DETERMINANTS OF FINANCIAL REPORTING QUALITY ON ETHIOPIAN INSURANCE COMPANIES

MSc. THESIS

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STATEMENT OF DECLARATION

By my signature below, I declare that this thesis entitled ‘‘Determinants Of Financial Reporting Quality In Ethiopian Insurance Companies’’ and the work presented in it are my own and has been generated by me as the result of my own original research. The study in which all sources of materials used has been duly acknowledged. I have produced it independently except for the guidance and suggestion of the thesis Advisor. To the best of my knowledge, this study has not been submitted for any degree in this University or any other University. It is offered for the partial fulfillment of the degree of Masters of Science in accounting and finance specialization in Wolkite University.

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ACCRONYMS AND ABREVATION

ARL	Audit Report Lag
FASB	Financial Accounting Standard Board
FRQ	Financial Reporting Quality
FS	Firm Size
IASB	International Accounting Standard Board
LV	Leverage Size
MRL	Management Report Lag
PR	Profitability
SFAC	Statement of Financial Accounting Concept
TA	Types of Auditors
US	United State

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Abstract

This study intends to assess the determinants of financial reporting quality of Ethiopian insurances companies over a period of 2014-2019. Consequently, the study used document review of insurances' audited financial statements. The explanatory variables used in this study were Board Size (BS), Leverage (LE), Profitability (ROA), Liquidity (LQ), Auditor Change(AC), Firm Age (FA) and Firm Size(FS). In this study sixteen Insurance companies were selected from a total population of insurances companies to accomplish a study for the period of six years (2014-2019) with the total of 96 observations. Moreover, for the dependent variable data were collected for seven years period, from (2013-2020). To test the hypotheses, the study adopted the quantitative research approach. The secondary data were analyzed using descriptive statistics, correlation matrix and linear regression analysis and data from document reviews were interpreted qualitatively. The study used panel data and random regression model to analyze the Determinants of Financial Reporting quality of Ethiopian insurance companies. The study found that profitability ratio has positive and significant effect on financial reporting quality. While, auditor changes, board size, leverage and liquidity were found to be insignificant effect on financial reporting quality of Ethiopian insurance companies. It is recommended that insurance companies should do to improve their liquidity management systems through broadening and diversifying of funding sources and shortening asset maturities that leads to a better quality of financial report.

Keywords: Financial Reporting Quality, Insurances Company, Earning Management, Abnormal Accrual.

CHAPTER ONE

INTRODUCTION

1.1. Background of the study

Financial institutions play a significant role in the socio-economic growth and development of a nation. Insurance companies, in particular, facilitate a nation's innumerable economic transactions through efficient and effective savings mobilization, risk transfer, indemnification, and financial intermediation processes (Salvatore, 2013; Mishkin, 2010). Today, the necessity for producing quality financial report has received great attention over the world. Providing high quality financial reporting information is important because it will positively influence capital providers and other stakeholders in making investment, credit and similar resource allocation decisions enhancing overall market efficiency (IASB, 2013).

Numerous accounting researchers have deep-rooted on the benefits and role of the quality of financial reporting and they also showed that insufficient quality of financial reporting might negatively influence the business performance and economic decisions of the companies (Jaballah *et al.,* 2014; Jane and Jung, 2015). This means that the financial reporting quality might determine managers' willingness for engaging in activities that are not valuable. Although, the financial reporting quality may facilitate better contracts to avoid investment efficiency. Furthermore, it can increase investors' ability to control the investment decisions. Therefore, it is expected that high-quality financial reporting reduces excessive and wasting investments (Biddle *et* al., 2009).

The main intention of financial reporting is to provide high-quality financial reporting information concerning economic entities, primarily financial in nature, useful for economic decision-making (IASB, 2008). According to IASB (2008), providing high quality financial reporting information is important because it will positively influence capital providers and other stakeholders in making investment, credit, and similar resource allocation decisions enhancing overall market efficiency.

In fact, the determinants of financial reporting quality were overlooked in many empirical studies. However, financial reporting quality cannot easily be measured

directly and it is very complicated issues. Assessing the quality of financial reporting requires a broad range of measurements using models, proxies, qualitative characteristics, and other elements of financial reports. In the literature, three different dimensions of financial reporting quality are frequently used: Accrual-Based Models, Accounting Conservatism, and Earnings Managements (Yimenu, 2016).

Many approaches have been used to measure and assess financial reporting quality and new approaches are still being developed. For this study the accrual-based model developed by Dechow and Dichev (2002) will be used to measures the financial reporting qualities of Ethiopian insurance companies.

As Jember (2014) report, the Ethiopian financial reporting status has been a remarkably increasing. Based on the recommendations of studies (Observance of Standards and Codes (ROSC), 2007; Ministry of Trade and Industry, 2005), the government has established Steering committees, passed financial reporting Proclamation and drafted the establishment of a professional body.

Several studies have been conducted on financial reporting quality in many parts of the world including Ethiopia. However, the contemporary literatures show conflicting in their findings. Furthermore, the literature in the context of Ethiopia, (Kirubel, 2016 and Eden, 2017) assessed the determinants of financial reporting quality from manufacturing companies and private banks cannot in Addis Ababa Ethiopia. In very recent year, the study conducted by Eden (2017) assessed the Determinants of Financial Reporting Quality: Evidence from Ethiopian Private Banks. These studies limit their scopes only on manufacturing share companies and Ethiopian private banks. However, these researchers cannot fill the gap. This study, therefore, has come to assess the determinants of financial reporting quality in Ethiopian insurance companies.

1.2. Statement of the problem

The results of different studies showed that one of the many challenges the financial world is facing currently is lacking quality financial reports. This might decrease the economic environments of the companies, if not assure the quality of financial reporting properly and timely. Today, the insurance sector plays important role in the financial services industry of developed and developing countries, contributing to economic growth, efficient resource allocation, reduction of transaction costs, creation of liquidity, facilitation of economics of scale in investment, and spread of financial losses (Haiss and Sümegi, 2008).

As noted by different empirical evidence that the quality of accounting information can influence the cost of capital, both directly, by affecting market participants' perceptions about the distribution of future cash flows, and indirectly, by affecting real decisions that alter the distribution of future cash flows Lambert, Leuz and Verrecchia (2007).

Other literature found that FRQ positively affects private firm's investment efficiency in emerging markets and that this effect enhances bank financing and decreases incentives to minimize earnings for tax avoidance purposes. It has been noted in different literatures that firms tend to manipulate financial information to meet investor's expectation or to reduce other financial burdens from authorities Chen *et al*. (2011).

Hassan and Bello (2013) stated that when operating performance is poor, managers tend to increase earnings; however, if operating performance is extremely poor, some firms may decrease income further, which is so called "taking bath" strategy. The empirical Studies implied that firm's quality of financial statement will most likely be influenced by the capital structure choice they make (Hassan *et.al.*2006).

Many researches were conducted on the determinants of Quality of Financial Reporting: measuring qualitative characteristics (Ferdy *et.al*, 2009; Ahmed *et.al*, 2018). In Ethiopia a plenty of studies were conducted on determinants of financial reporting qualities and much of them focused on manufacturing companies, private and government owner banks of Ethiopia (Eden, 2017; Yimenu, 2016). Moreover, very few studies were conducted on insurance companies in Ethiopia on the Determinants of Insurance Companies Profitability in Ethiopia (Tariku, 2019). Hence, apart from this conducted

research works the researcher found gap on determinants financial reporting quality on Ethiopian insurance companies. The studies locally have not been assessed in the relationship between financial reporting quality and factors determining financial reporting quality.

1.3. Objectives of the study

1.3.1. General Objective

To examine the determinants of financial reporting quality of insurance companies in Ethiopia

1.3.2. Specific Objectives

- To investigate the effect of profitability on financial reporting quality of Ethiopian Insurance companies
- To investigate the effect of firm size on financial reporting quality of Ethiopian Insurance companies
- Investigate the effect of board size on financial reporting quality of Ethiopian Insurance companies
- To identify the effect of auditors change on financial reporting quality of Ethiopian Insurance companies
- To identify the effect of leverage on financial reporting quality of Ethiopian Insurance companies
- To identify the effect of liquidity on financial reporting quality of Ethiopian Insurance companies

1.4. Hypothesis development

To achieve the objectives of the study concerning the determinants of financial reporting quality of Ethiopian insurance companies, the following hypotheses were developed from different previous works.

Financial Reporting Quality Vs Profitability

Few researches argued that profitability determine the quality financial reports and other said that profitability is not the determinants of quality financial reports. The studies conducted by Hosseinzadeh *et al*. (2014) showed that profitability is not determinants of

quality report. On the other hand the investigation conducted by AlAsiry (2017) and Fathi(2013) showed that profitability is one of the determinant of quality report.

