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Impact Of Board Independence on Financial Reporting Quality Of Pharmaceutical Companies in Nigeria.

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ABSTRACT:- The study so is set to examine the impact of Board Independence on Financial Reporting quality of Pharmaceutical companies in Nigeria. A total of 10 Pharmaceutical Companies were selected for the study. Time series data were obtained from annual report of Pharmaceutical companies from 2006 -2019. Accrual model was used to compute the proxy for financial reporting quality; while Board Independence is calculated as the ratio of Non-Executive to Executive directors on the Board. Regression analysis was used to analyze the data. The study indicated that Board Independence has significant impact on financial reporting quality of Pharmaceutical companies in Nigeria. Hence the study recommended that they should be inclusion of Non-Executive Directors into the Board which will help to promote quality of report.

Keywords: Board Independence, Pharmaceutical Companies, Accrual Model, Fincial Reporting quality.

I. INTRODUCTION:

The board of directors has long been recognized as an important governance mechanism for aligning the interest of managers and all stakeholders to a firm. Sanda,Garba and Mikailu (2008). The central role of board of directors in this process has therefore been recognized and in recent years has gain significant attraction for at least two reasons. One, both transition countries and other developing countries are struggling to attract resources for investment in an increasingly competitive global environment. Two, events at Enron, world com Health south, Tyco, and Waste Management and several other large corporations suggests the need for policies to promote board independence and other aspect of corporate governance. One of the corporate governance characteristics which are widely viewed as desirable in investigating costly managerial incentives relates to board independence. Khali &Ozkan(2013). It is argued that boards with a majority of independent directors in a place are more effective in controlling insider's opportunism

The ability of the board to effectively monitor the top management and to investigate the agency problems in greatly dependent in the board independence as the outside directors has absolutely to stake in the firm. Altuwajiri & kalyanaraman(2016) therefore board independence and other forms of firm governance is important, and particularly so in developing countries with weak institution that need to attract foreign resources.

To ensure that financial information conveys quality information to shareholders, company boards should be composed of a sufficient number of independent non executive directors who are more likely to be free from the management influence, Karamanou and Vafeas, 2005.The issue of board independence and corporate governance and in general has long been neglected in Nigeria. It was until November 2003 that code of corporate governance in general. Sanda, Garba& Milaliu(2008)The pharmaceutical sector is very vital to the economic development of Nigeria pharmaceutical companies promote socio-economic activities through the creation and development of drugs for human consumption. Yet pharmaceutical companies' investors hold poor perception about them in Nigeria. Good quality of financial reporting may help improve investor's perception.

II. CONCEPTUAL REVIEWS

A) The issue of board independence.

Board independence refers to the extent to which a board is comprised of non-executive directors who have no relationship with the firm beyond the role of directors, Davidson, Goodwin-stewart, and Kent (2005). A non- executive director is defined as a director who is not employed in the company's business activities and whose role is to provide an outsider's contribution and over right to the board of directors. A non-executive director who is entirely independent from management is expected to offer share holders the greatest protection in monitoring management. According to Fame& Jensen (1983) superior monitoring ability of non-executive can be attributed to the incentive to maintain the reputations in the external labour market. Board independent means when there are a significant proportion of independent non-executive directors. Non-executive directors are more effective in monitoring managers and protecting the interest of share holders and thereby reducing agency problem, Hillman and Daziel (2003). The code of cooperate governance recommends that non-

executive directors should be persons of calibre credibility and posses necessary skills and experience, at least one third of the board members should consist of independent non-executive directors for the board to be effective.

B) Financial reporting quality:

Financial reporting quality is referred to as the precision with which financial reporting present's information about a firm's operation Biddle, Hilary & Verdi (2009). Financial reporting quality is assumed to be fundamental to capital market, so information disclosure determines the efficiency with which resources are allocated. Bekiri & Doukakis (2011) users of financial statement are interested in the quality of earrings as well as the quality of reporting, because information influences their decision making.

Verdi (2006) defines financial reporting quality as the exact manner in which it shows information as regards a business activity and its anticipated cash flows, with the aim of informing the share holders about a company's operations. Financial reporting quality also refers to the degree in which financial statement provides us with information that is fair and authentic about the financial position and performance of an enterprise. It can be deduced from the statement that financial statement to be regarded as possessing high-quality attributes. It must be able to provide authentic or genuine information about the economic performance, financial positions and operations of cash flows with the aim of keeping share holders and other stake holders informed of the entity's current situation.

