impact the financial reporting quality of large manufacturing share companies.

The study found that liquidity, leverage and board composition has no any statistically significant impact on large manufacturing share companies financial reporting quality. However, there are findings that are in contrary to the expectations of the researcher, findings that are consistent with the results existing in the literature and findings that are inconsistent with the existing result in the literature. These are discussed one by one as follows:

Financial Leverage and FRQ of Large Manufacturing Share companies in Ethiopia

Financial leverage is a measure of long term financing that the companies used, it is measured by the ratio of long term debt for long term capital. The regression result of random effect model as reported in table 4.7 above clearly show that financial leverage as measured by ratio of long term debt for long term capital have no statistically significant negative impact on financial reporting quality of large manufacturing share companies in Ethiopia.

This result indicates that the null hypothesis of the study is rejected, since the t-statistic value is higher than 0.05. This imply that in Ethiopian large manufacturing share companies financial reporting quality will not be influenced by the companies

financing decision which leads us to reject the working hypothesis of the study,financial reporting quality is positively related to firm leverage.

The practitioners in the manufacturing companies argue that the financing decision of the firms will shape the quality that the companies disclose on the financial statements. They mentioned that if the companies are in need of additional capital from non-shareholders, mostly they have one alternative, long term loan from banks. Before the period of loan, the companies include the relevant information that the banks require in their financial statement. This shows that the companies will produce more disclosure in their financial statement before requesting for loan. This finding is consistent with agency theory thata company with a higher debt ratio has an incentive to disclose more information.

This regression finding is consistent with some existing findings in the literature. A study by Camfferman and Cooke (2002), Ali, Ahmed & Henry(2004), AlSaeed (2006) and Fathi (2013) have revealed that financial leverage as represented by the ratio of long term debt to long term finance has no significant impact on financial reporting quality.

However, there are also some existing findings in the literature that are inconsistent with the current finding. According to the finding of Hossain, tan and adams (1994), Naser, Al-Khatib and Karbhari (2002), Hassan, Percy and Stewart (2006) and Adelopo (2010), financial reporting quality is positively influenced by firm's leverage decision.

Board Composition and FRQ of Large Manufacturing Share companies in Ethiopia

Theoretically, companies with better supervision are expected to have a better quality on the financial report. The ratio of independent directors in the company's board of directors was expected to have a statistically significant positive impact on financial reporting qualities of large manufacturing companies. With the presence of independent board of directors in company's board of directors, it is expected that these directors will assemble different condition that the companies face objectivity

and with independence. Fama (1980) also noted the concept by emphasizing, the role of independent directors on providing efficient control through their reputation in the labour market.

The random effect regression result indicates that board composition had no significant impact on manufacturing companies financial reporting quality at 10% significance level. The result was not in accordance with working hypothesis which argued financial reporting quality is positively related to board composition. This imply that in Ethiopian large manufacturing share companies financial reporting quality will not be influenced by the share of independent board of directors in companies BOD.

The response from the interview indicated that the most of the companies compose their board of directors from shareholders. The shareholders in Ethiopian manufacturing companies are very small in number see table 4.1. The respondents argued that these small investors have knowledge and counselling from their own advisors. The investors use counselling when they face circumstances that require advanced knowledge. Some argue that since their companies are owned by the government, most of the representatives have knowledge of the current rules and regulations. Their argument is also in support of the regression result in that, whether independent or not the companies give high degree of focus in decisions.

This regression finding is consistent with some existing findings in the literature. A study by Camfferman and Cooke (2002), Ali, Ahmed &Henry (2004), AlSaeed (2006) and Fathi (2013) have revealed that board compositions as represented by the ratio of independent directors has no significant impact on financial reporting quality.

On the other hand, the results contradicted with the findings obtained by the researchers that the board composition positively affects financial. This argument is supported by Haniffa and Cooke (2002) in U.K. and Dutch Companies and Hassan and Bello, (2013) in Kenya who revealed that financial reporting quality is positively influenced by the presence of independent directors. They recommended that companies are keen on making high quality financial report if they have the independent director's judgment.

