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Board Characteristics, Audit Committee Composition, And Financial Reporting in Nigeria

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ABSTRACT
The purpose of this research paper was to investigate the relationship between audit committee composition, the board of directors' characteristics and the quality of financial reports of commercial banks in Nigeria. The data for the study was collected from the annual reports of fifteen (15) commercial banks using the method of contents analyses and covered a period of ten (10) years from 2009 to 2018. The Jones quality of accruals model and the ordinary least square method of regression were used to analyze the data for the study. The findings of the research showed that the audit committee composed more of independent members have a positive effect on financial reporting quality. Furthermore, the numerical size of the board of directors also showed a positive relationship with the quality of financial reports. Finally, the findings showed that board composition has a positive relationship with the quality of financial reports. Hence, it is concluded that the audit committee composition effect on the quality of financial reporting even though in the right direction is much too weak to deliver the desired results. In addition, the effect of the size and composition of the board of directors does not have much effect on the quality of financial reports of commercial banks. Consequently, there is a need to review and strengthen the composition and role of the audit committee especially as regards their monitoring and oversight function on the financial reports so as to improve the quality of financial reports. The size and composition of the board of directors in Nigerian commercial banks need to be reviewed and the board empowered to play a more active role in the financial reporting process.
Keywords: Board characteristics, Audit committee composition, Financial reporting

1.0 INTRODUCTION

The financial report is arguably the most important source of information about a corporate organization. Through the financial report, stakeholders can make rational future investment and fund commitment decisions by properly assessing the present and past performance of an organization based on its past performance in relation to other organizations in the same industry and across the entire economy. Even though there are other sources from which financial information about a corporate organization can be sourced, the financial reports released by the concerned corporation trumps them all as its content is generally more acceptable as to its fidelity.

Where information in the financial report is established to be materially false and misleading, a crisis may ensue for the corporation concerned as well as for its auditors and regulator which may include liquidation and litigation. However, as a myriad of scandals has shown, the contents of financial reports remain a source of worries for stakeholders. As noted by Al-Shaer, Salama, and Toms (2017) and Eriabie and lzedonmi (2016), high profile scandals like the ones involving Enron and Worldcom in the US and Cadbury, Afribank and Intercontinental Bank PLC in Nigeria involved extensive fraud and falsification of contents financial statement. To forestall financial statement fraud crisis, organizations take a wide range of actions which include setting up committees whose roles include watching closely the contents of the financial report from compilation to publication and beyond.

One of such committees is the audit committee which according to Eyenubo, Mudzamir, and Ali (2017) consists of a selection of members of an organization saddled with the duty of oversight of the companies accounting and financial reporting as a good corporate governance tool which enhances the integrity of financial reporting. Ramsay (2001) further opined that corporate organizations establish the audit committee so as to enrich the standard of financial practices and earnings besides reinforcing the credibility of financials. However, as observed by Umobong and Ibanichuka (2017) audit committees in Nigeria have not shown the capacity to perform expected oversight responsibilities as evidenced in the crumple of financial institutions and mismanagement of government agencies. Thus, questions continue to be raised about the efficiency of the audit committee.

Furthermore, board characteristics including structure, composition, independence, and experience among others also affect the quality of financial reports. As noted by Fama and Jensen (1983), independence of board members helps to prevent collusion between the board and management. Dimitropoulos and Asteriou (2010) in Ibrahim and Jehu (2018) assert that larger corporate boards are less efficient monitors than small boards, because of membership coordination and free-rider related problems. However, smaller boards may also lack the numerical strength needed to properly play their oversight function.

Prior research on corporate governance and financial reporting are quite numerous, focusing on specific areas, such as the studies by (Abbott, Young, and Susan 2000; Moses, 2016; Kusnadi, Leong, Suwardy, and Wang 2016; Umobong and Ibanichuka 2017; Al-Shaer, Salama and Toms 2017) which focused on the relationship between audit committee and financial reporting and the studies by (Vafeas, 2005; Kantudu & Samaila, 2015; Ibrahim and Jehu, 2018) which focused on the relationship between board of directors and financial reporting. A vast majority of these studies are concentrated in developed countries with very little such studies in Nigeria as noted by Okeahalam (2004). This research effort is intended to investigate the relationship between the board of directors' characteristics, audit committee composition and the quality of financial reporting among commercial banks in Nigeria.

