Local Government Characteristics and Financial Reporting Quality: Evidence from Lagos, Nigeria

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Abstract: *Against the background of the recurring challenges revolving around accountability of local governments in Lagos, Nigeria, this study examined the effect of local government characteristics on financial reporting quality in Lagos, Nigeria. Ex post facto research design was employed, on the basis of which secondary data were gathered from the audited financial statements of fifty-seven (57) local governments and local council development areas in Lagos state. Four research objectives were specified, while four hypotheses were formulated and tested. The data collected were descriptively analysed using mean, skewness, kurtosis, while logistic regression was adopted to inferentially test the four hypotheses. Findings revealed that capital expenditures ratio have no significant effect on financial reporting quality of local governments in Lagos, Nigeria ($\alpha = -0.0006$; p-value > 0.05). However, further results showed that size has significant influence on financial reporting quality of local governments in Lagos, Nigeria ($\alpha = 0.2937$; p-value < 0.05). Based on these findings, the study concluded that size and wealth significantly determine the quality of financial reports presented by local governments and local council development areas in Lagos state, Nigeria. The study recommended that local governments and local council development areas are to be encouraged to increase their carrying capacities and gets bigger, as doing these would be expected to engender increasing financial reporting quality.*

Keywords: Capital Expenditure Ratio, Financial Reporting Quality, Location, Size, Wealth,

1.0   Introduction

Financial reporting quality is one of the important yardsticks with which stakeholders assess and determine the quality of information they are provided by organisations (Krishnan, 2011). This applies whether the entity is in public sector or private sector. Generally, its purpose is to provide useful information for the decision-making process. However, as organisations tend to prepare and present their financial statements using different types of accounting principles (Choi & Pae, 2011), comparability becomes an issue, perhaps, snowballing into other larger problems connected with financial reporting malpractices. And so, the importance of a robust financial reporting process which engenders financial reporting quality cannot be over-emphasised. In the same vein, Chen, Wang & Zhao (2009) posited that high-quality accounting information is a valuable method used to counteract information asymmetry.

Financial reporting quality is strongly speculated to be one of the causes of stakeholders' distrust in a weak stock market. Its risk is associated with the inability to gain access to the information concerning the market situation, investee condition, and debts (Knechel & Salterio, 2016). Quality of financial information is influenced by the risk of the company's failure to obtain profits from creditors in the form of debt (Veliandina, 2013). It is also key issue that considerably drives transparency and accountability, especially in non-profit entities such as local governments.

The management of local governments is solely responsible for 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). Financial reporting aims to provide quality financial information to stakeholders (investors and creditors), driving plethora of activities, particularly, as it relates to source of organisational funding. Local governments are not exempted from matters connected with financial reporting quality, in the light of the fact that they are the grassroots governments saddled with even far greater transparency and accountability standards and responsibilities geared at driving multi-faceted developments. Their activities and performances affect greatly, people at that level and so, accountability through a sound financial reporting mechanism cannot be more crucial.

Indeed, organisations, through their managers, are duty-bound to report business activities for the benefit of shareholders, potential investors, regulators/policy makers, suppliers of finance and other stakeholders. This is usually done through the production of annual reports covering their economic, financial, environmental and social activities. These reports are expected to be high quality information, portraying a true and fair view of transactions. However, the practice of earnings management, which runs contrary to

the theme of financial reporting quality, punctured this process of producing quality financial reports and questions the credibility of the quality of reported earnings (Shehu & Abubakar, 2012). As not much is known about what drives financial reporting quality in local governments in Lagos, Nigeria, this study, therefore, investigates the characteristics of local governments as determinants of financial reporting quality, providing evidence from Lagos, Nigeria.

1.1   Statement of the Problem

Stakeholders require information that would enable them predict the future cash flows of local government and the risks they face (Grace & Ambrose 2013), amongst other informational needs, through financial statements. The quality of these statements will strongly influence the decisions made or to be made by these stakeholders. Financial reporting quality presupposes that organisations should voluntarily expand the scope and quality of the information they report, to ensure that stakeholders to whom they hold stewardships are fully informed in order to make well-grounded decisions. This promotes accountability, satisfies stakeholders' needs and greatly facilitates transparency, which in turn reduces the problem information asymmetries. However, the ceaseless yearnings on poor accountability and transparency by the governed about local governments performance have put on the front burner, the issue of poor financial reporting quality at local government levels, and its determinants.

Local governments, by their nature and processes, are forced to delay programs or activities until close to the end of fiscal year and consequently, they have a very limited time to spend the money and then prepare the financial report (Guillamon, Bastida & Benito, 2011). These problems may lead to lower financial reporting quality on the part of these local governments.

Prior studies (such as Imhof, 2015; Ray & Gupta, 1993; Surroca, Tribo & Waddok, 2010, Ali, Ahmed & Henry, 2004; Rakhman & Wijayana, 2019 and Irwandi & Pamungkas, 2020) have mainly focused on the determinants of financial reporting quality in private entities to the exclusion of public sector organisations, such as local governments. For instance, factors such as firm size, type of auditor and share dispersion are considered by Ray & Gupta (1993), Surroca, Tribo and waddok (2010) and Ali, Ahmed & Henry (2004) as the determinants of higher reporting quality. Rakhman and Wijayana (2019) noted that capital expenditures, size, mayors or chairmen experience and wealth are determinants of financial reporting quality. However, very few of these studies focused on local governments in developing countries such as Nigeria, and Lagos in particular. It is against this backdrop that this study is undertaken.

1.2   Research Objectives

Primarily, the objective of this study is to investigate the influence of local government financial characteristics on financial reporting quality in Lagos state, Nigeria. In order to achieve this primary objective, the study sought to:

i.   examine the effect of capital expenditures ratio on financial reporting quality of selected local governments in Lagos, Nigeria.
ii.   assess the influence of size on financial reporting quality of selected local governments in Lagos, Nigeria;
iii.   evaluate the effect of wealth on financial reporting quality of selected local governments in Lagos, Nigeria and
iv.   examine the relationship between location and financial reporting quality of selected local governments in Lagos, Nigeria.
v.   Assess the influence of the type of local government on financial reporting quality of selected local governments in Lagos, Nigeria.