The empirical studies conducted by (Hassan, 2013) found a positive relationship between financial reporting quality and profitability, the study considered financial reporting quality to be determinant of profitability. Agyei (2015) who studied the Ghanaian market examined some firm level data including profitability and how they affect the quality of financial ratio and by extension the quality of financial statement. They used a longitudinal approach and examined 35 firms listed on the Ghana Stock Exchange for the year 2012. The results were quiet compelling, as most firms in Ghana have not disclosed such financial ratios in their annual report. Hence, they fail to meet up with the qualitative characteristic's requirements (relevance, reliability, comparability and understandability) of the International Accounting Standard, which define the quality of a financial report. They further revealed profitability to be negatively related to financial ratio and disclosure.

H1: Profitability has a positive significant effect on Financial Reporting Quality of Ethiopian Insurance Companies**.**

Financial Report Quality VS Age of the Insurance Company

The empirical studies conducted by (Umoren and Asogwa, 2013) showed that company age has a positive significant effect on financial reporting quality. In the study the authors argued that older, experienced and well-established companies are likely to disclose more information because they have established and cost-effective reporting systems whereas the negative association on the contrary, signifies that younger companies disclose more information to boost investor confidence and reduce skepticism. Similarly (Alsaeed, 2006) argued that long established firms might have improved their financial reporting practices over time and try to enhance their reputation and image in the market.

H2: Age of insurance company has a positive significant effect on Financial Reporting Quality of Ethiopian insurance companies

Financial Report Quality Vs Leverage

Agency theory has largely been used also to explain the relationship between firm leverage and financial reporting quality. According to the agency theory (Jensen and Meckling, 1976), a company with a higher debt ratio has an incentive to disclose more information. Empirical evidence appears to be inconclusive for some cases. Studies of Prihata and Rahaya (2019) and ALAsiry (2017) established leverage is not a Determinants of Financial Reporting quality. The studies of Hossain, tan and Adams (1994), Naser, Al-Khatib and Karbhari (2002), Hassan, Percy and Stewart (2006) and Adelopo (2010) have all found a positive relationship between leverage and financial reporting quality, many researchers have not found the positive relationship (Camfferman and Cooke, 2002; Ali, Ahmed & Henry 2004; AlSaeed, 2006). While, the studies of Zarzeski (1996) and Ahmed (2012) found a negative relationship between leverage and disclosure, leverage and disclosure, suggesting that highly leveraged companies tend to disclose private information to their creditors which may not be reflected in their annual reports.

H3: Leverage has a positive significant effect on Financial Reporting Quality of Ethiopia Insurance Companies.

Financial Reporting Quality Vs Liquidity

Bardos (2011) examined the relationship between liquidity and quality of financial information by investigating long-term trends in Amihud's (2002) illiquidity figure for firms that restate financial statements. The overall results of the Authors showed that liquidity has a positive significant effect on financial reporting quality. In addition to this, many Studies were conducted on their relationship, among them the studies conducted by Amihud's (2002) and Chung *et al*. (2009) showed that liquidity and financial reporting quality had positively related to each other. While the study conducted by Ng (2011) showed that they have negative relationship. The author therefore, reported that higher information quality was associated with lower liquidity risk and that the reduction in cost of capital due to this association was economically substantial. The author also reported that the negative association between information quality and liquidity risk was stronger in times of large shocks to market liquidity.

H4: liquidity has a positive significant effect on financial reporting quality of Ethiopia Insurance Companies.

Financial Reporting Quality Vs Firm Size

Firm: Company size is measured by the logarithm of its total assets. It is common practice to use firm size as a determinant variable of economic and financial performance and as a determinant of FRQ. Larger firms are incentive to show a positive effect on FP (Prior *et al*., 2008; Surroca *et al*., 2010). Furthermore, the size of the firm has been used in several research projects about FRQ, but this effect is uncertain.

H5: firm size has a positive significant effect on financial reporting quality of Ethiopia Insurance Companies.

Financial Reporting Quality Vs Auditor Change

Documented evidence indicates that IAF has a significant impact on FRQ in terms of detecting and preventing fraud (Church *et al*., 2001; Coram et al., 2008) and reducing the level of earnings management (Prawitt *et al*., 2009). Also, investors who have access to IAF reports are more confident of financial statements reliability than those who do not have access to the reports (Archambeault *et al*., 2008; Holt and DeZoort, 2009; James, 2003). Other evidence indicates that IAF plays an important role in completing the financial statements audit (Felix et al., 2001; Zain *et al.*, 2006), implying that IAF has an effective role in improving the audit quality and, in turn, FRQ. Although, the evidence indicates the importance of IAF quality in influencing the quality of financial reporting, there has been little research on the link between IAF and FRQ. In a recent study, Coram et al. (2008) investigated whether organizations with IAF were more capable of detecting and preventing fraud than those without IAF. The study conducted by (Dabor and Ibadin, 2013) found a positive relationship between auditor change and earnings management. This study supports the finding that auditor change brings earnings management. Carcello and Nagy (2004) found that duplicitous financial reporting occurs early in an auditor-client relationship.

H6: auditor change has a positive significant effect on financial reporting quality of Ethiopia Insurance Companies.

1.5. Significance of the study

As mentioned above in the main objective of the research, the aim is to examine the determinants of financial reporting quality; the case of Ethiopian insurance companies by recognizing influential determinant variables and how these variables affect the quality of financial reporting in Ethiopian insurance companies. The study will add more knowledge on the concept of financial reporting quality and determinants of financial reporting quality and offer more empirical finding on the relationship between financial reporting quality (dependent variable) and independent variables these determine financial reporting quality. It will also serve as a source for other researchers who want to make depth study about the determinants of financial reporting quality in related companies or other companies else. More over the study will be supportive to various shareholders and stakeholders in the insurance's companies.

1.6. Scope of the study

The conceptual scope of this study concerned on the determinants of financial reporting quality of Ethiopian insurances companies. The study covered all insurance companies that were in full applicable in study period. The scope of study was also limited to the study the all-insurance companies with six-year annual audited reports.

1.7. Limitation of the Study

The researcher encountered different limitations that were likely to hindered access to information required by the study. The researcher faced problems of time as the research was being undertaken in a short period with limited time for doing a wider research. Moreover, the researcher countenanced a challenge in acquiring secondary data from the audited annual reports of the selected Ethiopian insurance companies since most of these insurance companies lack published audited annual reports at the time of this research.

Furthermore, in the study explanatory variables that are selected to study are limited to board size, leverage, liquidity, profitability ratio, auditor change, firm size and firm age. Therefore, the researcher tried to overcame the limitation of the explanatory variables by using the document review in addition to the secondary data from audited financial statement.

1.8. Organization of the Study

This research is organized in to five chapters. Chapter one presents introduction, background of the study, statement of the problem, research objectives, hypothesis development, scopes of the study and significance of the. The second chapter presents the literature review part of the study, which includes the theoretical review in its first section followed by empirical review of previous studies related to the topic, conclusion and knowledge gap of the study. Chapter Three focus on the methodology that is used by the researcher in order to achieve the objectives of the study. The chapter illustrates the research approach, research design, data sources and collection instruments. Moreover, this chapter also describes methods of data presenting, interpreting and analyzing of the data. Then Chapter Four presents results and analysis of the study and finally, Chapter Five presents discussion, conclusions and possible recommendations.

CHAPTER TWO

LITERATURE REVIEW

Introduction

This chapter presents the mixture of theoretical review, empirical review, hypotheses development conclusion and knowledge gap of the study. The theoretical review aims at giving the definition of basic terminologies and review theories that help in defining and

understanding determinants of financial reporting quality. The empirical review section is a review of different literatures that are related to the study. The last part is the conclusion and knowledge gap of the study.

2.1. Theoretical review

This section focuses on the definition and concepts of important terminologies, theories and creating an inclusive theoretical framework for the study. The next parts of this chapter will present definition of financial reporting quality including its objectives and few related theories to understanding determinants of financial reporting quality

2.1.1. Defining Financial reporting quality

According to Gaynor (2016), financial reporting is a process of reporting financial activities of business on a formal way. It has been considered as an essential resource for any market participant. It also reduces the mystery and the conflict in opinion between all interested users such as managers, investors, regulatory agencies, society and other stakeholders. Every one participates in this process (In financial reporting quality process), even each operation related to this process should be submitted carefully, especially the disclosure process, all transactions, the accounting policies and all judgments and opinions made by the staff involved in this process.

The value of financial accounting is generally determined by its quality (Pounder, 2013). The central concept of financial accounting quality is that some accounting information is better and more reliable than other accounting information in relation to its characteristic of communicating what it purports to communicate. That is why; accounting quality is of great interest to several types of users involved in the financial reporting chain. The term of financial accounting quality has no single, widely accepted definition.

The term financial accounting quality defines 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 (Biddle *et. al,* 2009). In study conducted by (Tanget, 2008), financial reporting quality is defined as the extent to which the financial statements provide true and fair information about the underlying performance and

financial position. The term 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). Anyway, a commonly accepted definition is provided by many scholars including, 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.

