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### RESEARCH ARTICLE

#### POLITICAL INFLUENCE AND GOVERNMENTAL FINANCIAL REPORTING.

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#### Abstract

Financial reporting quality (FRQ) refers to better information dissemination across different user groups. It remains a prevalent phenomenon for assessing organizations' performance and survival. Drawing on theoretical exigencies, this study tests the effects of political influence on FRQ using survey research approach and self-administered questionnaire. Data were gathered from 118 directors of finance representing local governments from four States at the north-west geopolitical zone of Nigeria. The regression estimate revealed a significant positive relation between political influence and FRQ. The study implication was discussed in the context of Nigeria.

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#### Introduction:-

Political influence is one of the institutional factor considered to influence the level of financial disclosure of an organization (Carpenter, 1991; Giroux, 1989; Misra, 2010; Zimmerman, 1977). Under the governmental sector, the extent of financial reporting quality (FRQ) is said to be determined among other reasons, by the interplay of incentives and relative powers expressed by a given user group and that of account preparers of organizations (Giroux, 1989; Zimmerman, 1977a). Key participants concerned with local government financial reporting include preparers (bureaucrats), citizens (voters), political officials, legislatures, local government employees and special interest groups (Giroux, 1989). This, however depends on the level of political awareness and configuration of the concerned constituencies (Carpenter & Sharp, 1992; Gallhofer & Haslam, 2007).

Extant literature have adopted users-preparers incentives and powers to explain financial reporting outcomes (Aljarde, 1997; Daniels & Daniels, 1991; Giroux, 1989; Robbins & Austin, 1986). It has been documented that, high financial reporting quality is influenced by high political influence (Batta, Heredia, & Weidenmier, 2014; Carpenter & Sharp, 1992; Giroux, 1989; Mellemvik, 2015). That is, in the public domain, based on the extent of power at the disposal of users of financial reports, they are expect to demand for financial reporting that possess appropriate quality to satisfy their economic decisions. The political officials, in other to serve the citizens, needs annual operating budgets submitted by the bureaucracy (preparers) to draw up annual budget plans. The government employees expectedly, demands information that discloses their benefits and entitlement from the governments. While preparers who are part of the organization's bureaucracy, express their political power and interest over the choice to either issue sufficient reports or withhold information for reasons of vested interest (Giroux, 1989; Zimmerman, 1977a).

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Therefore, the proposition in the present paper is that, the relative incentives and power of these groups can be ascertained by testing the measures of financial reporting quality (FRQ) against measures of political influence (power and incentives). This approach of examining the effect of political influence on FRQ has witnessed limited research consideration as a key organizational contingency that affects FRQ. Thus, testing this relationship (FRQ-political relations) adds to the literature on accounting reporting, particularly in the context of developing countries with an emerging political awareness. Therefore, the objective to be achieved by this paper is to test the perceived FRQ against perceived political incentives and powers exercised using theoretical exigency of agency and institutional theory. To achieve this objective, the paper based on preparers perception, designed questionnaire instrument that allows for measurement of the association between the perceived FRQ and political influence in a local government setting.

The choice of agency theory in the study enables us to demonstrate the implication of the contractual relationships between the financial reporting participants that necessitates the need for effective and appropriate financial reporting for governmental units. While institutional theory allow us to demonstrate how institutional considerations affects organizational outcomes. The remaining part of the paper continued thus: section two conceptualized the key variables of the study. Section three reviews prior studies regarding the relations between the underlying variables. Section four discusses the underpinning theories and formulation of hypothesis. The study's methodology and measurements were enumerated in section five. Analysis and result of the study's estimates forms the sixth section. While discussion of the paper and conclusion lies in section seven and eight respectively.

### **Conceptualization of Variables:-**

#### **Financial Reporting Quality:-**

Financial reporting is a communication medium between the preparers of accounts and the users (Tasios & Bekiaris, 2012). The preparers provide financial report to users who uses them for economic and financial decisions. The potential users of financial reports vary widely and include creditors, suppliers, financial analysts, government authorities, regulators and related stakeholders of organizations (Tasios & Bekiaris, 2012). Jonas and Blanchet (2000), states that "quality financial reporting is full and transparent financial information that is not designed to obfuscate or mislead users. In terms of its measurements, methods such as, accrual accounting model (Healy & Wahlen, 1999; Van Tendeloo & Vanstraelen, 2005), value relevance models (Barth et al., 2001, 2008, Maines & Wahlen, 2006), method focusing on specific elements of the annual report (Hirst, Hopkins, & Wahlen, 2004) have often been used to measure FRQ in the private sector. While in public sector, FRQ is measured largely through the operationalization of the qualitative characteristics of the financial statement (Braam & Beest, 2013; McDaniel, Martin, & Maines, 2002; van Beest & Braam, 2006; Van Beest, Braam, & Boelens, 2009)