1.3   Research Questions

Driven by the objectives of this study, answers were sought to the following questions:

i.   What is the effect of capital expenditures ratio on financial reporting quality of selected local governments in Lagos, Nigeria?
ii.   How does of size influence financial reporting quality of selected local governments in Lagos, Nigeria?
iii.   What is the effect of wealth on financial reporting quality of selected local governments in Lagos, Nigeria?
iv.   Is there any relationship between location and financial reporting quality of selected local governments in Lagos, Nigeria?
v.   How does the type of local government influence financial reporting quality of selected local governments in Lagos, Nigeria

1.4   Research Hypotheses

The following hypotheses, expressed in null form, were formulated and tested:

H_{01}: Capital expenditures ratio has no significant effect on financial reporting quality of selected local governments in Lagos, Nigeria.

H_{02}: Size does not have significant influence on financial reporting quality of selected local   governments in Lagos, Nigeria.

H$_{03}$: Wealth have no significant influence on financial reporting quality of selected local governments in Lagos, Nigeria.

H$_{04}$: There is no relationship between location and financial reporting quality of selected local governments in Lagos, Nigeria.

H$_{05}$: The type of local government has no significant influence on the financial reporting quality of selected local governments in Lagos, Nigeria.

2.0 Literature Review

2.1 Conceptual Review

Financial Reporting Quality

The value of financial reporting is generally determined by its quality (Pounder, 2013). The central concept of financial reporting quality (FRQ) 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 reporting quality has no single, widely accepted definition. There is 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.

Financial reporting 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) define 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.

Capital Expenditure

Capital projects promote the growth of local governments, which would to some extent support the financial reporting infrastructure and the IT systems and thus improve FRQ. However, the majority of the literature supports a negative association between capital expenditures and FRQ based on at least two arguments. First, government contracts are usually associated with less transparency and a lack of efficiency in their monitoring in comparison to their private counterparts (Berrios, 2006; Evenett & Hoekman, 2005). Moreover, capital expenditures usually involve construction and procurement where corruption and bribery frequently occur (Neu et al.,2015; Sikka & Lehman, 2015). On average, governments across the world spend a total of $9.5 trillion annually through public procurements, of which $2 trillion disappears from the procurement budgets (Kuhn & Sherman, 2014). The presence of corruption (which unfortunately is still common among Indonesian local governments) complicates the process of accountability and hinders transparency during the preparation of financial reports. Second, investing in capital projects generally involves a complex process (Warren & Jack, 2018) and is inherently risky. Failure to strictly follow the administrative guidelines would result in audit findings which may then be classified as irregularities. Additionally, capital projects generate long-term assets, which is one of the most common audit problems in governmental institutions (Rivenbark, 2000). This includes long-term assets that have been disposed of but still appear on the asset list, purchases of new assets that are not recorded on the asset list, and long-term assets that are not valued properly on the balance sheet. In fact, the Indonesian Supreme Audit Board found that most qualifications and findings in audits were associated with how local governments deal with long-term assets (BPK, 2013).

Wealth

The revenues of a local government usually come from two sources: revenues generated locally and revenues transferred from higher (provincial or central) governments. Local governments with higher financial independence are considered wealthier because they generate their revenues more from local sources, instead of from intergovernmental transfers. Wealthier local governments have greater resources to utilize information technology or hire consultants to support the accounting systems, increasing the likelihood of generating financial reports of higher quality. Tavares and da Cruz (2017) found that local governments with more revenues generated locally tend to be more transparent. Further, the society has greater incentives to monitor the local governments when more of the revenues come from local tax money. Geys et al. (2010) found that voter involvement improves local government performance only when financial independence is high.

Further, in relatively less wealthy local governments where revenues are mainly generated from higher governments, the funding might be provided in an amount and time that may differ from local governments' preferences. The amounts may be lower than what the local governments propose or expect and the availability of the funding is not always on time. Such issues then create uncertainty about the timing of programs or activities, resulting in more complexity in financial reporting.

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 Tribo, 2008; Surroca, Tribo and Waddok 2010).

Location

Location of organisations has been noted in prior empirical studies as one of the determinants of financial reporting quality. Such studies include Imhof (2015) and Rakhman and Wijayana (2019). Location with respect to local government presupposes whether the tier of government is in rural area or urban area. As argued by Loughran and Schultz (2006), Loughran, (2008), information is transmitted more slowly to the stakeholders of rural firms than for firms in the urban areas. In effect, organisations in the rural areas appeared to be more difficult to monitor by stakeholders (Ayers, Ramalingegowda &Yeung, 2011; John, Knyazeva & Knyazeva, 2011). Imhof (2015) contended that rural entities have higher quality financial reporting than urban firms due to low firm analyst coverage and the fact that they tend to have stock prices which are less responsive to missing the yearend consensus analyst earnings forecast.

Type of Local government

The type or structure of local government could be a driver of financial reporting quality. In Lagos, for instance, local governments are of two types, namely, local governments and local council development areas. These two operates with side-by-side with requisite operational autonomy. Whether they produce financial report of the same or different quality remains to be well known in cognate empirical literature.

2.2   Theoretical Review

Agency Theory

Scott (2012) defined this theory as a working relationship between the manager and the stockholder, which provides capital to the company. The connection between this theory and research is related to litigation risk and investor protection because the company tends to cover information on low investor protection.

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.

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. 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 signaling 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).

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.

2.3   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.

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 analyses, 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.

John, Kiru and Luka (2017) investigated the determinants of financial reporting quality in listed Agriculture and Natural Resources firms in Nigeria. Owing to the widespread advocacy to diversify the Nigerian economy, the choice of the Agriculture and Natural Resources sectors, being a prospective mainstay of the economy is necessary, so that investors and other stakeholders will understand the financial reporting practices in the sectors. The sectors comprise of 9 listed Agriculture and Natural Resources Firms, made up of 5 Agriculture and 4 Natural Resources firms.A sample of 7 firms was drawn from the population. Data was collected through secondary sources from annual financial reports of the firms from 2008-2015. The study adopted the correlation and ex-post factor research designs and employed the use regression as a tool for data analysis. The results showed a positive significant relationship between leverage, liquidity, board size and financial reporting quality, measured using residuals from the modified Jones model by Dechow, Sloan and Sweeney (1995). It is recommended among others that managers of firms in the Agriculture and Natural Resources sectors maintain an optimum liquidity level and finance their operations from more of debt instruments, so as to ensure quality of reported accounting numbers. Emphasis should not be placed on the number of independent members of the audit committee, but on their ability to checkmate management tendencies to manipulate the financials. The Nigeria Stock Exchange (NSE) should review its monitoring rules to ensure specific rules for the prevention of window dressing activities by management in financial reporting.