However, financial reporting quality is a broader concept that not only refers to financial information, but also to disclosures, and other non-financial information useful for decision making included in the report. Therefore, in the ED both the FASB and the IASB (2008) explicitly express their desirability of constructing a comprehensive measurement tool to assess the quality of financial reporting considering all dimensions of decision usefulness. Hence, this measurement tool considers all the qualitative characteristics because these characteristics determine the decision usefulness of financial reporting information (IASB, 2008).

In 2002, the IASB and the FASB showed their commitment towards developing a common set of high-quality accounting standards, which could be used worldwide. As a consequence of the joint project to converge the more principles-based IFRS and the more rules-based US GAAP, both boards agreed to develop new joint Conceptual Framework, which includes the objectives of financial reporting and the underlying qualitative characteristics on which accounting standards ought to be based. In May 2008, the FASB and the IASB therefore published an exposure draft of 'An improved Conceptual Framework for Financial Reporting' (IASB, 2008; FASB, 2008a). This Conceptual Framework represents the foundations of the accounting standards. "The application of objectives and qualitative characteristics should lead to high-quality accounting standards, which in turn should lead to high-quality financial reporting information that is useful for decision making" (IASB, 2008).

As Krishnan (2005) reported that, quality of financial report guarantees and enforces the company to present good and accurate information, which in turn reduces the mystery and the conflict in information provided for both shareholders and stakeholders and other market participants interested in this report. The integrity and reliability of data produced by organizational information systems are critical, not just for the production of reliable financial reports, but also for overall business success (Krishnan et al. 2005).

The important attributes for effective financial management include- access to relevant information; use of that information to enhance management standards; and assurance that the information is accurate, relevant and secure (Barrett, 2004). Accounting information systems maintain and produce the data (e.g., financial statements containing information about accounts and their balances) used by organizations to plan, evaluate and diagnose operations and financial position (Peters and Hlla, 2015), therefore, the aim of the regulators should be to make a system (accounting) that offers maximal benefits at lowest possible costs.

According to FASB (2010), the objective of financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decision about providing resources to the entity. These users of financial information want to make decisions about buying or selling both equity and debt instruments, they want to know how much interest or dividend to expect, they also want to know when to expect the payment of these interest and dividends.

Moreover, financial reporting quality requires companies to voluntarily expand the scope and quality of the information they report, to ensure that market participants are fully informed in order to make well-grounded decisions on investment, credit, etc. This high-quality information facilitates greater transparency and this greater transparency reduces the information asymmetries and satisfies investors and stakeholders' needs (FASB, 2010).

2.2. Theories

2.2.1 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. It also strives not to lose funds by providing attractive financial reports, which motivate the investor. This is achieved by ensuring that the reported information is in accordance with the real condition of the

company. Moreover, 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.

2.2.2. Legitimacy theory

The principal assumption of this theory is that companies consider themselves obliged to create additional value for the society in response to their right to operate. In order for this value to be made public, companies disclose their non-financial performance results: "the license to operate is central to legitimacy theory and posits that an organization can only continue to exist if its core values are aligned with the core values of the society in which it operates" (Blowfield, 2008).

As noted by Burlea and Popa (2013), Legitimacy theory is crucial in explaining the organization's behavior in implementing and developing social responsibility policies, and then communicating its results. It treats corporate social and environmental performance and disclosure of this information as a way to fulfill the organization's social contract that enables the recognition of its objectives. The sustainability of legitimacy theory is based on the management heritage that connects traditional norms and values with modern ethics.

Legitimacy is a mandate to act, to give something legal force, to sanction. Legitimacy is also considered a generalized perception or an assumption that the subject's actions are desirable or appropriate in a socially constructed system of norms, values, beliefs and definitions (Suchman, 2008).

Legitimacy in an enterprise is derived from its subordination to social norms and the law. It must be noted that there is a positive correlation between the size of the enterprise and its drive for legitimacy (Van, Ees and Witteloostuijn, 2008). The basic premise of the theory of legitimacy is the belief that a company influences the society in which it operates. At the same time, the company is also socially influenced, that is why its functioning is similar to a kind of social contract aimed at obtaining and maintaining social acceptance (ada and Kozarkiewicz, 2014).

This theory is constructed 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 and the author 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. The second component is based on the idea that companies can expect to benefit by a legitimate behavior based on the social responsibility activity (Toukabri, Ben and Julani, 2014).

Since the objective of accounting is providing users with information that helps 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).

In the academic context two levels of legitimacy are defined (Tilling, 2004):Institutional legitimacy relates to the issue of general acceptance of an organization by society at large and secondely, Organizational legitimacy deals with how organizations seek approval or try to avoid sanctions from the society.

In other words, there is an assumption that an organization should operate adequately in the given social and cultural context by employing its legitimacy as an organizational resource obtained from stakeholders (Blowfield, 2008). This type of legitimacy is both a process and a state (Deegan, 2002). As noted by different authors shows that, there is another typology of legitimacy (Suchman, 2008). According to the author Pragmatic (stakeholders grant legitimacy) to a company and expect influence or tangible return basing on their self-interest. Furthermore, moral(stakeholders assess actions of a company and decide on a moral approval for its actions) and finally Cognitive(either the company or its actions) are comprehensible or taken for granted.

The first two types of legitimacy (pragmatic and moral) are related to the discourse between the organization and its stakeholders, or, to put it differently, the first two types involve a form of accountability and reporting. Thus, one of the implications of the legitimacy theory is that by communicating the added value to its stakeholders (by e.g.,

issuing reports), a company reports on its responsibility and the way it is exercised towards stakeholders.

Moreover, Legitimacy is based on societal perceptions, and the only way to influence these perceptions is to provide the society with relevant information. As a response to a change in stakeholders' expectations, companies use disclosures to report on their progress in innovation, or to explain why no changes are made. In both cases, companies' actions are rooted in their legitimacy, and these actions and strategies constitute the actual focus of the legitimacy theory (Deegan, 2002).

2.2.3. Signaling Theory

The intuitive nature of signaling theory in part helps explain its pervasiveness. A journalist once famously asked Spence, who first put forth the theory, if it were possible that one could receive the Nobel Prize in Economics for simply noticing that in some markets certain participants do not know certain things that others in the market may wish to communicate (Spence, 2002). Spence replied that the correct answer was probably "no" but that what did blossom at the time was a serious attempt to capture the informational aspects of market structures. The profundity of the theory, therefore, lies in ascribing costs to information acquisition processes that resolve information asymmetries in a wide range of economic and social phenomena.

Moreover, this formulation of signaling theory, Spence (2002) utilized the labor market to model the signaling function of education. Potential employers lack information about the quality of job candidates. The candidates, therefore, obtain education to signal their quality and reduce information asymmetries. This is presumably a reliable signal because lower quality candidates would not be able to withstand the rigors of higher education. Spence illustrated how high-quality prospective employees distinguish themselves from low-quality prospects via the costly signal of rigorous higher education. This work triggered an enormous volume of literature applying signaling theory to selection scenarios that occur in a range of disciplines from anthropology to zoology (Bird & Smith, 2005). Kirmani and Rao (2000) provide a general example that helps illustrate a basic signaling model.

Like most examples of signaling, the authors distinguish between two entities: high quality firms and low-quality firms. Although the firms in this example know their own true quality, outsiders (e.g., investors, customers) do not, so information asymmetry is present. Consequently, each firm has the opportunity to signal or not signal its true quality to outsiders. When high-quality firms signal, they receive Payoff A, and when they do not signal, they receive Payoff B. In contrast, low-quality firms receive Payoff C when they signal and Payoff D when they do not signal. Signaling represents a viable strategy for high-quality firms when A > B and when D > C. Given these circumstances, high-quality firms are motivated to signal and low-quality firms are not, which results in a separating equilibrium. In such cases, outsiders are able to accurately distinguish between high- and low-quality firms. In contrast, when both types of firms benefit from signaling (i.e., A > B and C > D), a pooling equilibrium results and outsiders are not able to distinguish between the two types of firms (for a review of pooling and separating equilibrium, (Cadsby, Frank & Maksimovic, 1990).

Financial economists have developed several examples to demonstrate these general relationships. They have posited, for instance, that firm debt (Ross, 1973) and dividends (Bhattacharya, 1979) represent signals of firm quality. According to these models, only high-quality firms have the ability to make interest and dividend payments over the long term. In contrast, low quality firms will not be able to sustain such payments. Consequently, such signals influence outside observers' (e.g., lenders, investors) perceptions of firm quality. Owing to this foundational work, many of the core concepts and constructs of signaling theory grew out of the finance and economics literatures (Riley, 2001).

Although most signaling models include quality as the distinguishing characteristic, the notion of quality can be interpreted in a wide range of relevant ways. For the purposes of our review, *quality* refers to the underlying, unobservable ability of the signaler to fulfill the needs or demands of an outsider observing the signal. In Spence's classic example, quality refers to the unobservable ability of the individual, which is signaled by completion of the educational requirements necessary for graduation. In Ross's example, quality refers to the unobservable ability of the organization to earn positive cash flows in the future, which may be signaled by financial structure and/or managerial incentives(Kirmani *et.al.* 2000).