Conceptual measurement of the qualitative characteristics of financial reports have been developed by international accounting bodies such as the International Accounting Standard Board (IASB), International Federation of Accountants (IFAC) and the Financial Accounting Standard Board (FASB). This measurement primarily offers a comprehensive perspective for assessing the entire range of qualitative characteristics of the financial report (IASB, 2010). By this, different dimensions have been adopted to describe the qualitative attributes according to the literature. Accordingly, qualitative attributes/characteristics such as concept of relevance, faithful representation, understandability, comparability and timeliness are considered as potential qualitative factors that describes FRQ (Cohen, 2003; Cohen, Kaimenakis, & Venieris, 2013; IFAC, 2009a; IFAC, 2015; Jonas & Blanchet, 2000; Van Beest et al., 2009).

The qualitative characteristics of financial reporting model have been adopted at varying combination by different authors (Braam & Beest, 2013; Cohen, 2003; Cohen, Kaimenakis, & Venieris, 2013b; Jonas & Blanchet, 2000; Mbobo & Ekpo, 2016; McDaniel, Martin, & Maines, 2002; Suwanda, 2015). The underlying benefit of the model is, it provides a direct measure of financial reporting quality and covers all aspects of financial reports, including both financial and non-financial information. Although, in this paper, focus was on two sets of qualitative characteristics, namely, relevance and faithful representation. This, with a view to achieve parsimony in concept development and measurement (Arthur, 2011; Berry, Ones, & Sackett, 2007; Glomb & Liao, 2003). Notwithstanding the trade-off in this approach, we opted for simplicity rather than generalizability as may be inferred by the multidimensional consideration. In the view of Blalock (1979), generalization and simplicity cannot be achieved simultaneously. Moreover, the framework of IASB (2010), IFAC (2009b), referred to the qualitative attributes of relevance and faithful representation as the fundamental qualitative characteristics underlying usefulness of information for users' decision making.

Furthermore, Jonas and Blanchet (2000) informed that, the overall objectives of financial reporting is to provide users with useful information to make economic decision, and according to the conceptual frame of professional accounting boards (e.g. FASB, IASBs, IFAC), useful financial information must be relevant and be faithfully represented. Nonetheless, Jonas and Blanchet (2000) indicates that, some more specific qualitative attributes related to the two characteristics help determine relevance and faithful representation. For instance, according to Financial Accounting Standards Board (FASB 1980), timeliness is an ancillary aspect of relevance. Therefore, for purpose of measurement, relevance is largely operationalized in terms of predictive and confirmatory value (Braam & Beest, 2013; Mbobo & Ekpo, 2016; McDaniel et al., 2002). While faithful representation is operationalized in terms of neutrality, completeness, freedom from material error, and verifiability (Braam & Beest, 2013; Cohen, Wright, & Krishnamoorthy, 2004; Jonas & Blanchet, 2000).

Therefore, the present paper adopts relevance and faithful representation as dimensions to measure FRQ. Relevance is measured on items that determines the entity's ability to generate information about future operation and/or economic activities and whether the annual reports provides information about past operation and/or economic activities about the entity. On the other hand, faithful representation is measured in terms of the ability of financial reports to be presented in a comprehensive and transparent manner and whether the annual reports present information regarding positive and/or negative financial events of the entity.

### **Political Influence:-**

The importance of politics on specific issues of change is well documented in management literature. Burns (2000) opined that politics plays significant role in driving and shaping change processes. Early writers on basic issues on politics views politics as "attaining interest-based demand" (Pettigrew, 1973); "getting things done in your own way" (Buchanan & Badham, 1999). The centrality of politics as an organizational factor have been well researched (Archidona, Gandi, Gandia, & Archidona, 2008; Batta et al., 2014; Keerasuntonpong, Dunstan, & Khanna, 2015; Lopez Hernandez & Caba Perez, 2004). Its influence in the field of accounting and financial reporting have generated diverse research interest (Carpenter & Jones, 2015; Rita Hartung Cheng, 1992; Ingram, 1984; Khumawala et al., 2014; Martani & Lestiani, 2012; Misra, 2010; Salleh, 2009; Zimmerman, 1977).