2.2 Empirical Review

Bako (2018) examined the impact of corporate governance on the qualities of financial reporting in Nigeria chemical and plant industry. The study made use of the total number of quoted companies on the Nigeria stock exchange as of December 2013 is taken as the population, sample of 4 companies were selected for a period of 5 years (ie2009 – 2013). The data used were obtained from annual reporting of the selected companies; the data was analyzed using correlation and regression. The study concluded that board size, as well as board independence have insignificant effect in the financial, reporting in the Nigeria chemical and plant industry. The study recommended that regulatory agencies should set up a committee to verify the appointment of non-executive directors so that grey directors should not form part of the board of firms.

Elshawarby (2018) investigated the characteristics of the board of directors and their impact on the delay of external auditors report by applying to companies listed in the Egyptians stock exchange. The study made use of sixteen (16) listed companies in Egyptians stock exchange during the period (2013-2016). The data were obtained from published annuals reports of the sample companies on the Egyptians stock exchange website. Multiple regression analysis was used to test hypothesis of the study. The study found out that board size, board independence and experience of board of directors, has impact on the delay of the external report. The study hence recommended that there is need for legislation at the local and global level that enhances the characteristics of the board of directors in companies and its impact in delaying the issuance of the independent audit report so that it becomes mandatory for companies which in turn enhances the credibility and reliability of the financial statement.

Amran and Manaf(2014) examined board independence and accounting conservation in Malaysian companies. The study period of the study was between2000-2012. The study found out that higher board independence does not align with higher conservation. Instead the independent non-executive directors do not actually have the power of independence, monitoring and advising the board of directors.

Bakare (2019) did a work on board independence and audit quality in Nigeria. The study utilised 71 non-financial firms for the periods of 2009-2016. Audit quality was measured using a dummy variable of **"1"** and **0** with 1 representing the use of a big for auditor by the firm and 0 otherwise. **B**oard independence was measured using the population of non-executive directors to total directors. The data collected was analysed using the binary logic regression analysis. The findings reveal that board independence is negatively related to audit qualities. The study recommends that the composition of non- executive directors as members of the board should be sustained and improved upon.

Yohan An (2016) examined the effects of outside directors quality in firm value and earnings qualities of Korean listed firms, using panel data during the period 2000-2012. The study classifies quality of outside directors into 3 categories: 1 non financial expert 2) financial experts3) Gray experts .The study finds that outside directors on board positively affects firm value but not earnings quality. In the view of quality of outside directors only finance experts increase firm value but do not affect earnings quality.

Alzoubi(2014) investigated bard characteristics and financial reporting quality. Evidence from Jordan. The study throws light on the principle features of the board of directors ie board independence, C.E.O duality, financial expertise, governance, the paper used cross sectional version of the modified Jones model. A total of 86 industrial listed on Amman stock exchange for the years of 2008-2010. Discretionary accruals are used as proxy for EM. The findings of the study demonstrate that board independence, financial expertise, governance

expertise have a negative relation with earning management. It also found that C.E.O duality and board firm-specific expertise have an obvious positive relation with discretionary accruals.

Abudulamlik (2015) examine financial reporting quality, the role of independent and grey directors, board continuous training and internal audit function. The paper employed a sample of top 100 Malaysia firms identified by the Malaysia share holders watch dog group (MSWG) between the periods 2010-2011. Feasible GLS (FGLS) regression estimation method was used to test the relationship between the dependent variable of interest. The regression results reveals that while the population of grey directors in board room positively and significant relates with both accrual and real earnings management the proportion of independent directors was negative and significantly affect accrual and real earnings management. The study's findings have implication for future regulatory initiative, as our results suggest that board mechanisms as our results suggests that board mechanism specifically board mechanism specifically board composition are not effective in improving the quality of reported figures.

2.3 Hypothesis.

Board independent has no significant effect on financial reporting quality Pharmaceutical companies in Nigeria

2.4 Theoretical Review

This Work is based on Stewardship theory, which upholds that directors frequently have interests that are consistent with those of shareholders. According to them, there will not be any major agency cost, sine mangers are naturally trustworthy, Donaldson, (2003). Donaldson &Davis (1991) suggest an alternative ''mode of man'' where organizational role holders are concerned as being motivated by a need to achieve and gain intrinsic satisfaction through successfully performing inherently challenging work to exercise responsibility and authority and thereby to gin recognitions from boss. According to them where mangers have served a corporation for a number of years, there is a merging of individual ego in the corporation.

Cullen, Kirwan &Brennan (2000) opine that stewardship theory upholds that there is no inherent general problem of executive motivation. This implies that extrinsic incentive contracts are les crucial where the gain intrinsic satisfaction from performing their duties. Stewardship theory protects and maximizes shareholders wealth by so doing the steward's utility functions is maximized. The theory upholds that the attainment of organizational success also satisfies the personal needs of the steward.