2.0 LITERATURE REVIEW

2.1 Theoretical Framework

Among the theories proposed to explain or justify the need for corporate governance include the stakeholders' theory, agency theory, stewardship theory and the institutional theory among others. While each theory and their proponents have advanced well thought out proposals, this research believes the most appropriate is the stakeholders' theory. The agency theory for example which harps on the conflict of interest between managers (agents) and owners of the business (principals) (Jensen and Meckling, 1976), is somewhat restricted to the relationship between the agent and his principal with other stakeholders relegated to the background in terms of importance. Conversely, the stewardship theory proposes that the agent (steward) will without prompting act in the best interest of the principal, rendering the functions of the board of directors and audit committee needless.

However, practical experience has shown that this proposal is very far from the truth as evidence shows that managers routinely act in their best interest to the detriment of the owners. The stakeholder theory takes a more holistic view of the firm including investors, suppliers, employees, customers, and other segments of the society who may be affected by the business. The stakeholder theory is thus an extension of the agency theory in that it recognizes the stakeholders as critical to the firm's survival (Ofoegbu, Odoemelam, and Okafor, 2018). Thus, the corporate governance mechanism in the framework of the stakeholder theory is expected to cater for the wellbeing of all stakeholders, not just the owners (Freeman, Wicks, & Parmar, 2004). Further to this view is the fact that the financial report produced by the firm which is expected to be vetted by the board of directors and audit committee is used by all class of stakeholders. Thus, the oversight and monitoring role of these corporate governance mechanisms are of importance to all stakeholders.

2.2 Review of Concepts

Board Characteristics

According to Jensen (1993), the board of directors is responsible for a firm's internal control system and has the crucial responsibility for the overall operation of the firm. They define and set the rules for the CEO regarding hiring, firing, and compensation plans and providing strategic advice. These characteristics make for effective for monitoring of top management on behalf of stakeholders. The characteristics of the board of directors can be defined in terms of board size, board independence/composition, CEO Duality, gender diversity, board age, board education and board activity among others. Our characteristics of interest are board composition and board size.

The board size comprises all individuals that constitute the board of directors regardless of their other characteristics. Several researchers have expressed varied opinions on the impact the size of the board plays in their ability to deliver on their mandate. Kim and Nofsinger (2007) and Dimitropoulos and Asteriou (2010) argued that relatively smaller boards tend to perform better than larger boards because are they are easier to be coordinated/observed and not prone to the free rider problem. Conversely, Haniffa and Haudaib (2006) averred that larger boards are better able to explore more opportunities and secure the necessary resources for the firm.

The board of directors comprises executive directors and non-executive (independent) directors. An independent board is composed of more non-executive directors than their executive counterparts. The import of board independence is that non-executive members are more inclined to act in the best interest of owners than executive members who theoretically are anticipated to act in their own best interest. According to Daghsni, Zouhayer, and Mbarek (2016), "the board independence is considered the most important factor influencing the effectiveness of the board of directors in reducing the discretionary and opportunistic actions of the manager". Higgs (2003) opined that non-executive directors help to curtail managerial excesses that are capable of lowering the quality of accounting information conveyed in financial statements. Thus as stated by Fama and Jensen (1983), collusion by the board of directors and management can be curtailed by having a board of directors where non-executive directors are well represented.

Audit Committee Composition

According to Ayinde (2002), the audit committee is a standing committee established to enhance corporate accountability by working with internal auditors and management to improve and strengthen the accounting and financial reporting practices of an organization and ensure proper conduct of corporate affairs in keeping generally accepted ethical and legal standards. Audit committees help in the reduction of errors and promote regulatory compliance oversight of risk management and internal control systems and increased voluntary disclosures.

In Nigeria, while the CBN provides the code of corporate governance for commercial banks in Nigeria, it's further supplemented by Securities and Exchange Commission which regulates the activities of all quoted companies in the country. For nonbanking businesses and unquoted companies, the Companies and Allied Matters Act (CAMA) provides a semblance of a code of corporate governance for registered companies. CAMA stipulates that the audit committee comprise of six members drawn from three board members and three from the firm's shareholders. However for quoted companies, the SEC further enhances the constituents of the audit committee by specifying the addition of non-executive board members. The CBN further strengthens this code for banks by specifying that those representing shareholders should be drawn from the pool of ordinary shareholders and appointed openly during the annual general meetings (AGM) of banks.

The Audit committee in banks comprise of members appointed from the board of directors and shareholders. This structure is aimed to ensure that management and shareholders are adequately represented in audit committee considering the critical nature of their role, where the shareholders are expected to protect the interest of the owners by ensuring that released financial reports are fair representation of the state of affairs in the organization.