Among the seminar work in this line was Zimmerman (1977), which examend the institutions and incentives of voters and politicians on the state of municipal accounting reporting and proposed economic policies for accounting reforms among US municipalities. Ingram (1984), provided evidence on the association between economic factors and cross-sectional variations in accounting practices of state governments with specific interst on determining the characteristic of states that report quality accounting information and compliance with GAAP. This was extended by Carpenter (1987), using economic interest group theory developed a positive theory of governemrnt to examine the influence of political competition on governemnt financial disclosure practices.

However, the general notion of political influence on financial reporting outcomes is predicted on the assumption that the complexities of financial reporting disclosures are motivated by the incentives of account preparers' and power of the users of the financial information. This has been well illustrated in the work of Giroux (1989), Baber et al (1986), Ingram (1984), Carpenter (1987), where the key actors in the political competition were identified to include: bureacrats (preparers), voters, elected officials and special interest group (e.g. employee). And their relative power and incentives can be determined by measuring the direction of the financial reporting quality agianst the measures of their political influence. Thus, it is assumed under theory of public goods, accounting information are public goods (Watts & Zimmerman, 1986) which can be shaped by individual preferences expressed through political mechanisms (Craswell, 1975).

Moreover, Zimmerman (1977) describes influence of political interest group on financial reporting as the interrelationship between preparers incentives to produce quality information and users power to demand for needed information. This implies that, financial information needs of potential users are appropriately disclosed according to the extent of their power to influence the political system (Carpenter, 1987). For example, voters information needs are to be satisfied by the elected officials through decision taken in respect of the annual operating budget submitted by the prepaers (Giroux, 1989). Since voters cannot directly influence the bureacracy, they then employ mechanism of political pressures such as, voting, financial support for elected officials (Moe, 1984). Consequently, within organization arrangement, information on pension and employee benefits are needed by the government employees to allow for understanding of work entitlements . The bureacrats are preparers of the financial reports,

and they demonstrate their vested interest and incentive through possibility to withhold or provide complex confounding information to users.

The differing measures used by previous studies to operationalize political influence variable as shown above, particularly among the governmental constituencies, suggests that contextual differences and jurisdictional considerations interacts to define the results of the respective studies. Therefore, in the light of the above, the present study adopted seven items as proxies to operationalize political influence as an institutional factor.

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These items have been adopted from the study of Giroux (1989). The justification for adopting this items include, first, the measure is comprehensive and captures the relative interest and interactions between key actors that influences local government financial reporting quality. Second, the theoretical underpinning for the development of the items have been inferred from theory of “public choice” which has significant benefit on studies regarding the public sector and in particular, previous studies have recommended its application in accounting research (Chan & Rubin, 1987).

#### **FRQ and Political Influence Relations:-**

Political influence is one of the institutional factor considered to influence the level of financial disclosure. An exploratory research conducted by Ingram and Copeland (1981) based on 113 municipalities reveals useful information to explain voters’ incentives to utilize municipal accounting information as a basis to measure incumbent’s performance. Empirical evidence in the study of Baber et al (1986) finds that political costs and anticipated benefits of bargaining among political parties and their supporting interest groups in the case of debt-financed spending significantly affect accounting disclosure.

Another study by Archidona et al. (2008) assessed the extent of information disseminated on the internet by large Spanish city councils in relation to what factor(s) affects the observed levels of information disclosure. The regression estimate reveals that, political competition constitutes among factors that significantly influence quality financial disclosure. Relatedly, Serrano-Cinca et al (2009) finds significant positive relationship between political influence and quality of internet financial reporting among local government administration.

Conversely, few studies such as Giroux (1989), Zimmerman (1977) have reported insignificant relationship between political influence and FRQ. For instance, Giroux (1989), examined the relationship between political influence and financial reporting disclosure on cities of US municipalities. The regression analysis reveals overall, that political influence has limited significant influence on the disclosure quality. This finding support earlier studies by Zimmerman (1977), that there is little incentive (political influence) by users (voters) of annual reports in ensuring effective monitoring and scrutiny of preparers of accounting practices.

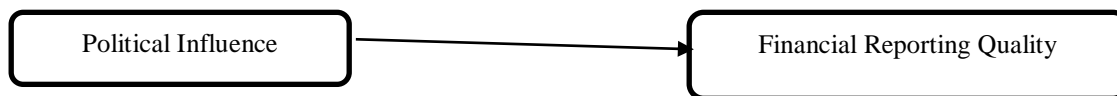
Base on the above review, more studies is needed to test the influence of political influence on FRQ due to the inconclusive findings. This is more pertinent regarding studies on developing countries that are still witnessing a less developed political system. Apart from this, studies examine the implication of the political system on disclosure quality in the countries are still scanty.