The notion of quality shares some characteristics with terms such as reputation (Certo, 2003), but we put forth that these terms are largely socially constructed and derive from the signaler's unobserved quality (or lack thereof).

2.2.4. Proprietary Costs Theory

This theory is stated that proprietary costs theory considers the costs of disclosures as well as its benefits. Managers take into account the costs of disclosing information and do not disclose when costs outweigh the benefits. These costs include not only those of preparing and disseminating the information, but also costs of appropriation of the information by competitors (Teixeira and Lima, 2007). Managers may decide the extent to which they use discretion, after considering the proprietary costs and benefits of comparability. In fact, comparable financial statements can lower the cost of capital (Imhof *et al.* 2017). On the other hand, comparable financial reporting can reveal proprietary information to peers, increasing threats to firms from competitors (Young and Zeng 2015; Choi *et al*. 2019).

Collectively, proprietary costs theory predicts a competitive industry would affect financial statement comparability. In addition, the main finding of Imhof *et al.* (2018) that competition incentivizes managers to use financial reporting discretion in a way that reduces financial statement comparability supports this theory. Most empirical studies on international accounting studies regarding the determinants of comparability have focused on the role of accounting standards (e.g. IFRS, US GAAP, and local GAAP) and have ignored unique country-level legal, cultural, and societal factors (Barth et al., 2013; Lang et al., 2010). Barth et al. (2013) suggests that the adoption of global accounting standards is necessary but not sufficient to explain accounting comparability.

2.3.5. Accounting theory

Many researchers are confused between normative accounting theory and positive accounting theory. Authors argue that there is no generally accepted "accounting theory" currently even though many attempts have been made to formulate one (Riahi, 2004). Accordingly accounting theory:

> "Accounting theory may be defined as logical reasoning in the form of a set of broad principles that (1) provide a general frame of reference by which accounting practice can be evaluated, and (2) guide the development of new practices and procedures. Accounting theory may also be used to explain existing practices or to obtain a better understanding of them. But the most important goal of accounting theory should be to provide a coherent set of logical principles that form the general frame of reference to the evaluation and development of sound accounting practice".

According to Napier (2013) the various "accounting theories" can be divided into two broad, but overlapping, groups reflecting the main purpose for which the theories have been developed. Some theories are intended to provide a structure for understanding existing accounting practice, usually with a view to its improvement. Such theories may be labeled "prescriptive" or "normative", and have sometimes been classified as "theories of accounting". Other theories also aim for an understanding of existing accounting practice, but here the objective is to explain the behavior of those who prepare and use financial reports of businesses and not-for-profit entities, and to predict the accounting choices that preparers and users may make. Such theories may be labeled "descriptive" or "positive'' and come within the classification "theories *about* accounting".

2.3. Empirical review

The existing literature is sated with studies undertaken internationally and locally on this phenomenon and the researcher attempt to review some of this study in line with the context of this study.

A study undertaken by Evada Dewata (2016), on Determinants Of Financial Reporting Quality And Its Implications On The Financial Performance Of State-Owned Enterprises, showed that Variable of the size of the board of directors did not have the significant influence on the quality of financial reporting in state-owned enterprises, meaning that there was no effect of increasing or decreasing the size of the board of directors to the quality of financial reporting.

Yimenu (2016) investigated the Determinants of Financial Reporting Quality: Evidence from Large Manufacturing Share Companies of Addis Ababa. The data were analyzed using Hausman Test. The finding of the study showed that liquidity, leverage and board composition has no any statistically significant impact on large manufacturing share company's financial reporting quality. He also found, audit firm size is the most Dominant Determinant of Financial Reporting Quality and very strong positive correlation between AUD and the dependent variable.

Al Daoud *et al.*, (2015) investigated on impact of internal corporate governance on the timeliness of generating financial reports of Jordanian firms. The data were collected from a two-year period of 2011 and 2012 and the multiple regression analysis was used to test the hypotheses. The findings of the study support the agency theory; hence the results of the relationships between the corporate governance mechanisms, finding that the audit report lag (ARL) and management report lag (MRL) were generally significant. Consequently, the results of the studies revealed that corporate governance mechanisms affect the timeliness generation of financial reports .

Adebiyi *et.al* (2015) appraised the relationship between corporate ownership structure and financial reporting quality among Deposit Money Banks in Nigeria. The study analyzed whether a firm's ownership structure (measured with three variables: managerial ownership, foreign ownership and institutional ownership) improves the quality of the financial reporting or not. Whereas financial reporting quality is measured by modified Jones model, the researchers used discretionary accruals as a proxy for financial reporting quality. The data are extracted from a sample of all Deposit Money Banks listed on Nigerian Stock Exchange for nine years between 2005 and 2013, using Ordinary Least Square Regression technique as a tool of analysis for the study. The result showed that financial reporting quality is positively related to managerial ownership and relates negatively to institutional and foreign ownership. This result is consistent with the alignment of interest hypothesis that suggests that managers who own a significant portion of the equity in a firm have less incentive to manipulate reported accounting information. The study's result suggests that managerial ownership improves the quality of annual earnings by reducing the levels of financial reporting manipulation.

The study conducted by Eden S. (2017) on Determinants of Financial Reporting Quality: Evidence from Ethiopian Private Banks shows that; profitability, liquidity, non-performing

loan and bank age has significant impact on the financial reporting quality of Ethiopian private banks. Moreover, the author in her study revealed that liquidity has statistically significant and positive effect on financial reporting quality of Ethiopian private banks. While, in this the author find that financial leverage as measured by ratio of total liabilities to total assets has no statistically significant positive impact on financial reporting quality of private banks in Ethiopia.

2.4. Conclusion and Knowledge Gap

A few literatures on financial reporting quality have been reviewed from previous studies and these literatures focused determinants of financial reporting qualities from different economic sectors of the world. More over the studies on the issue varies from countries to countries and as the researcher in these reviews restricted in developing countries in different time. As far as the knowledge of the researcher, the studies conducted in Ghana, Nigeria and our country Ethiopia.

Few researchers have found inconsistent results on the linkage between financial reporting quality and its determinant factors. In the context of Ethiopia, the related study conducted by Yimenu (2016) assessed the determinants of financial reporting quality in manufacturing companies in Addis Ababa Ethiopia. In very recent year the study conducted by Eden S. (2017) assessed the Determinants of Financial Reporting Quality: Evidence from Ethiopian Private Banks. These studies limit their scopes only on investigating determinants of financial reporting quality of manufacturing share companies and Ethiopian private banks. To the best of the researcher's knowledge, limited studies in Ethiopia were conducted on the determinants of financial reporting quality of the Insurance companies in Ethiopia. Thus, this study will intend to fill these gaps and try assessing the determinants of financial reporting qualities in case of Ethiopian insurance.

2.5. Conceptual frame work

To achieve the research objective and to test the research hypotheses, the research developed this conceptual framework. Since the insurances financial reporting quality is determined by various factors, these insurances companies need to recognize what influences their FRQ to reach optimal level of financial reporting. Financial Reporting

Quality (FRQ), which is the dependent variable, was represented (FRQ) as a proxy for earnings management, on the other hand, the independent variables are profitability (ROA), liquidity (LQ), leverage (LE), board size (BS), firm age (FA) and auditor change (AC).

Figure 1: Conceptual frame work: Relation between Financial Reporting Quality (FRQ) and its determinants.

Dependent variable		**Independent variable**
Financial Reporting Quality (logFRQ)		Profitability (ROA)
		Leverage ratio (LE)
		Liquidity (LQ)
		Board size(logBS)
		Firm size(logFS)
		Auditor change (AC)
		Firm age(logFA)

CHAPTER THREE

RESEARCH METHODOLOGY

Introduction

This chapter discusses the research methodology used in the study. The chapter is organized in following sections. The first section presents the research approach. The second section presents research design of the study. The next section presents sources and type of data and data collection instrument methods of the study. The fourth section focus on data analysis method and finally, model specification and model validity are presented in the study.

3.1. Research Approach

The research problem tends to be explanatory which seeks to assess the determinants of financial reporting quality in case of Ethiopian insurance companies. Therefore, Quantitative research approach employed and it is means for testing objective theories by examining the relationship among variables (Creswell, 2009). According to Kothari (2004), quantitative research is based on the measurement of quantity or amount. It is applicable to phenomena that can be expressed in terms of quantity.

3.2. Research Design

To achieve the objectives of the study the researcher used descriptive research design. The purpose of a descriptive study is to provide a picture of a situation, person or event or show how things are related to each other and as it naturally occurs. However, descriptive studies cannot explain why an event has occurred and is much suitable for a relatively new or unexplored research area. In the study the researcher was use secondary data from audited financial reports of insurances companies of Ethiopia from 2014-2019. Therefore, the population of this study were Ethiopian insurance companies, with audited financial report from 2014-2019. Accordingly, in Ethiopia there are 16 insurance companies and few companies were established in very recent times (Buna insurance established in 2013, Zemen Insurance) and were not included in the studies. Since, the study includes the annual reports of the companies from 2014 -2019. Therefore, the companies with six years audited financial report were used in the study.