Rakhman and Wijayana (2019), investigated the determinants of financial reporting quality in the public sector using the type of audit opinion as a proxy for reporting quality, with an unqualified opinion representing the best reporting quality while a disclaimer of opinion represents the worst quality. Using manually collected data from 2018 financial reports of local governments in Indonesia from 2008 to 2014, we find that a high proportion of capital expenditures in the total budget is associated with low financial reporting quality. Further, find that larger and wealthier local governments are associated with higher financial reporting quality. Finally, find that local governments under more experienced mayors have higher reporting quality. the results are robust to different measures of financial reporting quality. This study contributes to the reporting quality literature by providing empirical evidence on the determinants of financial reporting quality in the public sector, which has been relatively underexplored. conclude that certain characteristics of local governments and of mayors are associated with the types of audit opinion and that financial incentives accelerate the improvement of reporting quality.

Yeni, Anis and Tri Jatmiko (2019), examined the determinants of capital expenditure in local governments. These factors are locally-generated revenue, general allocation funds, special allocation funds, and revenue sharing fund of local governments. The population of this study are 35 local governments in the Province of Central Java, Indonesia. Using secondary data from the 2014-2016 Budget Realization Reports of local governments in the Province and employing multiple regression analysis, the findings indicate that locally-generated revenue, general allocation fund, special allocation fund, and revenue sharing fund positively affect capital expenditure. These findings imply that local governments should look more carefully at the proportion of general allocation fund allocated to capital expenditure in order to increase economic growth.

Irwandi & Pamungkas (2020) investigated the determinants of financial reporting quality. Data were obtained from the annual reports of the manufacturing companies listed at the Indonesia Stock Exchange during 2015-2018. The research sample consists of 287 public companies, with moderated regression analysis used to examine the hypotheses. The results show that the risk of investor distrust affects financial reporting quality, while legal expertise of the audit committee is a moderating variable that strengthens the relationship between the risk of investor distrust and financial reporting quality. Empirical results of the relationship between board size and earnings quality have been documented.

3.0   Research Methods

This study employed *ex post facto* research design, as it is suitable in dealing with historical data with which to interrogate, understand and explain events. In this study, the population is the aggregate number of local governments and local council development areas in Lagos state, Nigeria, which stood at fifty-seven (57) as at 31 December, 2018, from which samples were selected. Total enumeration is the method with which samples for this study are selected. This sampling method is suitable where a study intends to use all the elements constituting a population. Secondary data were collected for the purpose of this study. These data were gathered from the audited financial statements of the fifty-seven (57) local governments and local council development areas in Lagos, Nigeria for the period of three (3) years between 2016 and 2018. In other words, the study employed panel data, though a short panel.

The dependent variable in this study is financial reporting quality. This variable is measured using the type of audit opinion expressed on the financial statements. Following related studies such as Rakhman and Wijayana (2019), this study measured this variable by assigning value of 1 to audited financial statements which shows true and fair view and 0 to audited financial statements which does not show true and fair view.

However, the independent variables are capital expenditure ratio, size, wealth and location of the selected local governments and local council development areas. Capital expenditure ratio is measured by the amount of the capital expenditure divided by the total assets of local government i in year t. Capital Expenditure Ratio is considered as a variable in this study due to its susceptibility to financial mis-reporting, considering its size relative to other items in the statement of financial position. Size is measured as the natural logarithm of the total assets of local government i in year t. Wealth of local government variable, operationalised as financial independency ratio, is measured as by the locally generated revenues divided by the total revenues of local government i in year *t*, while location is measured using a dummy variable set to a value of one (1) if the local government and local council development area is a city and zero (0) if the local government and local council development area is not in the city. The control variable is a dummy variable which assign value of 1 where the cross-sectional unit is a local government, and set the value of zero (0) where the cross-sectional unit is a local council development area.

The data collected were descriptively and inferentially analysed. The descriptive statistical tools are: mean, standard deviation, Jarque-Bera statistics, kurtosis and skewness. These tools are used to describe certain properties of the variables. However, based on the nature of the dependent variable (that is, financial reporting quality), a probability model was employed to conduct the inferential analysis.

A probability model (also referred to qualitative response regression model) is a type of regression model in which the dependent variable is qualitative in nature, while the explanatory variables are either qualitative or quantitative. Thus, the dependent variable in this study is financial reporting quality having two categories: 'a true and fair view' and 'not a true and fair view'. Such a qualitative dependent variable with two categories is called a binary or dichotomous variable. Thus, the dependent variable (financial reporting quality) in this study is a binary response variable. The financial reporting quality is assigned the value '1' if it is a 'true and fair view' and the value '0' if it is 'not a true and fair view'.

More specifically, the type of the qualitative response regression model employed in this study is the "binary choice" model or binary response regression model since the dependent variable (financial reporting quality) is qualitative with two categories ('true and fair view' and 'not true and fair view') being assigned the values of 1 and 0. Thus, the objective of employing a binary choice model is to find the conditional probability of financial reporting quality (dependent variable) of an audited financial statement being a true and fair view' or a 'not a true and fair view' given capital expenditure ratio, size, wealth, location and type (independent variables). Thus, the conditional probability of financial reporting quality being a 'true and fair view' given capital expenditure ratio, size, wealth and location is given as:

$$E(FRQ_{it} = 1|CAPEX_{it}, SIZE_{it}, WEH_{it}, LOC_{it}, TYPE_{it}) \qquad (1)$$

In estimating the binary choice model, the study employed logit regression model. Although there are four major approaches in developing and estimating a binary response regression model, viz. Linear Probability Model, Logit model, Probit Model and the Tobit Model. The choice for the Logit model is based its simplicity and usage in empirical literature. More significantly, using linear probability model (LPM), that is OLS estimation technique, is likely to produce negative probability values which nullify one of the axioms of probability that the numerical value of any probability must lies between 0 and 1.