The Steward derives greater utility from satisfying organizational goals that through self serving behaviour. The theory recognises the essential of structure that empower the steward offering maximizing autonomy but upon trust.

III. METHODOLOGY

3.1 Research Design

The research design adopted in this study is the ex post facto research design.

3.2. Method of Data collection and Analysis.

Annual time series data was employed ranging from 2006-2019 with a sample size of 10 pharmaceutical companies, and Annual report published by the pharmaceutical companies Selected.

In this study Accrual model was used as a proxy for financial reporting quality serves as the dependent variable. Accrual model was developed by Jones 1991 which is

$\Delta WC = CFO_{t-1} + CFO_1 + CFO_{t+1} + \Delta Sales + PPE + €$

Where ΔWC= Change in Working Capital in year t, ie ΔAccounts receivables +Δinventory – ΔAccounts Payable – Δtaxes payable + Δother assets (Net).

CFO_{t-1}= Cash flow from operation in year t-1

CFO_1= Cash flow from operation in year t

CFO_{t+1}= Cash flow from operation in year t+1

ΔSales= Sales in Year t less sales from Operation in year t-1

GPPEt= Gross property, plant and equipments in the Year.

The Independent Variable is the board independent which is computed as the ratio of non-executive to executive directors on the board.

Proxy for financial reporting quality is the accrual model which is calculated using Jones model.

The study made use of simple linear regression sine the explanatory variable (Board Independent) is one. The method of data analysis is Ordinary Least Square (OLS) technique. The statistical formation of the model is presented as follows:

FRQ = f (BI)

The simple linear relationship is stated thus:

$LOGFRQ = \beta + \beta_1 \text{ LOG BI} + \mu$

Where:
FRQ- Financial Reporting Quality
BI-Board Independent
β- Intercept
β_1- Estimation of Coefficient
μ- Error term

IV. RESULTS AND DISCUSSION.

Dependent Variable: ACCRUAL				
Method: Least Squares				
Date: 08/16/20 Time: 00:31				
Sample: 1 120				
Included observations: 120				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
BIND	0.276909	0.076432	3.622938	0.0004
C	5.552461	0.161305	34.42213	0.0000
R-squared	0.100100	Mean dependent var		5.039372
Adjusted R-squared	0.092474	S.D. dependent var		0.887917
S.E. of regression	0.845867	Akaike info criterion		2.519617
Sum squared resid	84.42792	Schwarz criterion		2.566075
Log likelihood	-149.1770	F-statistic		13.12568
Durbin-Watson stat	0.488060	Prob(F-statistic)		0.000431

The value for the coefficient for BIND (i.e β_1) is 0.276909, while the constant intercept, c is 5.552461. The value of 5.552461 for c represents what financial reporting quality of Pharmaceutical companies quoted in Nigeria will be without Board independence.

The value 0.276909for β_1 implies that holding all other factors constant, a unit increase in BIND (Board independence) will lead to0.276909 increases in financial reporting quality of Pharmaceutical companies quoted in Nigeria. R^2 tells the percentage variation in financial reporting quality of Pharmaceutical companies quoted in Nigeria explained by Board Independence. By implication, the value of 0.100100 means that about 10% of total variation in financial reporting quality of Pharmaceutical companies quoted in Nigeria is as a result of changes in Board Independence, while 90% is unexplained. This remaining percent could be caused by other factors or variables not built in the model. The estimated F-value is significant at 1% level (because the p value is zero) we can strongly reject the null hypothesis that Board Independence has no significant impact on financial reporting quality of Pharmaceutical companies quoted in Nigeria. We therefore conclude that that Board Independence has a significant impact on financial reporting quality of Pharmaceutical companies quoted in Nigeria.

V. CONCLUSION AND RECOMMENDATIONS.

This Study examines the impact of Board Independence on the financial reporting quality of pharmaceutical companies in Nigeria .The study found out that Board Independence is associated with the quality of financial reporting. The implication of the result is that the ratio of non-executive directors to the executive director has or tends to have a positive and significant effect on financial reporting quality of firms. This result is consistent with the findings of Akejua &Babatude(2017), Waidi & Kreem (2017). Inclusion of non-executive directors who are not servant of the company into the board should be encouraged as this will promote financial reporting quality. Hence the following recommendations were made

-The should be compliance to code of corporate governce as enshrined by the regulatory authorities guarantee continues existence of this firms which in turns establishes confidence in the mind of shareholders.

-They should be heavy sanction for those firms that may violet SEC regulation and other regulatory authorities.

-That the regulatory authorities should restrict their regulatory framework and strengthen their supervisory capacity to ensure a smooth working relationship with firms and prevent distress and failure.

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