3.3 Sources and Types of Data

According to Yugi (2006), secondary data has its own advantages. Compared to primary data, secondary data gives higher quality data, the feasibility to conduct longitudinal studies and the permanence of data which means secondary data generally provide a source of data that is both permanent and available in a form that may be checked relatively easily by others. Consequently, to enhance the dependability of the data, the researcher used secondary data which is based on the audited annual financial statement of the insurances companies which are readily presented on their website(2014-2019).

3.4. Data Collection Instruments

In the data collection process different data collection instruments can be used. According to the source of data that have to be collected to conduct the study, the researchers used secondary data by reviewing the annual audited financial statements of Ethiopian insurance companies from year 2014 to 2019.

3.5. Method of Data Analysis

The data were analyzed by using descriptive statistics, correlations analysis and multiple linear regression analysis. Mean values and standard deviations were employed to analyze the trends of the data from 2014 to 2019 based on the companies. Moreover, the researcher was used correlation matrix to examine the relationship between the dependent variable and independent variables. Finally, ordinary least square (OLS) were conducted using statistical package "EVIEWS -8" to know the most significant and influential explanatory variables affecting the financial reporting quality in insurance companies of Ethiopia.

3.6. Definition of Variables and Model Specification

A. Dependent variable

Assessing the quality of financial reporting requires a broad range of measurements using models, proxies, qualitative characteristics, and other elements of financial reports. In the literature, three different dimensions of financial reporting quality are frequently used: Accrual-Based Models, Accounting Conservatism, and Earnings Managements (abnormal accrual). Many approaches have been used to measure and assess financial

reporting quality, and new approaches are still being developed. For this study the accrual-based model developed by Dechow and Dichev (2002) were employed to measures the financial reporting qualities of Ethiopian insurance companies.

Dechow and Dichev (2002) extend the idea on a practical measure of accrual and earnings quality. The model developed a way of combining Dechow and Dichev (2002) and Jones model. They provide a new approach to estimate the quality of accruals, as an example which is related to earlier researches. The accruals quality and earnings process advocates that the size of estimation errors is related to business systematically. The modified model were added to the model of Dechow and Dichev (2002) the essential variables present in the model of Jones, as the annual revenue variation and the value of gross property, plant and equipment as proposed by McNichols (2002).

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

$$\Delta WCit = \beta 0 + \beta 1 CFOit - 1 + \beta 2 CFOit + \beta 3 CFOit + 1 + \beta 4 \Delta REVit + \beta 5 PPEit + \varepsilon$$

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

The residuals for the modified Dechow and Dichev's model, after adding the firms' data represented financial reporting quality in the second regression model specified for the study. However, the residual measure the accrual quality, the lower the residuals, the higher and the quality of accruals vice versa as in McNichols (2002).

To solve this problem, multiplied the absolute values of the modified DechowDichev measure by −1 (Dechow and Dichev's model). Thus, higher values of Dechow and Dichev's model represent higher FRQ.

B. Independent Variables

Profitability ratio: is measured in return on asset. It is metrics that assess a company's ability to generate income relative to its revenue, operating costs, balance sheet assets, or

shareholders equity. It shows how efficiently companies generate profit and value for shareholders.

Liquidity measures the ability of insurance companies to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses (CR) is measured by dividing current asset to current liability. It is the ability of the insurer to fulfill their immediate commitments to policyholders without having to increase profits on underwriting and investment activities and/or liquidate financial assets

$$\boldsymbol{Liquidity\ ratio\ = Current\ Assets/Current\ Liabilities}$$

Leverage; is measured as the ratio of total debt to owners' equity. It refers to the use of debt (borrowed funds) to amplify returns from an investment or project. Companies use leverage to finance their assets instead of issuing stock to raise capital, companies can use debt to invest in business operations in an attempt to increase shareholder value.

$$\boldsymbol{Leverage\ Ratio = Total\ Debt/Total\ equity}$$

The firm size*:* The size of a business affects its operations and financial transactions. The firm is described as the business unit or undertaking which owns the resources of the business, within the scope of its plant's arsenal, its controls and how it is been managed. There is no particular description for a particular firm.

Age of the insurance company: measured age by the numbers of years plus one. Company age is therefore the number of years (plus one) elapsed since the year of the companies. We refer to this variable as the firm's listing age. We add one year to avoid ages of zero.

Auditor change: Auditor change is measured by dummy variable, 1 if auditor was changed in the year and 0 otherwise.

3.7. Model Specification

To assess the determinants of financial reporting quality in insurance companies in Ethiopia, the following general empirical research model will be taken from empirical studies (Ahmed, 2012; Hassan and Bello, 2013; Fathi, 2012; Dechow, Ge and Schrand, 2010; Atanasko, 2013; Ole, Wayne and Dushyantkumar, 2011; Ferrero, 2014).

$$FRQit = \beta 0 + \beta 1(ROAit) + \beta 2(FSit) + \beta 3(BSit) + \beta 4(Acit) + \beta 5(LEit) + \beta 6(LQit) + \beta 7(FAit) + \varepsilon i$$

Where;

- FRQ*it* is financial reporting quality of insurance companies i at time t
- β0 is intercept
- ROA*it* is Return On Asset of insurance companies i at time t
- FS*it* is firm size of insurance companies i at time t
- BS*it* is board size of insurance companies i at time t
- FA*it* is Firm Age of insurance companies i at time t
- Ac *it* is change of auditor of insurance companies i at time t
- LE*it* is leverage size of insurance companies i at time t
- LQ*it* is liquidity of insurance companies i at time t
- β 1- β7 are Coefficient's parameters
- εi is error term

CHAPTER FOUR

RESULTS

4.1. Introduction

In the previous chapters, the review of relevant literature helped this study to identify the problem and to design right research approach to deal with. The preceding chapter also talks about the research design employed to achieve the objectives of the study and to test the research hypotheses there on. Chapter four discusses about the analyses of data the collected from various statistical tools and presents the results and discussion accordingly. This chapter is organized in as follows. The first sub section presents the result which includes Descriptive Statistics, Correlation Analysis, Normality Testing, Hetrosckedasticity Testing, Multi-Co Linearity Testing (Variance Inflation Factor), Confidence Interval Testing, Random Regression Results and Discussion.

4.2. Descriptive statistics

Under this section the researcher presents descriptive statistics of independent and dependent Variables obtained in the study. The independent variable included in the study are return on asset, liquidity ratio, leverage ratio, board size, audit change, firm age and firm size and the dependent variable included in the study is financial reporting quality (FRQ). The number of observations were 96 (16 Ethiopian insurance company for the period from 2014-2019). The descriptive statistics include mean, median, maximum, minimum and standard deviation of variables included in the study period.

Table 1: Descriptive statistics

	LOGFRQ	ROA	LQ	LE	LOGFS	LOGBS	AC	LOGFA
Mean	-7.94	0.22	1.23	1.75	8.74	0.93	0.25	1.05
Median	-8.01	0.07	1.22	1.70	8.77	0.95	0.00	1.20
Maximum	-6.59	1.84	2.09	3.56	10.00	1.00	1.00	1.63
Minimum	-8.73	-1.48	0.27	0.62	7.73	0.69	0.00	0.00
Std. Dev.	0.48	0.44	0.27	0.61	0.43	0.07	0.43	0.36
Observations	96	96	96	96	96	96	96	96

Source: output of EViews 8

The result in the above table 1 showed that, financial reporting quality, have a mean value of -7.94 and standard deviation of 0.48. This indicates that the Ethiopian insurance companies have abnormal accrual, on average, with log value of -7.94 and the minimum and maximum value of the financial reporting quality are -8.73 and -6.59 respectively. This implies that the sampled Ethiopian insurance company with -6.59 has the highest financial reporting quality on the contrary insurance company with -8.73 have a minimum financial reporting quality. The finding showed that the Ethiopian insurance companies have on average negative 7.94 of abnormal Accrual, financial reporting quality and a 0.48 is its standard deviation.

The maximum and minimum value of the independent variable return on asset is 1.84 and -1.48 respectively. This result showed that there are insurance companies with the maximum value of 1.84 and insurance companies with minimum value of -1.48, and a standard deviation of 0.44from its mean value with 0.22 .The finding implies that the Ethiopian insurance company generates the average value of 22% of return for each asset in the study period.

The next independent variables which explain dependent variable is liquidity ratio. Its mean, maximum, minimum, and standard deviation are 1.23, 2.09, 0.27 and 0.27 respectively. This implies that the insurance companies used on average 12.3% of current asset to cover their current liability. According to this Ethiopian insurance companies have ability to pay its short-term liabilities during the study period.

The result as shown on the above table 1 shows that the other explanatory variable of the study is leverage ratio, which has a minimum value and maximum value of 0.62 and 3.56 respectively. The result showed that there are Ethiopian insurance companies with the maximum value of 3.56 and a minimum value 0.62 and the standard deviation of 0.61 from its mean value with 1.75. This implies that on average Ethiopian insurance companies finance their business around 17.5% from long term loan.