Implicitly, the functional relationship between financial reporting quality and its determinants is expressed as follows:

$$FRQ_{it} = f(CAPEX_{it}, SIZE_{it}, WEH_{it}, LOC_{it}, TYPE_{it}) \qquad (2)$$

Where:
FRQ = financial reporting quality

$$FRQ = \begin{cases} 1, & \text{if it is a true and fair view} \\ 0, & \text{if it is not a true and fair view} \end{cases}$$

$CAPEX$ = capital expenditure ratio

$SIZE$ = size
WEH = wealth
LOC = location

$$LOC = \begin{cases} 1, & \text{if the LG/LCDA is located in the city} \\ 0, & \text{otherwise} \end{cases}$$

$TYPE$ = type

$$TYPE = \begin{cases} 1, & \text{if the unit is an LG} \\ 0, & \text{if unit is an LCDA} \end{cases}$$

i = 1, 2, 3… 57 i.e. individual cross-sectional units (*LG* and *LCDA*)

t = 2016, ..., 2018.

The following equation represents the cumulative logistic regression distribution function.

$$P_{it} = \frac{1}{1 + e^{-Z_{it}}} = \frac{e^{Z_{it}}}{1 + e^{Z_{it}}} \tag{3}$$

Where:

P_{it} = the probability that financial reporting quality of an audited financial statement is a true and faire view for a given LG or LCDA and a given period of time. Thus, $1 - P_{it}$ = the probability of a financial reporting quality of an audited financial statement is not a true and faire view.

"e" is called Euler's number which is approximately 2.718.

Thus,

$$1 - P_{it} = \frac{1}{1 + e^{Z_{it}}} \tag{4}$$

$$Z_{it} = \alpha_0 + \alpha_1 CAPEX_{it} + \alpha_2 SIZE_{it} + \alpha_3 WEH_{it} + \alpha_4 LOC_{it} + \alpha_5 TYPE_{it} \tag{5}$$

Thus,

$$P_{it} = \frac{1}{1 + e^{-(\alpha_{it} + CAPEX_{it} + SIZE_{it} + WEH_{it} + LOC_{it} + TYPE_{it} + \mu_{it})}} \tag{6}$$

Therefore, dividing equation (3) by equation (4) gives the following equation:

$$\frac{P_{it}}{1 - P_{it}} = e^{Z_{it}} \tag{7}$$

Therefore, the expression $\frac{P_i}{1-P_i}$ in equation (7) above is called **odds ratio** in favour of financial reporting quality being a true and fair view. The odds ratio is the ratio of the probability that an audited financial statement will reflect a true and fair to the probability that it will not reflect a true and fair view.

Taking the natural log of equation (7) gives the following equation called logit model or logistic regression model.

$$L_{it} = \ln\left(\frac{P_{it}}{1 - P_{it}}\right) = \ln(e^{Z_{it}}) = Z_{it} \tag{8}$$

In a more formal representation the logit model is presented as follows:

$$L_{it} = \ln\left(\frac{P_{it}}{1 - P_{it}}\right) = \alpha_0 + \alpha_1 CAPEX_{it} + \alpha_2 SIZE_{it} + \alpha_3 WEH_{it} + \alpha_4 LOC_{it} + \alpha_5 TYPE_{it} + \mu_{it} \tag{9}$$

Where:

L is the natural log of the **odds ratio** called the **Logit**

α_0 = intercept coefficient

α_1 = the partial slope coefficient of **CAPEX** with respect to **L** (logit) i.e. a measure of the change in the estimated **L** for a unit change in **CAPEX**.

α_2 = the partial slope coefficient of **SIZE** with respect to **L** (logit) i.e. a measure of the change in the estimated **L** for a unit change in **SIZE**.

α_3 = the partial slope coefficient of **WEH** with respect to **L** (logit) i.e. a measure of the change in the estimated **L** for a unit change in **WEH**.

α_4 = the partial slope coefficient of **LOC** with respect to **L** (logit) i.e. a measure of the change in the estimated **L** for a unit change in **LOC**.

α_5 = the partial slope coefficient of **TYPE** with respect to **L** (logit) i.e. a measure of the change in the estimated **L** for a unit change in **TYPE**.

However, to present a more meaningful interpretation, the values of the slope coefficients can be expressed in odds-ratio terms given as the natural antilog of the various slope coefficients, that is:

$$O(\alpha_j) = e^{\alpha_j} = \frac{P_j}{1 - P_j} \tag{10}$$

Where:

$O(\alpha_j)$ = value of the jth slope coefficient in odds term. This measures the change in the ratio of the probability of having a true and fair view to the probability of not having a true and fair view resulting from a change in any of the explanatory variables

J = 1, 2, …, 5 (slope coefficients)

P_j = value of the jth slope coefficient in probability terms. This measures the change in the probability of financial reporting quality being a true and fair view resulting from a change in any of the explanatory variables. Thus,

$$P_j = \frac{e^{\alpha_j}}{1 + e^{\alpha_j}} = P(\alpha_j) \tag{11}$$

In summary, the estimated slope coefficients are expressed in (i) logit terms - α_j (ii) odds ratio terms - $O(\alpha_j)$ (iii) probability terms - $P(\alpha_j)$.

4.0 Analyses and Results

The results from the analyses and the discussion of the findings are presented below:

4.1 Descriptive Analyses

This section presents the results of the descriptive statistics for the given panel data variables.