Profitability and FRQ of Large Manufacturing Share companies in Ethiopia

The regression result above also shows that profitability, measured by return on asset has a statistically significant positive impact on financial reporting quality of large manufacturing share companies in Ethiopia. This result is accordance with the result expected by the researcher and consistent with many results in the literature Raffournier 1995; and Patton & Zelenka 1997). Profitability indicates efficiency of management in operating the business. If the management of the company is efficient in managing its operation and achieved its objective, it could disclose more information to indicate the credibility of its reported earnings.

The data from the interview can be viewed in two categories. Some of the practitioners argue from experience that, the more the firms become profitable the company management fear the response of the shareholders to large tax obligations which result in manipulation of earnings. Now a day, such practices are dangerous because the government is giving for tax audit. Whereas, others argue that when the companies face losses they will be forced to bring future revenues to this period to mitigate the loss and avoid evaluation from board of directors this idea is also consistent with AICPA(2015).

The main source of revenue for manufacturing companies in Ethiopia is from sale of products. Special occasions may also boost profitability of some sectors which will lead to the presence of abnormal earning a best example could be, natural disaster like famine for food processing companies.

Therefore, working hypothesis 3 of the research, Financial reporting quality is positively related to profitability is not rejected.

Liquidity and FRQ of Large Manufacturing Share companies in Ethiopia

The regression result in this study also shows that liquidity ratio of large manufacturing companies in Ethiopia have no statistically significant impact on financial reporting quality. However, this is in contrary to the expectation of the researcher and it is an inconsistent result with the existing findings in the literature.

The data from the interview have also found no connection between liquidity and financial reporting quality. Among the various previous study, a study conducted by Hassan and Bello(2013) shows that there is negative relationship between liquidity ratio and financial reporting quality. Hassan and Bello(2013) argument is also supported by Easley and O'Hara (2004) who have found the same result.

Firm Size and FRQ of Large Manufacturing Share companies in Ethiopia

The size of firms measured by logarithm of total asset, was negative and statistically significant at 1% significance level (p-value=0.0006) which is not in line with a prior expectation or it will reject the working hypothesis, which argues, financial reporting quality is positively related to firm size.

Though negative sign confirms that an increase in the total asset would certainly lead to a decrease in financial quality, the significant result indicates that firm size was considered as a proper explanatory variable of financial reporting quality in Ethiopian manufacturing share companies.

In terms of total asset impact on financial reporting quality, previous studies of Prior, Surroca and Tribó (2008), and Surroca, Tribo and waddok (2010) showed a positive result and this implies that during the period of the study, total asset may constitute an important impact that inversely influence financial reporting quality.

However, the result of this study clearly shows as total asset has a negative impact on financial reporting quality. unfortunately, the data collected from interview cannot draw any relationship between financial reporting quality and firm size.

Type of auditor and FRQ of Large Manufacturing Share companies in Ethiopia

Audit firm size was considered to be one of the key factors that can affect the financial reporting quality of manufacturing share companies in Ethiopia. Signalling theory predict a positive relationship between audit firm size and financial reporting quality for at least two reasons: first, big size audit firms exhibit higher levels of ethical reasoning and attract a greater variety of clients because of their appeal on quality grounds, and the associated benefits their reputation brings; second, big size audit firms usually thought to have higher the number of clients and the greater

theprobability that the range of services provided is bigger. This minimizes dependency and results in providing good quality audit service on particular clients.

The study found a positive support of size of audit firm in influencing the level of quality of financial report of manufacturing companies in Ethiopia. The results of the regression analysis shown in table 4.7 revealed that there was a strong relationship between size of audit firm and financial reporting quality, with a regression coefficient of 0.616, t-statistic of 8.45 and P-value of 0.0000. Therefore, working hypothesis of the research, financial reporting quality is positively related to firm size, is not rejected.