The study, as shown on the above table 1 displays the board size of Ethiopian insurance company with the maximum, minimum, mean and Standard deviation value of 1.00, 0.69, 0.93 and 0.07 respectively. The finding displays that there are Ethiopian insurance companies having a board size with a maximum and a minimum value of 1 and 0.69. On

the other hand, Ethiopian insurance company having, the average value of 93 % of board size.

The auditor change shows the change of an audit firm for a given insurance company's in a given year while providing external audit service. The mean of this variable for the insurance company's stands at 0.25 which implies that the average period of a given insurances changes its audit firm. The minimum and maximum value for the variable is 0 and 1 respectively with a standard deviation of 0.43. The minimum value implies that there is a insurance company which did not change an audit firm within the study period and the maximum value indicates that there is insurance company which changed its audit firm within the study period.

As shown in the table 1 above indicates that the independent variable, firm size included in this study. It is computed by the log of total asset and its maximum, minimum, standard deviation and the mean value of 10.00, 7.73, 0.43 and 8.74 respectively. The result showed that there are insurance companies in Ethiopia which has a maximum and minimum value of 10.00 and 7.73 of asset size. In addition to this result, Ethiopian insurance has an average value of 87.4% of asset size on average.

The final independent variable included in this study is firm age. This is computed by log of counting the number of years of establishment of the Ethiopian insurance company and it has a maximum, minimum, standard deviation and mean value of 1.63, 0.00, 0.36 and 1.05 respectively. This implies that there is Ethiopian insurance company which has a maximum and minimum value of 1.63 and 0.00. Moreover, the finding showed that the Ethiopian insurance company has 10.5 % of age on average.

4.3. Correlation Analysis

Correlation is defined as the linear association between the dependent and independent variables values of the correlation coefficient are always between positive one, negative one and zero. The correlation coefficient of positive one indicates that there is a perfect positive association between the dependent and independent variables; while a correlation coefficient of negative one indicates that there is a perfect negative association between the dependent and independent variables. However a correlation coefficient of zero indicates that there is no linear relationship between the independent

and dependent variables. As shown in the above table 2 presents the relationship between the explanatory variables and financial reporting quality in the study. As displayed in Table 2 the explanatory variables, return on asset (roa), liquidity (lq), leverage, (le), firm size, (fs) and age of the firm (fa) are correlated with dependent variable financial reporting quality (frq).

Table 2: Correlation Matrix for independent variables

	ROA	LQ	LE	LOGFS	LOGBS	AC	LOGFA
ROA	1						
LQ	-0.0150	1					
LE	-0.0123	-0.4710	1				
LOGFS	0.02123	-0.2608	0.1295	1			
LOGBS	-0.1224	-0.1456	0.0728	0.2474	1		
AC	-0.0045	-0.0254	0.1279	0.0031	0.1026	1	
LOGFA	0.0085	-0.2443	-0.0369	0.7751	-0.0292	0.0413	1

Source: Output of Eviews 8

Table 3: **Correlation analysis**

	LOGFRQ	ROA	LQ	LE	LOGFS	LOGBS	AC	LOGFA
LOGFRQ	1							
ROA	0.5559	1						
LQ	0.1596	-0.01502	1					
LE	-0.2191	-0.0124	-0.4710	1				
LOGFS	-0.4264	0.0212	-0.2608	0.1295	1			
LOGBS	-0.1258	-0.1224	-0.1456	0.0728	0.2474	1		
AC	0.0086	-0.0045	-0.02545	0.1279	0.0031	0.1026	1	

LOGFA	-0.2649	0.0085	-0.2443	-0.0369	0.7751	-0.0292	0.0413	1

Source: out put of eveiews 2021

As shown on the above table **3** the correlation coefficient of the independent variable return on asset, has a correlation coefficient of 0.5559. This indicates that return on asset has perfect positive correlation with financial reporting quality. Accordingly the numerical value provides the evidence that Ethiopian insurance companies are profitable during the study period. The correlation coefficient of liquidity ratio is (0.1596). This indicates that liquidity has a perfect positive association with that of the financial reporting quality. This suggests that Ethiopian insurance company has ability to pay its current liability. The correlation coefficient of leverage indicates that the value of (-0.2191). This implies that leverage has a perfect negative association with that of financial reporting quality. The correlation coefficient of firm size is a negative (-0.4264). Accordingly there is a perfect negative relationship between firm size and financial reporting quality in Ethiopian insurance company.

The correlation coefficient of board size showed that the value of a negative (-0.1258). This implies that there is a perfect negative correlation among the independent variable board size and the dependent variable financial reporting quality. The correlation coefficient of audit change indicates the value of 0.0086. This displays that there is a perfect positive association between audit change and financial reporting quality. The correlation coefficient of firm age indicates that a value of negative (- 0.2648) this displays that there is a perfect negative correlation between firm age and financial reporting quality.

4.4. Normality test

Ho: residuals are normally distributed

H1: residuals are not normally distributed

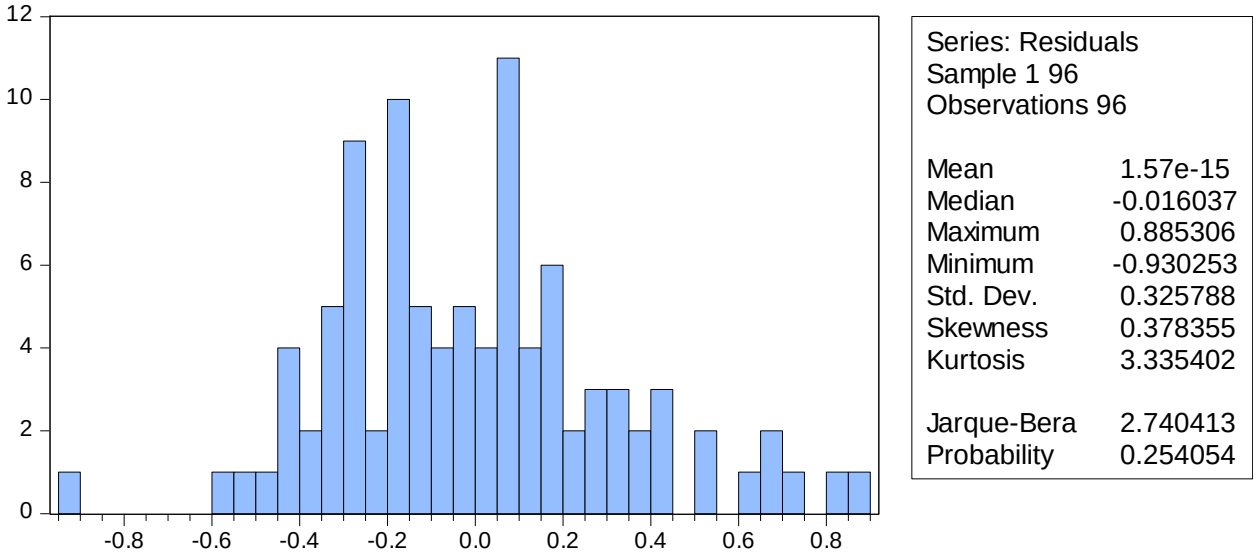


Figure 2: Normality test

The result in the above figure 1 indicates that there is no the problem of normality. Since the p-value of 0.25 is greater than 0.05 implies residuals are normally distributed as a result the researcher decide to accept the null hypothesis during the study period.

4.4. Hetrosckedasticity

Ho: the disturbance term is normally distributed

Table 4: **Breusch-Pagan-Godfrey**

F-statistic	0.179843	Prob. F(7,88)	0.9888
Obs*R-squared	1.353974	Prob. Chi-Square(7)	0.9869
Scaled	1.328509	Prob. Chi-	0.9877

explained SS		Square(7)	

Source: Output of Eviews 8

Heteroscedasticity test is used to detect whether variance of the disturbance term is normally distributed or not distributed. In order To test for the existence of heteroscedasticity, Breusch Pagan-Godfrey test was employed for this study. The result in the above table 3 indicate that the p-value for chi-square (0.9869) is greater than 0.05, therefore there is no heteroscedasticity problem in the study and the decision is accept the null hypothesis.

4.5. Multicollinearity

Ho: there is existence of multicollinearity problems

H1: there is no existence of multicollinearity problems

Table 5: variance inflation factor

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	1.102104	923.3837	NA

ROA	0.006286	1.280086	1.025988
LQ	0.023421	30.95580	1.459659
LE	0.004729	13.55204	1.462070
LOGFS	0.022177	1422.241	3.374336
LOGBS	0.267958	197.3116	1.321705
AC	0.006717	1.406970	1.055227
LOGFA	0.030980	32.01027	3.308249

Source: Output of Eviews 8

Multicollinearity defined as a condition for existence of exact (linear) or inexact (nonlinear) relationship between the independent variables. The result in the above table 5 indicates that there is no a problem of multicollinearity in the explanatory variables. The value of all the independent variables has a Coefficient Variance factor which is less than 0.7; this implies that there is no evidence of multicollinearity problem among the explanatory variables, the X's. This result led to the researcher decides to accept the null hypothesis.