Table 4.1-: Descriptive Statistics

Statistics	Variables					
	FRQ	**CAPEX**	**SIZE**	**WEH**	**LOC**	**TYPE**
Mean	0.228070	8.861873	19.83809	0.121080	0.754386	0.350877
Median	0.000000	0.246702	20.45734	0.074553	1.000000	0.000000
Maximum	1.000000	442.1814	23.37057	0.703963	1.000000	1.000000
Minimum	0.000000	-5.066278	13.87810	0.014372	0.000000	0.000000
Std. Dev.	0.420820	39.30961	2.472065	0.128301	0.431715	0.478646
Skewness	1.296175	8.630316	-0.636453	2.183648	-1.181952	0.624932
Kurtosis	2.680070	90.13507	2.212340	7.519533	2.397010	1.390541
Jarque-Bera	48.61127	55890.69	15.77823	278.1420	42.40541	29.58672
Probability	0.000000	0.000000	0.000375	0.000000	0.000000	0.000000
Sum	39.00000	1506.518	3352.638	20.46257	129.0000	60.00000
Sum Sq. Dev.	30.10526	261146.5	1026.666	2.765490	31.68421	38.94737
Observations	171	170	169	169	171	171

Source: Author's Computation using Eviews, 2021

Table 4.1 presents the results of the descriptive analysis for the panel data series such as financial reporting quality (*FRQ*; binary response variable) capital expenditure ratio (*CAPPEX*; ratio), size (*SIZE*; log of Naira value), wealth (*WEH*; ratio), location (*LOC*; dummy variable) and type local government unit (*TYPE*; dummy variable). Thus, capital expenditure ratio (*CAPPEX*), size (*SIZE*) and wealth (*WEH*) are quantitative variables while financial reporting quality (*FRQ*), location (*LOC*) and type local government unit (*TYPE*) are qualitative variables.

The panel series such as *FRQ, CAPEX, WEH* and *TYPE* are positively skewed distributions while *SIZE* and *LOC* display negatively skewed distributions as judged by the coefficients of skewness. The kurtosis statistic for all the variables are somewhat different from the threshold of 3. *CAPEX* and *WEH* are leptokurtic as their kurtosis statistics are substantially above the threshold of 3 while *FRQ, SIZE, LOC* and *TYPE* display a platykurtic distribution since their kurtosis statistics are below 3.

The Jarque-Bera statistics reveal that all the panel series are not normally distributed having their p-values 1 and 5 per cents.

4.2 Test of Hypotheses

Four hypotheses were formulated and tested at the conventional 1%, 5% and 10% levels of significance. The results are shown below:

Hypothesis One

H$_{01}$: Capital Expenditures Ratio has no significant effect on financial reporting quality of selected local governments in Lagos, Nigeria.

(a) The regression coefficient of *CAPEX* with respect to *FRQ*

As shown in table 4.2, the partial regression coefficients of *CAPEX* in terms of logit, odds ratio and probability are α_1 = -0.0006, $O(\alpha_1)$ = 0.9994 and $P(\alpha_1)$ = 0.4998 respectively with the p-value of 0.9839. Thus, at all the conventional levels of significance (that is 1%, 5% and 10%), capital expenditure ratio (*CAPEX*) is not a significant determinant of financial reporting quality (*FRQ*). However, the magnitude of the logit coefficient implies that every 1-unit (in Naira value) increase in *CAPEX*, on average, leads to a decrease in the estimated logit (*L*) by about 0.0006 unit. This suggests that logit (*L*) responds negatively but insignificantly to capital expenditure ratio *CAPEX*.

More importantly, the magnitude of the odds ratio indicates that for a unit (Naira value) increase in *CAPEX*, the odds ratio in favour of true and fair view increases by 0.9994 unit. This implies that considering *CAPEX* as a determinant of *FRQ*, the ratio of the number of LGs and LCDAs whose financial reporting quality is a true and fair view to those whose financial reporting quality is not a true and fair view is about 1:1. Alternatively, the probability coefficient indicates that for every 1-unit increase in *CAPEX*, on average the probability that the financial reporting quality of an audited financial statement is a true and fair view rises by about 0.4998 or 49.98%. Nevertheless, *CAPEX* is not a significant determinant of the financial reporting quality of the audited financial statements of LGs and LCDAs in Lagos State.

Table 4.2 presents the result of the estimated binary logit model.
Table 4.2: Binary Logit Model Estimation Result
Panel Data Dimensions: 2016 – 2018 X 57

	Dependent Variable: FRQ				
	Coefficient				
	Logit α_j	Odds ratio $O(\alpha_j)$	Probability $P(\alpha_j)$	Z-statistic	P-values
Independent Variable					
Constant	α_0 = -6.6987	$O(\alpha_0)$ = 0.0012	$P(\alpha_0)$ = 0.0012	-2.2749	0.0229
CAPEX	α_1 = -0.0006	$O(\alpha_1)$ = 0.9994	$P(\alpha_1)$ = 0.4998	-0.0201	0.9839
SIZE	α_2 = 0.2937	$O(\alpha_2)$ = 1.3414	$P(\alpha_2)$ = 0.5729	2.1186	0.0341
WEH	α_3 = -3.7005	$O(\alpha_3)$ = 0.0247	$P(\alpha_3)$ = 0.0241	-1.8283	0.0675
LOC	α_4 = 0.1603	$O(\alpha_4)$ =1.1739	$P(\alpha_4)$ = 0.5400	0.3244	0.7457
TYPE	α_5 = -0.5877	$O(\alpha_5)$ = 0.5556	$P(\alpha_5)$ = 0.3572	-1.2330	0.2176
Statistics:					
McFadden R-squared	0.0834				
LR statistic (p-values)	15.2021 (0.0095)				
Diagnostics:					
Jarque-Bera (p-values)	110.473 (0.0000)				

Source: Author's Computation using Eviews, 2021

(b) The regression coefficient of *SIZE* with respect to *FRQ*

Hypothesis Two

H$_{02}$: Size does not have significant influence on financial reporting quality of selected local governments in Lagos, Nigeria.

As also shown in table 4.2, the partial regression coefficients of *SIZ* in terms of logit, odds ratio and probability are α_2 = 0.2937, $O(\alpha_2)$ = 1.3414 and $P(\alpha_2)$ = 0.5729 respectively with the p-value of 0.0341. Thus, the size (*SIZE*) of an LG or LCDA is statistically significant at 5% level of significance in determining the financial reporting quality (*FRQ*) of the LGs and LCDAs in Lagos State. The magnitude of the logit coefficient implies that every 1-unit (Naira) increase in *SIZE*, on average, results in an increase in the estimated logit (*L*) by approximately 0.294 unit. This suggests that *SIZE* exerts significantly positive impact on logit (*L*).