This indicates that audit firm size was significant even at 1% to further the relationship with financial reporting quality since the p value is less than 0.01. The significant result indicates that audit firm size is considered as a proper explanatory variable of financial reporting quality in Ethiopian manufacturing companies. Hence the result is consistent with the working hypothesis of the study.

This significant regression result was consistent with the findings of Ahmed and Nicholls (1994), Wallace and Naser (1995), whose study suggested that audit firm size is one of the prime determinant of higher level of financial reporting quality that as long as professional standards and qualifications are maintained throughout the sector; otherwise small size audit firms may be replaced simply because they are less well known, even though they may well be providing as high or higher audit quality services.

The response from interview imply that firms with high abnormal earning will be most likely to choose audit firms with lower standards. Whereas if firms have higher reporting quality they will prefer audit firm with higher standard. The response is consistent with signalling theory, firms with higher financial reporting quality will prefer to signal the quality of their report by signalling it to large audit firms.

Share Dispersion and FRQ of Large Manufacturing Share companies in Ethiopia

Share dispersion is the number of shareholders in manufacturing share companies in Ethiopia. This variable was statistically significant at 5% significance level (p value =

0.0143) in explaining the variability in financial reporting quality of manufacturing share companies in Ethiopia. The coefficient of the DISP is 0.049 and this means if number of shareholders increase by on the financial reporting quality measured by negative log discretionary accrual of will increase by 0.049, showing that an increase in number of shareholders will assure higher reporting quality driver. This clearly leads to not rejecting the working hypothesis which states, financial reporting quality is positively related to firm size.

This is in agreement with a prior expectation as the number of shareholders with in a company increase the monitoring of management will increase, this will lead to the betterment financial reporting quality. The reason could be when the shareholders increase in number, different shareholders will enter the firm with different knowledge and experience, this experience and knowledge helps BOD and management to perform relevant roles or tasks to the required standard more effectively and has more capabilities and competence to deal with problems arising from unforeseen accounting and reporting processes, thus the higher the number of shareholders, the lower the incidence of abnormal earning. Accordingly, the findings of the regression result demonstrate number of shareholders as a vital driver of Ethiopian manufacturing share companies' financial reporting quality.

The result from interview indicated that, when the number of shareholders increase the managements must provide sufficient and objective information on the financial reports. Further when the number of shareholders increase the management cannot produce information at lower quality because the owners will require the information to be objective and follow the rules and regulations set by accounting standards and government.

Table 4.8 Summery of hypothesized and actual impact

Independent Variables	Measurement	Hypothesized	Actual impact
Firm Leverage	ratio of total non-current liabilities to long term finance	Positive and significant	Positive and insignificant

Board Composition	proportion of independent directors on the board	Positive and significant	Negative and insignificant
Firm Profitability	return on asset	Positive and significant	Positive and significant
Firm Liquidity	ratio of current assets and current liabilities	Positive and significant	Positive and insignificant
Firm Size	Natural logarithm of total asset	Positive and significant	Negative and significant
Type Of Auditor	1 if the audit firm belongs to the big group or 0 if it is another audit firm	Positive and significant	Positive and significant
Share Dispersion	Number of shareholders	Positive and significant	Positive and significant

Chapter Five: Conclusion and Recommendations

The preceding chapter presented the results and discussion, while this chapter deals with the conclusions and recommendations based on the findings of the study. Accordingly, this chapter is organized into two sub-sections. The first section presents the conclusions and the second presents the recommendations.