#### **Theory And Hypothesis:-**

The analysis of the theoretical review in the previous section signifies the implication of political influence as an organizational factor that influences FRQ. Consequently, the interplay of political power among interest groups (users and preparer) in the government sector constitute the major cause of variation in the findings of previous research. Nonetheless, to allow for formulation of testable hypothesis, this study invoked theoretical exigency of agency theory to contextualize the perspective of political influence on FRQ. Based on the theory, it has been

established that, public governmental sector is characterized by the principal-agent contract, which requires the adoption of efficient governance mechanism to ameliorate the effect of agency problem that may be created by account preparers. This mechanism promotes efficient accounting and administrative monitoring as a way of checking the activities of the agent. This became illustrative from the study of Giroux (1989) that high levels of disclosure should be associated with cities having high political competition and low bureaucratic power.

On the contrary, low political influence, that is, where the citizens have low political incentive and power to demand for quality financial disclosure, or the winning chances of the incumbent government (political executives) is very low, its result to low political influence and weak internal control mechanisms to monitor bureaucratic opportunistic tendencies, thus, leading to low quality disclosure. However, prior studies that have examined the interplay of political incentives in relation to FRQ mostly describe the political influence as an endogenous organizational contingency (Batta et al., 2014; Giroux & Jones, 2011; Jones & Giroux, 2002; Zimmerman, 1977b). Nevertheless, in the realm of sub-national government (e.g. local government) where there is lack of absolute operational independence, political influence transcends the limit of organizational jurisdictions. Based on this argument, the present study conceived political influence as an exogenous institutional factor that portends possible influence to shapes organizational financial reporting outcome. This is relationship can thus, be illustrated in Figure 1 below.



**Figure 1:-** Conceptual Model

Furthermore, this perspective is consistent with institution isomorphic coercive theory, which compels organizations to adopt formal or informal structures or rules, including governmental mandate (DiMaggio and Powell, 1983). That is, coercion may originates from political influence and the need for legitimacy that forces organizations and decision-makers to follow or adopt certain institutionalized rules and practices by other organizations upon which they are dependent and by cultural expectations from the society within which the organizations function (Ahmad, 2015; Mustapha et al., 2017). This was exemplified in the study of Mustapha et al (2017) in the case of Nigeria, where the government adopted the cash-basis IPSAS across the three tiers of government and are coerced to adopt. Moreover, Leuz et al. (2004) opined that politics in accounting as an institution, which affects changes or may prevent proposed changes and may also subjects current accounting practice to scrutiny.

Therefore, the imperatives of government will towards good governance and accountability is a potential support for rendition of high quality financial reports by government units. Meaning that, high political influence expectedly should result to high quality financial reporting and accountability. This notion depicts prior findings by Keerasuntonpong et al. (2015). To empirically substantiate this arguments in the context of this paper, the hypothesis is stated thus:

**Ha:** *High political influence has significant positive influenced on FRQ*

#### **Methodology and Measurements:-**

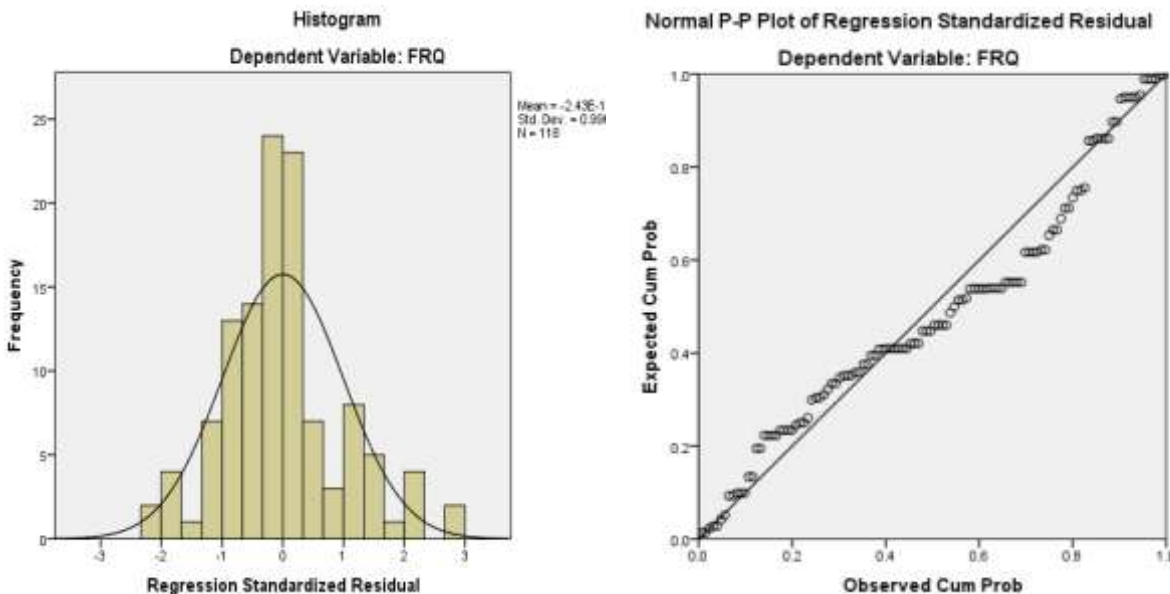
This study's unit of analysis are the 124 Local government councils that formed the four States drawn from the Northwest geopolitical zone of Nigeria (Kaduna, Kano, Katsina and Sokoto). Data were collected from total of 118 directors of finance representing the sample local governments. The data collected relates to information representing their perception concerning their respective local governments. Directors of finance were selected as subjects for the research based on the understanding that they possessed the required knowledge and experience about local government accounting and operations. This understanding is consistent with the views of Larcker and Lessig (1980) that argues that managers (preparers) possess sufficient insight based on their decision process to specify information they consider useful.

Further, self-reported questionnaires were personally administered to the sample local government councils. To reduce the effects of common method variance (CMV), several procedural remedies were adopted as suggested by Podsakoff and Organ (1986), such as, elimination of ambiguous items from the questionnaire, allowing for respondents' anonymity and avoiding respondents evaluation apprehension. Table 1, outlines the demographic profile of the respondents.

As shown in the study's conceptual frame work (Figure 1.), the latent variables for this study are two, namely, financial reporting quality (FRQ) as the explained variable, political influence (POL) as the predictor variable. FRQ was measured by four items adapted from the study of Bartov, Goldberg, and Kim, (2005), Jonas and Blanchet (2000), McDaniel, Martin and Maines (2002). We asked respondents perception on 7-point scale statements, ranging from "1" "strongly disagree" to "7" "strongly agree" on statement such as "The annual financial report concerning your local government discloses information about future operation and/or future economic activities of the council". Items operationalized to measure political influence were rated based on 7-point Likert-scale. Here, respondents were required to express their level of agreement or otherwise, i.e. 1 (strongly disagree) and 7 (strongly agree). Seven (7) items were adapted from the study of Giroux (1989) and we asked questions such as "service delivery is used by politicians in your LG for re-election campaign".

### Analysis and Results:-

Consequent upon the data generated from the survey, a normality test was performed prior to running the regression analysis in order to ascertain the normality of the data. A data set is referred to as normally distributed when its curve resembles a symmetric bell-shaped, having highest frequency in the middle and lower frequencies towards the extremes (Gravetter & Wallnau, 2000). Therefore, to ensure that the assumption regarding normality of the distribution is not violated in the present paper, the graphical representation of normality test was explored. Figure 6.1 presents the normality distribution in a graphical form.



**Figure 6.1:- Histogram and Normal Probability Plots**

Based on graphical approach, the recommendation of Srivastava (1984) and Gravetter and Wallnau (2000) regarding histogram and normal probability plots were examined. As revealed in Figure 5.1, the shape of the histogram depicts a symmetrical bell-shaped curve and in the normal p-plots, the plots revolve around the straight line. These according to the two figures indicates that the data from the survey were normally distributed (Gravetter & Wallnau, 2000; Srivastava, 1984).

Next, is to present the result of the regression analysis which was performed using SPSS software 22 version. Table 6.1 presents the result of the descriptive value, the standard deviation, the variance explained of the model (R-square), the t-value and the significance level of the postulated hypothesis.