4.6. Confidence interval test

Confidence interval display the probability that a parameter fall between a pair of values around the mean .confidence interval measure the degree of uncertainty or certainty in a sampling method .They are most often constructed using confidence interval of 95% and

99%. The confidence interval for a mean gives us a range of likely value for the population mean. If a confidence interval does not include a particular value, we can say that, it is not likely that the value is the true population. The result showed below table 5 the independent variable return on asset (ROA) lies between the confidence interval of 0.4699 and 0.7850. This implies that, the sample is fall around the mean of the true population. The independent variable liquidity (LQ) lies between the confidence interval of -0.2776 and 0.3305. This numerical value indicated that, it is not likely that the value is the true population. The independent variable leverage (LE) lies between the confidence interval of -0.2392 and 0.0340. It implies that, it is not likely that the value is the true population. The independent variable firm size (FS) lies between the confidence interval of -0.9614 and -0.3695. This implies that the sample is fall around the mean of the true population. The explanatory variable board size (BS) lies between the confidence interval of -0.3569 and 1.7005. The result showed that it is not likely that the value is the true population. The explanatory variable auditor change (AC) lies between the confidence interval of -0.1504 and 0.1752. The result displayed that it is not likely that the value is the true population .the explanatory variable firm age (FA) lies between the confidence interval of -0.0936 and 0.6058. This showed that it is not likely that the value is the true population.

Table 6: Confidence of interval

		95% CI	
Variable	Coefficient	Low	High
C	-3.015358	-5.101638	-0.929079
ROA	0.627469	0.469911	0.785026
LQ	0.026436	-0.277695	0.330567
LE	-0.102622	-0.239277	0.034033
LOGFS	-0.665482	-0.961430	-0.369534
LOGBS	0.671791	-0.356922	1.700505
AC	0.012405	-0.150470	0.175280
LOGFA	0.256113	-0.093670	0.605897

Source: Output of Eviews 8

4.8. Random effect testing

Table 7: Correlated Random Effects - Hausman Test

Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section	7.489725	7	0.3797

random			

Commonly there are two panel data analysis, these are random and fixed effect models, in order to select the appropriate models to estimate the study variables. However, the choice between fixed effects and random effects model is by computing fixed effect testing and the Hausman specification tests to decide which model is appropriate to estimate the data.

Ho: Random- effect model is more appropriate

H1: Fixed-effect model is more appropriate

In order to select the appropriate model for the study the Hausman's specification test was employed during the period. The table 6 showed that random effect model is more appropriate than fixed effect model for this study, as the p-value (0.3797) is greater than 0.05 to conduct the panel regression estimation of the model. As a result, the researcher decides to accept the null hypothesis.

The researcher used correlated random effect regression models to analyze result of the study and the output is shown in the above table 5. Accordingly, the R-squared statistics and the adjusted-R squared statistics of the model are 0.5151 and 0.4765 respectively. This implies that the independent variables included in this model could explain variation in the dependent variable by about 51% and 47.6% respectively. The remaining 49% indicates that explanatory variables that are not included in this model but that have impact on the financial reporting quality. The F-statistics probability value 0.0000 implies that the data fit the mode well and the explanatory variables are jointly having significant effect on financial reporting quality of Ethiopian insurance companies.

4.7. Random effect result

Table 8: Random effect result

	Confidence interval test (95%)

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Low	High
C	-3.199120	1.224280	-2.613062	0.0106	-5.101638	-0.929079
ROA	0.618113	0.077449	7.980897	0.0000	0.469911	0.785026
LQ	0.002171	0.163958	0.013241	0.9895	-0.277695	0.330567
LE	-0.095810	0.073779	-1.298598	0.1975	-0.239277	0.034033
LOGFS	-0.644431	0.175004	-3.682384	0.0004	-0.961430	-0.369534
LOGBS	0.751996	0.557419	1.349067	0.1808	-0.356922	1.700505
AC	0.010066	0.080989	0.124289	0.9014	-0.150470	0.175280
LOGFA	0.204155	0.209549	0.974261	0.3326	-0.093670	0.605897

R-squared	0.515117	Mean dependent var	-6.072244
Adjusted R-squared	0.476547	S.D. dependent var	0.450923
S.E. of regression	0.326243	Sum squared resid	9.366242
F-statistic	13.35532	Durbin-Watson stat	1.901021
Prob(F-statistic)	0.000000		

4.9. Discussion of the results

Under this section, particularly the researcher analyzed in detail the regression result of random effect model. The results of this study show that all variables in the model except

Return on asset (ROA) not affect financial reporting quality of Ethiopian insurance companies. Moreover, the regression result indicates that ROA has positive and significant impact on the financial reporting quality of Ethiopian Insurance companies. On the other hand, the regression result shows that LQ has positive and insignificant effect, BS has positive and insignificant effect; LE has negative and insignificant effect,

The researcher analyzed the result of random effect model and shows that the explanatory variables included in the model such as return on asset (roa), liquidity (lq), leverage (le), board size (bs) and audit, (ac) and the dependent variable is financial reporting quality (frq). While firm size (fs) and firm age (fa) are constant variables.

Financial Reporting Quality Vs Profitability

The random effect regression result indicates that the coefficient of the independent variable return on asset has a positive and statistically significant effect on financial reporting quality at a value of 0.6181 and the p- value of 0.0000. It implies that return on asset is statistically significant at 5% level. It interpreted as a one percent (1%) increase in return on asset results a 0.6181 increase in financial reporting quality on average. said that profitability is not the determinants of quality financial reports. In line with this the study conducted by AlAsiry (2017), Takhtaei *et al*. (2014), and Fathi(2013) showed that profitability is one of the determinant of quality report. Other empirical studies contradict the finding of the current study. The study conducted by Eyunobo e*t al.* (2017) and Hosseinzadeh et al. (2014) showed that profitability is not determinants of quality report.

Financial Reporting Quality Vs Liquidity

The independent variable liquidity has a positive and statically insignificant effect on a financial reporting quality at the coefficient of 0.0021 and the p-value of the 0.9895. It is not significant at 5% level. Finally, it is interpreted as a one percent (1%) increase in liquidity ratio results a 0.0021 increase in financial reporting quality on average. Therefore, the hypothesis that liquidity has a positive and statically significant effect on a financial reporting quality is rejected and accepted the null hypothesis. Similarly, the finding of Amihud's (2002) and Chung *et al*. (2009) showed that liquidity and financial reporting quality had positively related to each other. Moreover, the finding of John *et al* 2017 showed that liquidity has positive but significant effect on financial reporting

quality. This means that a strong and high liquidity position of the in the sectors and Natural Resources firms in Nigeria will enhance financial reporting quality. This finding agrees with the position that firms with good performance indicator such as liquidity, profitability, etc, will like to disclose their performance in the financial report.

Other authors also found the same results that liquidity had Positive and significant impact on financial reporting quality Takhtaei and Mousavi (2012), Amr (2016) and Shehu and Farouk (2014). This understanding of the positive relationship between liquidity and financial reporting quality in the Agriculture and Natural Resources sectors could elicit, as a matter of policy, the maintenance of an optimum level of liquidity by management. On contrary, the finding of Ng (2011) showed that they have negative relationship. The author therefore, reported that higher information quality was associated with lower liquidity risk and that the reduction in cost of capital due to this association was economically substantial. The author also reported that the negative association between information quality and liquidity risk was stronger in times of large shocks to market liquidity

Financial Report Quality Vs Leverage

The explanatory variable leverage has a negative and statistically insignificant effect on financial reporting quality with its coefficient of -0.0958 and the p-value of 0.1975. This implies that leverage ratio has statically insignificant effect on financial reporting quality at 5% level. Generally it is interpreted as a one percent increases in leverage results a 0.0958 decrease on financial reporting quality on average. As result, the hypothesis that states that leverage has positive and statistically significant impact on financial reporting quality of Ethiopian insurance companies is rejected and accepted the null hypothesis, that leverage has negative and statistically insignificant impact on financial reporting quality of Ethiopian insurance companies. This finding showed that leverage is not the DETERMINANTS OF FINANCIAL REPORTING quality of the company. In the same way, Studies of Prihata and Rahaya (2019) and ALAsiry (2017) established leverage is not a DETERMINANTS OF FINANCIAL REPORTING quality. Furthermore, the studies of Zarzeski (1996) and Ahmed (2012) found a negative relationship between leverage and disclosure, suggesting that highly leveraged companies tend to disclose private information to their creditors which may not be reflected in their annual reports. The regression result is contradictory with some previous studies. The study conducted

by Watts (1990) showed that highly leveraged firms are more likely to engage in opportunistic activities and manipulation to avoid violation of debt covenants. This means that firm leverage is negatively and significantly affects the relationship between financial reporting quality and investment efficiency in the Ethiopian insurance companies, is rejected at 95 percent significance level.