5. 1. Conclusions

Financial reporting is central to economic activities. Recently there is an increasing interest in research on financial reporting quality. Nevertheless, the characteristics or determinants of financial reporting quality are not well understood in the current accounting literature because the meaning of quality in accounting is rather different from those in many other fields. Furthermore, different accounting environments and regulations are one of the main causes and consequences of the variety of quality level in financial reporting. The basic question is can we measure financial reporting quality and identify its determinants. Extensive research has attempted to identify these factors; however, the findings of prior empirical studies have provided varying evidence related to the impact of these factors on financial reporting quality. Furthermore, the majority of these studies have been conducted in developed countries that have many institutional similarities and developed regulatory framework.

In light of the above, the main objective of this study was to examine the relationship between financial reporting and firm specific (Firm Leverage, Board Composition, Firm Profitability, Firm Liquidity, Firm Size, Type of Auditor and Share Dispersion) determinants of financial reporting quality in fracturing share companies in Ethiopia. To achieve the intended objective, the study used mixed methods by combining quantitative and qualitative approaches together. The quantitative data were collected through survey of document reviews from a sample of fourteen companies over the time period from 2010 - 2014. The collected data were analysed by employing multivariate OLS model using statistical package EVIEWS 8. Besides, the qualitative data that were collected through in-depth interviews was used to

support the quantitative findings and to gain additional insight into the factors that may affect the financial reporting quality of large manufacturing companies in Ethiopia.

In order to conduct the empirical analysis, one dependent variable (FRQ), and seven independent variables were selected from prominent previous research works on financial reporting quality; namely firm leverage, board composition, firm profitability, firm liquidity, firm size, type of auditor and share dispersion. The results of the random effect estimation model showed the existence of the following relationship between FRQ and independent variables.

leverage had statistically insignificant negative relationship with FRQ, which was not in line with prior expectation. Similarly, board composition h had a negative and statistically insignificant relationship with FRQ, which was not also in line the expected sign. The result suggests that company's composition of independent board of directors will not influence the FRQ of large manufacturing share companies.

Regarding to the effect of profitability on the financial reporting quality of large manufacturing share companies in this study, the result shows that there was positive and statistically significant relationship with FRQ, which is in line with signalling theory. Besides, the results of study indicated that liquidity had statistically insignificant relationship with FRQ.

Surprisingly, firm size had a negative relationship with financial reporting quality, and statistically significant. The relationship between financial reporting quality and type of auditor is positive and statistically significant in large manufacturing share companies in Ethiopia. This result was also consistence with Signal theory and other studies which reveals significant impact.

The impact of exogenous variable share dispersion is positive and statistically significant. The relationship between share dispersion and financial reporting quality in large manufacturing share companies in Ethiopia are significantly related.

This result was also consistence with agency theory and other studies which reveals significant impact.

In addition to the findings of random effect regression results, interviews were undertaken with the finance managers of selected banks to better investigate the determinants of bank capital structure. Accordingly, the interview result also indicates Firm Leverage, Firm Profitability, Type of Auditor and Share Dispersion in Ethiopian manufacturing share companies.

In conclusion, the finding of the study suggests that Firm Profitability, Firm Size, Type of Auditor and Share Dispersion influence manufacturing companies financial reporting quality. However, there were no support of Firm Leverage, Board Composition and Firm Liquidity of large manufacturing share companies in Ethiopia. The results also, confirms that signalling theory and agency theory are pertinent theory in Ethiopian manufacturing industry.

5.2 Recommendations

The analyses indicated that the variables of Firm Profitability, Firm Size, Type of Auditor and Share Dispersion were significantly related to financial reporting quality. From the result it is noted that firms showing lower performance may have a lower quality financial report than highly profitable ones. It is therefore recommended that auditors, board of directors, analysts, regulators, and shareholders, shall consider intensive investigation on the financial information conveyed by low performing large manufacturing share companies.

Since total assets, negatively affect the financial reporting quality of large manufacturing companies, the study strongly recommends manufacturing companies management to design and formulate strategiesthat will not only maximize total assets but also enhance financial reporting quality. For instance, maintaining internal control over financial reporting: maintaining accountability for assets, limiting access to assets, comparing financial record with existing asset, etc.