More significantly, the magnitude of the odds ratio indicates that for every 1-unit increase in *SIZE*, the odds ratio in favour of financial reporting quality (*FRQ*) being a true and fair view increases by 1.3414 units. This implies that considering *SIZE* as a determinant of *FRQ*, the ratio of the number of LGs and LCDAs whose financial reporting quality is a true and fair view to those whose financial reporting quality is not a true and fair view is approximately 2:1. That is, given the sizes of the LGs and LCDAs in Lagos State, for every two (2) of the third arm of government (LGs and LCDAs) in Lagos State that are likely to have audited financial statements with true and fair view, there is one LGs or LCDA whose financial reporting quality is not a true and fair view. More precisely, the magnitude of the probability coefficient indicates that for every 1-unit increase in *SIZE*, on average the probability that the financial reporting quality of an audited financial statement of LG or LCDA indicates a true and fair view goes up by 0.5729 or 57.29%.

Table 4.3: Binary Logit Model Estimation Result
Panel Data Dimensions: 2016 – 2018 X 57

	Dependent Variable: FRQ				
	Coefficient				
	Logit α_j	Odds ratio $O(\alpha_j)$	Probability $P(\alpha_j)$	Z-statistic	P-values
Independent Variable					
Constant	$\alpha_0 = -6.6987$	$O(\alpha_0) = 0.0012$	$P(\alpha_0) = 0.0012$	-2.2749	0.0229
CAPEX	$\alpha_1 = -0.0006$	$O(\alpha_1) = 0.9994$	$P(\alpha_1) = 0.4998$	-0.0201	0.9839
SIZE	$\alpha_2 = 0.2937$	$O(\alpha_2) = 1.3414$	$P(\alpha_2) = 0.5729$	2.1186	0.0341
WEH	$\alpha_3 = -3.7005$	$O(\alpha_3) = 0.0247$	$P(\alpha_3) = 0.0241$	-1.8283	0.0675
LOC	$\alpha_4 = 0.1603$	$O(\alpha_4) = 1.1739$	$P(\alpha_4) = 0.5400$	0.3244	0.7457
TYPE	$\alpha_5 = -0.5877$	$O(\alpha_5) = 0.5556$	$P(\alpha_5) = 0.3572$	-1.2330	0.2176
Statistics:					
McFadden R-squared	0.0834				
LR statistic (p-values)	15.2021 (0.0095)				
Diagnostics:					
Jarque-Bera (p-values)	110.473 (0.0000)				

Source: Author's Computation using Eviews, 2021

Hypothesis Three

H03: Wealth has no significant influence on financial reporting quality of selected local governments in Lagos, Nigeria.

(c) The regression coefficient of *WEH* (Wealth) with respect to *FRQ*

As also shown in table 4.2, the partial regression coefficients of *WEH* in terms of logit, odds ratio and probability are $\alpha_3 = -3.7005$, $O(\alpha_3) = 0.0247$ and $P(\alpha_3) = 0.0241$ respectively with the p-value of 0.0675. Thus, the wealth (*WEH*) of an LG or LCDA is statistically significant at 10% level of significance in determining the financial reporting quality (*FRQ*) of the LGs and LCDAs in Lagos State. The magnitude of the logit coefficient suggests that every unit increase in *WEH*, on average, results in a fall in the estimated logit (*L*) by approximately 3.7005 units. This suggests that *WEH* exerts significantly negative impact on logit (*L*).

More precisely, the magnitude of the odds ratio indicates that for every 1-unit (Naira value) increase in *WEH*, the odds ratio in favour of financial reporting quality (*FRQ*) being a true and fair view increases by 0.0247 units. This implies that if *WEH* is to be considered as a determinant of *FRQ*, the ratio of the number of LGs and LCDAs whose financial reporting quality is a true and fair view to number of LGs and LCDAs whose financial reporting quality is not a true and fair view will be approximately 1:40. This suggests that, given the wealth (*WEH*) of the LGs and LCDAs in Lagos State, for every one LG or LCDA whose audited financial statement reflects a true and fair view, there are forty (40) LGs and LCDAs whose audited financial statements do not reflect true and fair views. In addition, the magnitude of the probability coefficient implies that for every 1-unit increase in *WEH*, on average, the probability that the financial reporting quality of an audited financial statement of an LG or LCDA shows a true and fair view goes up by 0.0241 or 2.41%.

Table 4.4: Binary Logit Model Estimation Result
Panel Data Dimensions: 2016 – 2018 X 57

	Dependent Variable: FRQ				
	Coefficient				
	Logit α_j	Odds ratio $O(\alpha_j)$	Probability $P(\alpha_j)$	Z-statistic	P-values
Independent Variable					
Constant	$\alpha_0 = -6.6987$	$O(\alpha_0) = 0.0012$	$P(\alpha_0) = 0.0012$	-2.2749	0.0229
CAPEX	$\alpha_1 = -0.0006$	$O(\alpha_1) = 0.9994$	$P(\alpha_1) = 0.4998$	-0.0201	0.9839
SIZE	$\alpha_2 = 0.2937$	$O(\alpha_2) = 1.3414$	$P(\alpha_2) = 0.5729$	2.1186	0.0341
WEH	$\alpha_3 = -3.7005$	$O(\alpha_3) = 0.0247$	$P(\alpha_3) = 0.0241$	-1.8283	0.0675
LOC	$\alpha_4 = 0.1603$	$O(\alpha_4) = 1.1739$	$P(\alpha_4) = 0.5400$	0.3244	0.7457
TYPE	$\alpha_5 = -0.5877$	$O(\alpha_5) = 0.5556$	$P(\alpha_5) = 0.3572$	-1.2330	0.2176
Statistics:					
McFadden R-squared	0.0834				
LR statistic (p-values)	15.2021 (0.0095)				
Diagnostics:					
Jarque-Bera (p-values)	110.473 (0.0000)				

Source: Author's Computation using Eviews, 2021

Hypothesis Four
H04:   There is no relationship between location and financial reporting quality of selected local governments in Lagos, Nigeria.