**Table 6.1:- Regression Result**

Variable	Mean	SD	R-square	t-value	Sig.
Political influence	24.57	10.72	0.667	34.911	0.000***
***p<0.01	Dependent variable: Financial Reporting Quality, n= 118				

First, the descriptive statistics of the predictor variable (political influence) shows a mean value of 24.57 with a standard deviation of 10.72. Given the minimum and maximum values of the variables, it shows the relationship between the variable has a good fit. This followed by the variance explained of the model. Accordingly, the R-square value represent 0.667 (66.7%) of the model, depicting that the predictor variable – political influence account for 66.7% of the variance in FRQ. Next is the level of correlation between the variables. Based on the postulated hypothesis, it was predicted that high political influence has significant positive influenced on FRQ. Thus, based on the result on Table 6.1, this hypothesis stood supported. Because, at 1% (0.01) significant level, the statistical estimate reveals thus (t-value=34.911 and sig. 0.000). Suggesting that, political influence significantly influence FRQ amongst the local governments understudy.

### **Discussion:-**

The primary objective of this study was to examine the effect of political influence on financial reporting quality (FRQ). That is, to investigate whether political influence occasioned by the interplay of interest and powers of users and preparers matter in shaping financial reporting outcomes. Moreover, inference from the statistical result concerning the hypothesized relationship revealed a significant and positive relationship between political influence and FRQ. This suggests that, based on the measures adapted for the operationalization of political influence in this paper, FRQ is significantly and positively affected by political influence. This result is consistent with findings of previous studies (e.g. Baber et al., 1986; Carpenter, 1991; Keerasuntonpong et al., 2015; Misra, 2010; Serrano-Cinca et al., 2009). For instance, Serrano-Cinca et al (2009) finds significant positive relationship between political influence and quality of internet financial reporting among local governments in Spain.

Furthermore, the result substantively illustrates the theoretical postulation of institution theory of isomorphic coercion (DiMaggio and Powell, 1983), which demonstrates that, due to political influence and incentive for legitimacy, organizations are susceptible to adopt institutionalized rules imposed by other organization upon which they are dependent. That is, the local government, being a sub-national government at the grassroots, may be coerced by higher governments to adopt necessary internal control mechanisms within the local government (e.g. audit and oversight functions) to forestall transparency and accountability that will consequently impacts on quality financial disclosure.

However, within the context of the present study, plausible explanation for this may be inferred from the recent development leading to adoption of the cash-basis IPSAS in Nigeria across the three tiers of government (Federal, State and local government). Like other countries, Nigeria adopts the cash-basis IPSAS out of the need to secure international legitimacy and relevance (Abimbola et al., 2017; Suchman, 1995). Therefore, to demonstrate their seriousness with the new accounting reform in the eyes of the world, government of Nigeria took some proactive measures which seems to have strengthen mechanisms for internal control scrutiny and control (e.g. internal audit). This responsibility (political influence) might probably have caused the observed significant effect of political influence on internal control mechanisms (e.g. auditing) to influence FRQ.

Overall, result of statistical inferences and justifications of the current study portends a significant implication for theory and practice. Firstly, additional empirical evidence has been provided in this study, particularly in the area of institutional implication and financial reporting quality, which indicates that, the interplay of political competition has a significant effect on the quality of reporting outcomes. This area adds to extend the literature on accounting reporting, that political influence is an important environmental contingency that needs to be considered while making decision on how to improve FRQ in the public sector.

However, as it is common with other studies, the present study seems to have limitations regarding method of data collection, number of explanatory variable. Nonetheless, for benefit of future research, this limitations may be overcome. First, this study may need to be replicated in different settings and context, using different sample and methods to further validate the revealed findings. Second, a longitudinal research design approach may be explored in future research, to detect and provide insights into changes over time. This may serve as an advantage over the present study that adopted a cross-sectional design, with causal inferences could not be made to the population.

Third, FRQ has been measured in the present study through a self-reported measure, and the use of self-report measures as been accused of the problem of common method variance (CMV) and social desirability bias (Podsakoff & Organ, 1986). Although this challenges have been ameliorated in this paper through several procedural remedies suggested by Podsakoff and Organ (1986). Therefore, future research may attempt other methodology to measure FRQ in the context of public sector, such as compliance indexing, examining specific items

of the annual reports to ascertain reporting quality. In addition, given that the model for this study explained 66.7% of the total variance of factor that influences FRQ, means that more studies are needed to uncover more potential factors that affects FRQ.

### Conclusion:-

The objective of this paper was to carry out a study on local governments, with a view to examine the perceived role of political influence on quality of accounting reporting amongst local governments in Nigeria. The present paper was able to reveal that high political influence significantly and positively influences perceived FRQ. These results however, underscore the importance of political factor as an important consideration in ensuring quality financial reporting among governmental agencies. Finally, this study provides some useful understanding into perceptions of preparers of financial reports among local governments in Nigeria.

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