The study found that audit firms with higher number of certified audit professionals in audit service provide a better quality audit than the smaller counter parties. Therefore, the researcher recommends manufacturing share companies to get audited by such audit firms thereby enhancing their financial transparency through better quality audit.

This study found that Ethiopian manufacturing share companies actually engage in earning management activities but external auditors failed to inspect such practices. To curb such management opportunistic behaviour of manufacturing share companies, the researcher recommends companies to hire big size audit firm to conduct intensive audit. Further the researcher recommends interested users such as shareholders to reconsider how companies financial reporting quality is determined.

It is concluded that firms with better share dispersion have better reporting quality, so it is recommended that government monitory body of large manufacturing company shall consider owner dispersion as influencing factor of management opportunistic behaviour.

This study examined only firm specific determinants of financial reporting quality of large manufacturing share companies in Ethiopia because of resource and time limitation. Thus, future researcher may address these deficiencies by identifying different measure for reporting quality and conducting more qualitative investigation of each companies. Further this study explained only 65% of variation in FRQ, other researchers shall identify and clarify the path for including other variables.

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Appendix

Regression output from Eviews

Dependent Variable: FRQ
Method: Panel EGLS (Cross-section random effects)
Date: 05/02/16 Time: 04:13
Sample: 2010 2014
Periods included: 5
Cross-sections included: 14
Total panel (balanced) observations: 70
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-3.306623	1.285821	-2.571605	0.0125
LEV	-0.044148	0.239418	-0.184399	0.8543
COMP	-0.168776	0.227408	-0.742172	0.4608
PROF	2.292755	0.672806	3.407751	0.0012
LIQ	0.063389	0.044768	1.415937	0.1618
LOG_SIZE	-0.565998	0.156763	-3.610539	0.0006
AUD	0.616052	0.072820	8.459981	0.0000
DISP	0.049462	0.019621	2.520884	0.0143

Effects Specification	S.D.	Rho
Cross-section random	0.240659	0.4659
Idiosyncratic random	0.257676	0.5341

Weighted Statistics

R-squared	0.691602	Mean dependent var	-3.075235
Adjusted R-squared	0.656783	S.D. dependent var	0.435579
S.E. of regression	0.255183	Sum squared resid	4.037333
F-statistic	19.86273	Durbin-Watson stat	1.783644
Prob(F-statistic)	0.000000		

Unweighted Statistics

R-squared	0.646055	Mean dependent var	-7.120600
Sum squared resid	6.668492	Durbin-Watson stat	1.301183

Heteroskedasticity Test: White

F-statistic	1.253219	Prob. F(34,35)	0.2548
Obs*R-squared	38.43168	Prob. Chi-Square(34)	0.2756
Scaled explained SS	18.66744	Prob. Chi-Square(34)	0.9847

Test Equation:
Dependent Variable: RESID^2
Method: Least Squares
Date: 04/28/16 Time: 14:55
Sample: 1 70
Included observations: 70
Collinear test regressors dropped from specification

Variable	Coefficient	Std. Error	t-Statistic	Prob.