Quality Financial Reporting

According to Adebayo (2005), financial reports provide a medium for communicating information concerning the financial dealings of organizations to stakeholders. It represents an instrument of identifiable stewardship (Nwanyanwu, 2013). According to Jonas and Blanchet (2000), "quality financial reporting is full and transparent financial information that is not designed to confuse or mislead users". Tang, Chen, and Zhijun (2008) further stated that quality financial report can be gauged from the extent the financial statements provided therein is fair and authentic regarding the financial state and performance of an enterprise. Provision of the quality financial report by business organizations is important not only for the concerned organization but also for the industry and economy. An organization is noted for providing questionable information in its financial reports may suffer an existence-threatening a crisis of confidence with its stakeholders.

2.3 Empirical Review

Holtz and Neto (2014) in "effects of board of directors' characteristics on the quality of accounting information in Brazil" showed that board independence and separation of the roles of chairman and executive director positively influenced the quality of accounting information. These findings imply that stronger governance structures have a positive impact on the quality of reported accounting information.

Kipkoech and Rono (2016) attempted to establish the effect of audit committee size and experience on firm performance among listed firms Kenya. The research which covered the period 2006 to 2011 utilized the multiple regression analyses hypotheses testing. The findings revealed that having audit members with experience reduced financial misrepresentation and enhanced quality monitoring. The findings further showed that audit committee size and experience significantly affected the performance of the firms.

Moses, Ofurum, and Egbe (2016) in "audit committee characteristics and quality of financial reporting in quoted Nigerian banks" used five years documentary records from the annual reports and accounts of fifteen banks which were analyzed using correlation and modified Jones model. The findings indicated no significant impact between audit committee size and the quality of financial reporting in quoted Nigerian banks. Among other things, the paper recommended that audit committee size be considerably enlarged with members having accounting and finance knowledge making up the majority.

Eriabie and lzedonmi (2016) evaluated the impact of Audit Committee on financial reporting quality in Nigerian quoted companies in Nigeria. Data was sourced from annual reports of one hundred and thirty- one (131) companies for the periods, 2006 to 2012 and analyzed using correlation and ordinary least squares (OLS) regression. The findings showed that audit committee attributes, such as frequency of meetings, financial literacy, independence, size, and meeting attendance had a positive and significant effect on financial reporting quality.

Umobong and Ibanichuka (2017) examined the relationship between audit committee characteristics and financial reporting quality of food and beverage firms using secondary data obtained from the Nigeria Stock Exchange. Financial expertise and Audit committee independence were regressed against financial reporting quality measured by relevance and reliability. The findings showed that an increase in audit committee independence, financial expertise of members, firm age and frequency of meetings increases financial reporting quality. While the increase in audit committee size and firm size decreases reporting quality.

Adebiyi (2017) investigated how board composition affects financial reporting quality of deposit money banks in Nigeria. The study which used a sample of fifteen commercial banks between 2005 and 2016 and analyzed and using ordinary least square (OLS) regression and panel data estimation technique. The study established that that board composition critically impacts on financial reporting quality of commercial banks in Nigeria, as discretionary accrual - a proxy for financial reporting quality was shown to be positively related to board size and board independence.

Ibrahim and Jehu (2018) examined the relationship between board composition and financial reporting quality using data on 576 Nigerian firms between 2011 and 2016. The results from the multivariate regression analyses suggested that the proportions of non-executive directors, as well as that of the independent non-executive directors, have a negative and significant relation with abnormal accruals, which in turn improves the quality of financial reporting. However, the board size was not statistically significant.

Onyabe, Okpanachi, Nyor, Onipe, and Mohammed (2018) examined the effect of the audit committee meeting and expertise on financial reporting quality of commercial banks in Nigeria. The study which obtained data from the NSE fact-books and the financial statements of fifteen commercial banks over a period of ten years from 2007-2016 adopted the modified Jones (1991) model to measure financial reporting quality. The findings showed that the audit committee meeting had a positive but statistically insignificant effect on financial reporting quality. Also, that audit committee expertise had a negative effect on the financial reporting quality of the banks.