(d) The regression coefficient of *LOC* (Location) with respect to *FRQ*

As also shown in table 4.2, the partial regression coefficients of *LOC* (location of an LG or LCDA) in terms of logit, odds ratio and probability are $\alpha_4 = 0.1603$, $O(\alpha_4) = 1.1739$ and $P(\alpha_4) = 0.5400$ respectively with the p-value of 0.7457. Obviously, the location of location of an LG or LCDA (*LOC*) is not a statistically significant determinant of the financial reporting quality (*FRQ*) of the LGs and LCDAs in Lagos State at 10% level of significance since the p-value is greater than 0.1.

However, the average odds ratio in favour of financial reporting quality (*FRQ*) being a true and fair view for an LG or LCDA not located in the city (base or omitted category) is 0.0012. Thus, average odds ratio in favour of financial reporting quality (*FRQ*) being a true and fair view for an LG or LCDA located in a city is 1.1751 (1.1739 + 0.0012). This suggests that considering *LOC* as a determinant of *FRQ*, the ratio of the number of LGs and LCDAs located in the cities, whose financial reporting quality is a true and fair view to the number of LGs and LCDAs located in the city, whose financial reporting quality is not a true and fair view is approximately 2:1. Moreover, the average probability that the financial reporting quality of the audited financial statement of an LG or LCDA not located in a city (base or omitted category) reflects a true and fair view is 0.0012. Thus, the average probability that the financial reporting quality of the audited financial statement of an LG or LCDA located in a city reflects a true and fair view is 0.5412 (0.5400 + 0.0012) or 54.12%. However, location of an LG or LCDA is not a statistically significant determinant of *FRQ* in Lagos state.

Table 4.5: Binary Logit Model Estimation Result
Panel Data Dimensions: 2016 – 2018 X 57

	Dependent Variable: FRQ				
	Coefficient				
	Logit α_j	Odds ratio $O(\alpha_j)$	Probability $P(\alpha_j)$	Z-statistic	P-values
Independent Variable					
Constant	$\alpha_0 = -6.6987$	$O(\alpha_0) = 0.0012$	$P(\alpha_0) = 0.0012$	-2.2749	0.0229
CAPEX	$\alpha_1 = -0.0006$	$O(\alpha_1) = 0.9994$	$P(\alpha_1) = 0.4998$	-0.0201	0.9839
SIZE	$\alpha_2 = 0.2937$	$O(\alpha_2) = 1.3414$	$P(\alpha_2) = 0.5729$	2.1186	0.0341
WEH	$\alpha_3 = -3.7005$	$O(\alpha_3) = 0.0247$	$P(\alpha_3) = 0.0241$	-1.8283	0.0675
LOC	$\alpha_4 = 0.1603$	$O(\alpha_4) = 1.1739$	$P(\alpha_4) = 0.5400$	0.3244	0.7457

TYPE	$\alpha_5 = -0.5877$	$O(\alpha_5) = 0.5556$	$P(\alpha_5) = 0.3572$	-1.2330	0.2176

Statistics:

McFadden R-squared	0.0834
LR statistic (p-values)	15.2021 (0.0095)

Diagnostics:

Jarque-Bera (p-values)	110.473 (0.0000)

Source: Author's Computation using Eviews, 2021

(e) The regression coefficient of *TYPE* with respect to *FRQ*

The partial regression coefficients of *TYPE* (type of government unit, that is, either an LG or LCDA) in terms of logit, odds ratio and probability are $\alpha_5 = -0.5877$, $O(\alpha_5) = 0.5556$ and $P(\alpha_5) = 0.3572$ respectively with the p-value of 0.2176. Apparently, *TYPE* (type of local government unit, that is, either an LG or LCDA) is not a statistically significant determinant of the financial reporting quality (*FRQ*) in Lagos State at 10% level of significance since the p-value is greater than 10%.

Nevertheless, the average odds ratio in favour of financial reporting quality (*FRQ*) being a true and fair view for a type of local government unit being an LCDA (base or omitted category) is 0.0012. Thus, average odds ratio in favour of financial reporting quality (*FRQ*) being a true and fair view for a type of local government unit being an LG is 0.5568 (0.5556 + 0.0012). This suggests that considering *TYPE* as a determinant of *FRQ*, the ratio of the number of LGs type, whose financial reporting quality is a true and fair view to the number of LGs type, whose financial reporting quality is not a true and fair view is approximately 1:2. Moreover, the average probability that the financial reporting quality of the audited financial statement of an LCDA type (base or omitted category) reflects a true and fair view is 0.0012. On the other hand, the average probability that the financial reporting quality of the audited financial statement of an LG type reflects a true and fair view is 0.3584 (0.3572 + 0.0012) or 35.84%. However, the type of local government unit (LG or LCDA) is not a statistically significant determinant of *FRQ* in Lagos state.

4.3.2 Measure of Goodness of fit

The Count R^2 is employed to determine the explanatory power of the estimated binary logit model. The McFadden R^2 coefficient (0.0835) presented in table 4.2 is quite low and thus, could not be used to determine the goodness of fit. The Count R^2 is calculated using the following formula:

$$Count \ \boldsymbol{R}^2 = \frac{Number \ of \ correct \ predictors}{Total \ number \ of \ included \ observations}$$

Table 4.6-: Expectation-Prediction Evaluation Result

	Estimated Equation			Constant Probability		
	Dep=0	Dep=1	Total	Dep=0	Dep=1	Total
P(Dep=1)<=C	129	39	168	129	39	168
P(Dep=1)>C	0	0	0	0	0	0
Total	129	39	168	129	39	168
Correct	129	0	129	129	0	129
% Correct	100.00	0.00	76.79	100.00	0.00	76.79
% Incorrect	0.00	100.00	23.21	0.00	100.00	23.21
Total Gain*	0.00	0.00	0.00			
Percent Gain**	NA	0.00	0.00			

Source: Author's Computation using Eviews, 2021

Given that the dependent variable in the model is a binary response variable and using a threshold of 0.5, the predicted probability takes the value of 1 if it is greater than 0.5, and the value 0 if it is less than 0.5. As shown in table 4.3, the number of correct predictions is 129 out of total number of 168 included observations. Therefore, the **Count R^2** is computed as follows:

$$Count \ \boldsymbol{R}^2 = \frac{129}{168}$$
$$Count \ \boldsymbol{R}^2 = 0.7679$$

The coefficient of the measure of the goodness of fit of 0.7679 using **Count R^2** implies that 76.79% of the variation in dependent variable (*FRQ*) is accounted for by the independent variables (*CAPEX, SIZE, WEH, LOC, TYPE*) in the model. Thus, the explanatory power is quite high and thus, implies that the variables included in the model are good determinants or predictors of *FRQ* (financial reporting quality).