While, studies of Hossain, tan and Adams (1994), Naser, Al-Khatib and Karbhari (2002), Hassan, Percy and Stewart (2006) and Adelopo (2010) have all found a positive relationship between leverage and financial reporting quality. In addition, the works of Shehu (2013), Karami and Akhgar (2014), Kim and Yang (2014), Shehu and Farouk (2014) and Amr (2016) different from the finding of this study and they founded that leverage has a positive and significant influence on financial reporting quality. More over Leverage is also connected to financial reporting choices. Agency theory clarifies this link. The results of the study not the same as this theory, highly leveraged firms have an inducement to voluntary increase the level of corporate reporting to stakeholders through conventional financial statements (Jensen & Meckling, 1976).

The other independent variable included in the study is board size and it has a positive and statically insignificant impact on financial reporting quality. The coefficient of the variable indicates that 0.7519 with its p-value of 0.1808. This showed that board size is not statically significant at 5% level. Finally it is interpreted as a one or more increase in board size results a 0.7519 increase in financial reporting quality on average. Similarly, the finding of most previous studies showed that, board size has positive relationship with FRQ. For instance, Bradbury *et al.* (2006), Fathi (2013), Htay *et al.* (2013), Haji and Ghazali (2013), Chakroun, and Hussainey (2014), Asegdew (2016), Uwuigbe *et al*. (2017) and Akeju and Babatunde (2017) found a positive relation between board size and FRQ. These results implied that better disclosure quality of the annual reports could be achieved by having greater board size (Htay et al., 2013). Larger board size could provide more competence and knowledge to the firm and may have the capability to monitor excellently, which could consequently lead to higher quality of financial reporting (Haji and Ghazali, 2013). In contrast Yoshikawa and Phan (2003), Byard et al. (2006) and Ostadhashemi et al. (2017) found a negative relation between board size and FRQ. This finding demonstrated that the lesser the board size, the better communication

and coordination is which in turn will result in better disclosure quality of accounting information (Yoshikawa and Phan, 2003).

Financial Reporting Quality Vs Auditor Change

The explanatory variable of audit change is a positive and statically insignificant impact on financial reporting quality with the coefficient of 0.0100 and the p-value of 0.9014. This numerical value indicates that audit change is not statically significant at 5% significance level. It is interpreted as a one or more increase in audit change results a 0.0100 increase in financial reporting quality on average. Similarly, the study conducted by (Dabor and Ibadin, 2013) found a positive relationship between auditor change and earnings management. This study supports the finding that auditor change brings earnings management.

The evidence indicated by IAF plays an important role in completing the financial statements audit (Felix et al., 2001; Zain et al., 2006), implying that IAF has an effective role in improving the audit quality and, in turn, FRQ. In the same way, the study conducted by (Dabor and Ibadin, 2013) found a positive relationship between auditor change and earnings management. This study supports the finding that auditor change brings earnings management. Carcello and Nagy (2004) found that duplicitous financial reporting occurs early in an auditor-client relationship.

Financial Reporting Quality Vs Firm Size

More over the constant variable for the firm size has a negative and statically significant impact on financial reporting quality with the coefficient of a -0.6444 with a p-value of 0.0004. The finding implies that firm size has statically significant at 5% level. Many studies have researchers founded that firm have positive and significant effect on FRQ and the results were mixed. In opposite to this, larger firms are incentive to show a positive effect on FRQ (Prior *et al.*, 2008; Surroca *et al.*, 2010). Moreover, Naser and Al-Khatib (2000), Street and Bryant (2000), Alsaeed (2006), Mangena and Tauringana (2007), Haji and Ghazali (2013), Agyei-Mensah (2013), Ebrahimabadi and Asadi (2016) and Monday and Nancy (2016) found a significant positive relation between firm size and FRQ.

Financial Report Quality VS Age of the Insurance Company

The other constant variable included in the study is firm age. It has a positive and statically insignificant impact on financial reporting quality with coefficient of 0.2041 at p-value of 0.3326. The result showed that firm age is not significant impact at 5% level. It is interpreted as a one or more increase in age of the firm results a 0. 2041 increase in financial reporting quality on average. Similarly, Umoren and Asogwa (2013) found that company age has a positive and significant effect on financial reporting quality. In the study the authors argued that older, experienced and well-established companies are likely to disclose more information because they have established and cost-effective reporting systems. Moreover, firms advance in age improve in their governance mechanisms, and as a result, become more closely monitored by government regulatory agencies. This is expected to produce a corresponding improved financial reporting practice (Chalaki, Didar, & Riahnezhad, 2012). From this one can understand that firm age had a positive and significant impact on and financial reporting quality.

The firm gets stronger with age, and a strong and well-structured internal control system guarantees quality financial reporting process, (Huang, Ena & Lee, 2012). On the other hand, younger companies disclose more information to boost investor confidence and reduce skepticism.

Table 9: Summary of Hypothesized and Actual Impact

Independent variables	Measurement	Hypothesis	Actual Impact or effect
Profitability ratio	Measured in return on asset	Positive and significant	Positive and significant

Age of the Insurance Company (FA)	Measured age by the numbers of years plus one	Positive and significant	Positive and insignificant
Leverage (LE)	Measured as the ratio of total non-current liabilities to owners' equity and long-term liabilities	Positive and significant	Negative and insignificant
Liquidity (LQ)	Measures the ability of insurance companies to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses (CR) is measured by dividing current asset to current liability.	Positive and significant	Positive and insignificant
Firm Size (FS)	The firm is described as the business unit or undertaking which owns the resources of the business, within the scope of its plant's arsenal, its controls and how it is been managed	Positive and significant	Negative and significant
Auditor Change (AC)	Auditor change is measured by dummy variable, 1 if auditor was changed in the year and 0 otherwise	Positive and significant	Positive and insignificant
BOARD SIZE (BS)	Measured by counting the number of board directors in company	Positive and significant	Positive and insignificant

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

INTRODUCTION

The previous chapter presented the results, discussion and summary of chapter four whereas this chapter discusses with the conclusions and recommendations based on the findings of the study. Therefore, this chapter is organized into conclusions and recommendation.

5.1. Conclusion

Financial institutions play a significant role in the socio-economic growth and developments of the nation. Today, there is an increasing interest in research on financial reporting quality. However, few studies were conducted on determinants of financial reporting quality but not studied in the insurance companies in the current accounting literature. The main objective of this study was to examine the determinants of financial reporting quality in Ethiopian insurances companies. To achieve the intended objective, the study used quantitative research method. The quantitative data were collected through reviewing annual audited report of the companies from a sample of thirteen insurances companies over the time from 2014-2019. The collected data were analyzed by using statistical package EViews 8.

Based on the study findings, the study makes a number of conclusions. First, the study concludes that financial reporting quality is the main core of economic activity. The nature of reporting quality varied with the insurance as evidenced by a difference in the trends of the variables. The determinants of financial reporting quality are not well described in previous literature since the meaning of quality in accounting is rather different from those in many other fields of study.

The results of the study showed that profitability ratio has statistically significant effect on financial reporting quality of Ethiopian insurances companies. While, others are opposite to the expectations of the researcher and the study found that auditor change,

board size, leverage and liquidity do not have statistically significant effect on financial reporting quality of Ethiopian Insurance companies.

5.2. Recommendations

The results of this study showed that the variables of profitability and firm size were significantly related to financial reporting quality and other like age of the firm, liquidity, auditor change and board size had positive relationship with financial reporting quality. Therefore, the insurances companies should pay better attention to these significant variables in determining their financial reporting quality. The following recommendations are made based on results of this study.

- It is noted that highly profitable insurance company may have lower quality financial reports than lower performing insurance companies. The reason could be that as insurance company's profits increase, management may fear the response of shareholders to large tax obligations and may engage in manipulation of earnings. This manipulation of earnings by management leads to low financial reporting quality of the insurance companies.

Therefore, it is recommended that auditors, analysts and regulators should consider intensive investigation on the financial information conveyed by low performing insurance companies.

- It was found that the older the insurances companies, the better the quality of their financial reports. So it is recommended that NBE set down a minimum standard for the internal control of the Ethiopian insurance companies so that both new and old insurances will achieve a minimum level of quality in their financial reporting practices. Besides, the companies should have a well-structured and strong internal control as soon as they start operation in order to maintain the quality of their financial reports.
- Liquidity positively affects the financial reporting quality of insurance company but not significant, as result it is recommended that insurance companies should do to improve their liquidity management systems through broadening and diversifying of funding sources and shortening asset maturities that leads to a better quality of financial reports.

Auditor change has an insignificant positive effect on the financial reporting quality of insurance companies. This suggests that insurance company change the auditors at limited time interval to improve the auditing activities of the companies. Therefore, it is recommended that insurance company manage and control the interval of changing the auditor in the companies. This study did not represent all insurances companies in the country, so further depth study is needed to clear out the doubt on the topic.

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