Founded on the review of the literature, this study empirically formulated the ensuing hypotheses that trail the relationship among board characteristics, audit committee composition, and financial reporting in the null form:

1. There is no significant relationship between board size and the quality of financial reporting.

2. There is no significant relationship between board composition and the quality of financial reporting.

3. There is no significant relationship between audit committee composition and the quality of financial reporting.

3 MATERIALS AND METHODS

Data for the study was collected from secondary sources using the method of content analyses from the annual reports of a sample of 15 Nigerian commercial banks (Access Bank, Diamond Bank, Fidelity Bank, Ecobank bank, Guaranty Trust Bank, Sterling Bank, UBA, WEMA bank, Zenith bank, Skye bank at the present Polaris bank, FCMB, Unity Bank, Union Bank, First bank and IBTC) chosen on the basis of availability of data. Period covered is ten (10) years from 2009-2018. The collected data consisted of those on audit committee composition (AUDCOMP) measured as the ratio of independent audit committee members to the audit committee size; board of directors characteristics comprising - board size (BODSIZE) measured as total number of board members and board composition (BODCOMP) measured as the ratio of independent members to the total board size; financial reporting quality (FRQUAL) was measured using the modified Jones model for accrual quality as proposed by Dechow, Sloan, and Sweeney (1995) and Mouselli, Jaafar, and Hussainey (2012) and widely accepted by accounting academics as a good measure of quality of financial reports. It is estimated by obtaining discretionary accruals (DACC) from total accruals (TACC) and non-discretionary accruals (NDAC) in the form.

DACC = [(TACCi,t / TAi,t -1) - NDACi,t] . . . . . (1)

Where:

TACC = (ΔCAi,t - ΔCASHi,t) - (ΔCLi,t - ΔSTDEBTi,t) . . . . . (2)

NDAC = (1/TAi,t -1) + [(REVi,t - RECi,t) / TAi,t -1] . . . . (3)

ΔCA = change in current assets

ΔCash = change in cash and cash equivalent

ΔCL = change in current liabilities

ΔSTDEBT = change in short-term debt

TAi,t -1 = the lagged value of bank i's total assets

ΔREVi,t = change in annual revenue of bank i in year t from period t-1

ΔRECi,t = change in receivables of bank i in year t from period t-1.

Adopting the ordinary least square (OLS) regression method of data analyses and controlling for bank size (BNKSIZE) and bank age (BNKAGE), we posit that:

Financial report quality = f (audit committee composition, board characteristics, bank size, bank age) . . . . (4)

Where financial reporting quality is denoted as (FRQUAL); audit committee composition is denoted as (AUDCOMP); board size is denoted as (BODSIZE), and board composition is denoted as (BODCOMP); bank size (BNKSIZE) and bank age (BNKAGE), the above equation is rewritten as:

$FRQUAL = \beta_0 + \beta_1 AUDCOMP + \beta_2 BODSIZE + \beta_3 BODCOMP + \beta_4 BNKSIZE + \beta_5 BNKAGE + \mu$ . . . (5)

Based on results from previous empirical literature reviewed for the purpose of this research, it is expected that the results for β_1, β_2, and β_3 will be greater than zero.

4.1 DATA ANALYSES AND RESULTS

Table 1: Regression Result

Dependent Variable: FRQUAL
Method: Least Squares
Date: 01/22/19 Time: 21:33
Sample: 1 150
Included observations: 150

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	20.97125	27.89165	0.751883	0.4533
AUDCOMP	1.855200	0.7064979	0.959562	0.3389
BODSIZE	0.032379	0.938266	0.034509	0.9725
BODCOMP	4.055803	2.039612	1.922468	0.0565
BNKSIZE	3.177790	1.569264	2.025020	0.0447
BNKAGE	-0.081770	0.168311	-0.485827	0.6278

R-squared	0.371214	Mean dependent var	29.10359
Adjusted R-squared	0.238964	S.D. dependent var	26.62205
S.E. of regression	26.09824	Akaike info criterion	9.400791
Sum squared resid	98081.02	Schwarz criterion	9.521216
Log likelihood	-699.0593	Hannan-Quinn criter.	9.449716
F-statistic	2.208219	Durbin-Watson stat	1.369256
Prob(F-statistic)	0.056613		