Global Test of Significance of the Estimated Binary Logit Model

This test is carried out to examine if all the explanatory variables are jointly or collectively significant to determine the dependent variable (*FRQ*) using likelihood ratio (LR) statistic.

$$H_o: \alpha_1 = \alpha_2 = \alpha_3 = \alpha_4 = 0$$
$$H_o: Not\ all\ \alpha_j's\ are\ simultaneously\ equal\ to\ zero$$

In the table 4.2, the LR-statistic (15.2021) and its p-value (0.0095) suggests that the independent variables (*CAPEX, SIZE, WEH, LOC, TYPE*) are jointly significant to influence the dependent variable financial reporting quality (*FRQ*).

Serial Correlation Test

Table 4.7-: Serial Correlation Test Result using Correlograms-Q-Statistics
Panel Data Dimensions: 2016 – 2018 X 57

Lag	AC	PAC	Q-Stat	P-value
1	-0.058	-0.058	0.5774	0.447
2	-0.057	-0.060	1.1295	0.568

Source: Author's Computation using Eviews, 2021

Tables 4.4 presents the results of the serial correlation test using Correlograms-Q-Statistics. All the Q-statistics at all lags (1 and 2) are statistically insignificant (p-values more than 10%). Thus, the null hypothesis of "no serial correlation" is not rejected. This implies that is no presence of serial correlation in the residuals of the estimated binary logit model for the given panel data dimensions.

4.3 Discussion of Findings

From the data analyses, finding shows that capital expenditure ratio (*CAPEX*) is not a significant determinant of financial reporting quality (*FRQ*). Put differently, Capital Expenditure Ratio (CAPEX) is noted not to be a significant determinant of financial reporting quality of the audited financial statements of LGs and LCDAs in Lagos State. This result supports that of Rakhman and Wijanana (2019) whose study on determinants of financial reporting quality in the public sector provided evidence that a high proportion of capital expenditures in the total budget is associated with low financial reporting quality. Besides, the location of an LG or LCDA (*LOC*) is not a statistically significant determinant of the financial reporting quality (*FRQ*) of the LGs and LCDAs in Lagos State at 10% level of significance.

However, further analyses revealed that the size (*SIZE*) of an LG or LCDA is significant in determining the financial reporting quality (*FRQ*) of the LGs and LCDAs in Lagos State. In additional, the wealth (*WEH*) of an LG or LCDA is statistically significant, but at at 10% level of significance, in determining the financial reporting quality (*FRQ*) of the LGs and LCDAs in Lagos State. These findings corroborate that of Rakhman and Wijayana (2019) which showed that larger and wealthier local governments are associated with higher financial reporting quality.

In summary, the above findings suggested that, while size and wealth of local governments and local council development areas are significant determinants of financial reporting quality, capital expenditure ratio and location are not.

5.0 Conclusion and Recommendation

Stakeholders require information that would enable them predict the future cash flows of local government and the risks they face (Grace and Ambrose 2013), amongst other informational needs, through financial statements. The quality of these statements tends to strongly influence the decisions made or to be made by these stakeholders. Financial reporting quality presupposes that organisations should voluntarily expand the scope and quality of the information they report, to ensure that stakeholders to whom they hold stewardships are fully informed in order to make well-grounded decisions. This promotes accountability, satisfies stakeholders' needs and greatly facilitates transparency, which in turn reduces the problem information asymmetries.

However, the ceaseless yearnings on poor accountability and transparency by the governed about local governments performance have put on the front burner, the issue of poor financial reporting quality at local government levels, and its determinants. It is against this background that this study was undertaken, focusing on the local governments and local council development areas in Lagos, Nigeria. Four objectives, research questions and hypotheses were stated. Cognate literature were reviewed, from which four relevant theories of agency, signalling, legitimacy and proprietary costs and positive accounting theories were noted to underpin this study. Secondary data were collected from the audited financial statements of these local governments and local council development areas.

This study empirically investigated the determinants of financial reporting quality in local governments and local council development areas in Lagos, Nigeria. From the data collected and analyses carried out, there were pieces of evidence that the size and wealth of local governments and local council development areas are significant determinants of financial reporting quality of these governmental structures at the grassroot levels. In contrast, evidence was further provided that capital expenditure ratio and location are not significant determinants of financial reporting quality of local governments and local council development areas. Based on these findings, the study concludes that size and wealth significantly determine the quality of financial reports presented by local governments and local council development areas in Lagos, Nigeria, while location and capital expenditure ratio play no significant role in this regard.

On the basis of the above findings and conclusion, this study makes the following recommendations:

   i.   Financial reporting quality is function of timeliness with which financial reports are presented. Therefore, local governments and local council development areas should be encouraged by the Lagos State Audit Service Commission to prepare and publish their annual reports, on a very timely basis;
   ii. There should be continuous regimen of training and development for the accounting officers in these local governments and local council development areas who are responsible for the preparation and presentation of audited financial statements;
   iii. Local governments and local council development areas are to be encouraged to increase their carrying capacities and gets bigger, as doing these would be expected to engender increasing financial reporting quality and
   iv. More investments should be made in the area of financial reporting system and architecture, as this would be expected to increase the efficiency and robustness with which financial statements are prepared.

The current study has made contributions to knowledge by providing empirical evidence that Capital expenditure ratio and location are not significant determinants of financial reporting quality in Local Governments (LG) and Local Council Development Areas (LCDA) in Lagos, Nigeria. However, it provided further evidence that Size and wealth of an LG or LCDA are significant in determining the financial reporting quality of the LGs and LCDAs in Lagos State.

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