C	-3.790736	15.09303	-0.251158	0.8032
AUD^2	1.175171	0.833531	1.409870	0.1674
AUD*COMP	-0.017663	0.135356	-0.130492	0.8969
AUD*DISP	-0.014381	0.014681	-0.979597	0.3340
AUD*LEV	0.161588	0.222498	0.726245	0.4725
AUD*LIQ	0.011182	0.038933	0.287211	0.7756
AUD*LOG_SIZE	-0.133366	0.100882	-1.321998	0.1947
AUD*PROF	-0.167669	0.462962	-0.362165	0.7194
COMP^2	0.109930	0.315517	0.348412	0.7296
COMP*DISP	0.001693	0.025919	0.065311	0.9483
COMP*LEV	0.074665	0.591239	0.126286	0.9002
COMP*LIQ	0.063630	0.118035	0.539078	0.5932
COMP*LOG_SIZE	0.225658	0.273993	0.823591	0.4157
COMP*PROF	0.615146	1.338782	0.459482	0.6487
COMP	-2.017825	2.397261	-0.841721	0.4057
DISP^2	0.003632	0.004620	0.786071	0.4371
DISP*LEV	-0.078648	0.051883	-1.515884	0.1385
DISP*LIQ	-0.006583	0.010042	-0.655517	0.5164
DISP*LOG_SIZE	-0.021236	0.025559	-0.830852	0.4117
DISP*PROF	-0.190332	0.118199	-1.610269	0.1163
DISP	0.190752	0.219504	0.869016	0.3908
LEV^2	-0.642568	0.721035	-0.891175	0.3789
LEV*LIQ	-0.104506	0.164582	-0.634980	0.5296
LEV*LOG_SIZE	0.235431	0.509547	0.462041	0.6469
LEV*PROF	0.999074	1.915669	0.521528	0.6053
LEV	-0.895985	4.114447	-0.217766	0.8289
LIQ^2	0.006541	0.014128	0.462973	0.6462
LIQ*LOG_SIZE	0.011924	0.089373	0.133422	0.8946
LIQ*PROF	-0.895195	0.309118	-2.895970	0.0065
LIQ	-0.016044	0.734576	-0.021841	0.9827
LOG_SIZE^2	-0.058051	0.213026	-0.272508	0.7868
LOG_SIZE*PROF	0.727820	1.137094	0.640070	0.5263
LOG_SIZE	0.902473	3.573548	0.252543	0.8021
PROF^2	1.175221	2.780515	0.422663	0.6751
PROF	-3.674074	9.041472	-0.406358	0.6870

R-squared	0.549024	Mean dependent var	0.088937
Adjusted R-squared	0.110933	S.D. dependent var	0.099685
S.E. of regression	0.093993	Akaike info criterion	-1.584341
Sum squared resid	0.309214	Schwarz criterion	-0.460093
Log likelihood	90.45192	Hannan-Quinn criter.	-1.137776
F-statistic	1.253219	Durbin-Watson stat	2.158928
Prob(F-statistic)	0.254835		

Correlated Random Effects - Hausman Test

Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	5.805875	7	0.5626

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
LEV	0.114177	-0.044148	0.013883	0.1790
COMP	-1.187688	-0.168776	0.530480	0.1618

PROF	3.114427	2.292755	0.306524	0.1378
LIQ	0.039233	0.063389	0.000475	0.2678
LOG_SIZE	-0.609987	-0.565998	0.018892	0.7489
AUD	0.655892	0.616052	0.000681	0.1268
DISP	0.072790	0.049462	0.000640	0.3564

Cross-section random effects test equation:
Dependent Variable: FRQ
Method: Panel Least Squares
Date: 05/02/16 Time: 05:45
Sample: 2010 2014
Periods included: 5
Cross-sections included: 14
Total panel (balanced) observations: 70

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-2.830547	1.703235	-1.661865	0.1029
LEV	0.114177	0.266841	0.427885	0.6706
COMP	-1.187688	0.763017	-1.556568	0.1260
PROF	3.114427	0.871316	3.574394	0.0008
LIQ	0.039233	0.049794	0.787903	0.4345
LOG_SIZE	-0.609987	0.208486	-2.925787	0.0052
AUD	0.655892	0.077353	8.479226	0.0000
DISP	0.072790	0.032013	2.273786	0.0274

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.827316	Mean dependent var	-7.120600
Adjusted R-squared	0.756832	S.D. dependent var	0.522542
S.E. of regression	0.257676	Akaike info criterion	0.369100
Sum squared resid	3.253457	Schwarz criterion	1.043649
Log likelihood	8.081497	Hannan-Quinn criter.	0.637039
F-statistic	11.73773	Durbin-Watson stat	2.141764
Prob(F-statistic)	0.000000		