The regression result in table 1 shows that the audit committee (AUDCOMP) composed more of independent members has a positive effect on the financial reporting quality (FRQUAL) of commercial banks in Nigeria. With a coefficient of regression of 1.8552 implying that a unit increase in the independence of audit committee members will predict 1.8552 units increase in the financial reporting quality. Furthermore, the numerical size of the board of directors (BODSIZE) also shows a positive relationship with the quality of financial reports (FRQUAL) released by commercial banks. With a coefficient of regression value of 0.00323 which indicates that one unit increase in the size of the board of directors will lead to 0.00323 units increase in quality of financial reports and vice versa.
As will be observed from the results, the size effect of board size on the quality of financial is quite low indicating that it has a very weak effect on the quality of financial reporting. The findings also show that composition (BODCOMP) has a positive relationship with the quality of financial reports of commercial banks. With a coefficient of regression value of 4.0558 indicating that higher numbers of independent members represented in the board of directors will lead to higher levels of quality of financial reports. The global statistics (R-Squared) gave a value of 0.3712 indicating that audit committee composition (AUDCOMP), Board size (BODSIZE) and board composition (BODCOMP), as well as bank size (BNKSIZE) and bank age (BNKAGE) as a unit, can account for about 37.12% of the changes in the quality of financial reports released by commercial banks in Nigeria.
Finally, it is noted that none of the variables had a statistically significant relationship with financial reporting quality of commercial banks in Nigeria. This is considering that the probability of t-statistics gave values of 0.3389, 0.9725, 0.0565 respectively for audit committee composition (AUDCOMP), the board of directors size (BODSIZE) and board of directors' composition (BODCOMP) which was greater than the default probability value of 0.05. Thus, each of the three null hypotheses was not rejected implying that none of audit committee composition, the board of directors' size and board of directors' composition has a statistical relationship with the quality of financial reports.

4.2 DISCUSSION OF FINDINGS

The purpose of this research paper was to investigate the relationship between audit committee composition, the board of directors' characteristics as components of corporate governance and the quality of financial reports of commercial banks in Nigeria. Data for the study was collected from the annual reports of fifteen (15) commercial banks using the method of contents analyses and covered a period of ten (10) years from 2009 to 2018, was analyzed using the Jones quality of accruals model and the ordinary least square method of regression.

The findings of this research showed that the audit committee composed of more independent members has a positive effect on the financial reporting quality of commercial banks in Nigeria, following the coefficient of the regression value of 1.8552. This finding is agreement with Umobong and Ibanichuka (2017) who confirmed in their research that an increase in audit committee independence, financial expertise of members, firm age and frequency of meetings increases financial reporting quality. While the increase in audit committee size and firm size decreases reporting quality. Similarly, Eriabie and lzedonmi (2016) showed that audit committee attributes, such as frequency of meetings, financial literacy, independence, size, and meeting attendance had a positive and significant effect on financial reporting quality in Nigerian companies.

Furthermore, the numerical size of the board of directors also showed a positive relationship with the quality of financial reports released by the banks, with a coefficient of regression value of 0.00323 which indicates that one unit increase in size of board of directors will lead to 0.00323 units increase in quality of financial reports and vice versa. This implies a very weak effect of the size of the board of directors on the quality of financial reporting. This finding contradicts previous findings which argue that having a small board of directors will lead to better performance in the financial reporting quality as a smaller board of directors is easier to manage/coordinate. In a similar study, Adebiyi (2017) showed that discretionary accrual as a measure of financial reporting quality had a positive relationship with Board size and board independence.

Finally, the findings showed that board composition had a positive relationship with the quality of financial reports of commercial banks, with a coefficient of regression value of 4.0558 which indicates that higher numbers of independent members represented in the board of directors will lead to higher levels of quality of financial reports. Affirming this finding, is the study by Ibrahim and Jehu (2018) that investigated the relationship between board composition and financial reporting quality and found that the proportions of the non-executive directors, as well as that of the independent non-executive directors, have a negative and significant relation with abnormal accruals, which in turn improves the quality of financial reporting.

5 CONCLUSION AND RECOMMENDATIONS

The effect of audit committee composition on the quality of financial reporting of commercial banks in Nigeria even though in the right direction is much too weak to deliver the desired results. A review of the composition of the audit committee to include more independent members who are duly qualified for the role and are people of impeccable character, might improve their impact on the quality of financial reporting. The fact that the board of directors in Nigeria seems to be unduly large and tilt towards favouring more executive members than non-executive members, is a reason the numerical size and composition of the board of directors does not have much effect on the quality of financial reports produced by commercial banks. Finally, the oversight role of the board of directors on the quality of financial reports of commercial banks in Nigeria is mostly vested in the audit committee - making the board of directors play a more or less a spectator role as it concerns financial reporting quality. The board of directors should be empowered to play a more active role in the financial reporting process of commercial banks in Nigeria.

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