AUDIT COMMITTEE CHARACTERISTICS AND QUALITY OF FINANCIAL REPORTING IN QUOTED NIGERIAN BANKS

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ABSTRACT
The research was carried out to statistically examine the influence of audit committee characteristics on quality of financial reporting in listed Nigerian banks. The study used documentary records gotten from the financial statements of fifteen twelve-monthly reports and accounts of the banks whose stocks are traded in the Nigerian Stock Exchange as at December 31, 2014. The research design utilized in this dissertation is correlation research design. The investigator adopted Jones (1991) modified model which provided the measure for earnings management which is the representation for quality of financial reporting. The test of hypotheses and other breakdown of data were empirically completed by SPSS statistic 22.0. The outcomes of the study depicted that audit committee independence has no significant effect on earnings management in quoted Nigerian banks. The study endorses that audit committee should be well-thought-out and operational so as to curtail earnings management. Again, we recommend the orientation and reorientation of audit committee members to guarantee significant influences on financial reporting quality.

Keywords: Audit Committee, Audit Committee Independence, Financial Reporting

1.0 Background to the Study

Financial reporting in banks is essentially the responsibility of directors and this is carried out by accountants and verified by auditors. It is targeted at producing reliable in addition accurate information to assist users in taking a good stand. Kamaruzaman *et.al.* (2009) opined that financial statements should be capable of revealing relevant, reliable, comparable and comprehensive information. The aim of Generally Accepted Accounting Principles (GAAP) compliance is to ensure that companies prepare accurate financial statements that faithfully represent their financial positions and operating results. However, Johnson, Khorana and Reynolds (2002) contended that an annual report cannot be totally devoid of prejudice, since fiscal phenomenon deposited in yearly disclosures are continually estimated within the circumstances of Skepticism.

Audit committee has been considered as constitutive to quality financial reporting. Ramsay (2001) submitted that companies set up this particular committee to enrich the standard of financial practices and earnings. Audit committee guarantees the protection of the stockholders welfares. Basically, audit committee monitors the procedures involved in financial reporting and to check the likelihood of managers to control earnings. Recently, audit committee has become obligatory for listed companies. Audit committee supervises operations in large firms in capital market. This makes the audit committee a system of respectable structure of procedures, practices and methods by which a company is directed and well-ordered.

Different characteristics of audit committee like Meetings (Beasley et al., 2000), Independence (Klein, 2002; Bedard et al., 2004) and Size (DeZoort and Salterio, 2001) have affected effective financial reporting over the years.

1.1 Statement of the Problem

Financial reporting entails the preparation by management of accounting information to meet the requirements of various users. The Financial Accounting Standards Board (FASB, 2005) specified economic disclosure ought to make available fact that remains significant for making rational decisions by investors, creditors and other users. Igben (1999) posits that financial reports ought to be a formal record of business transactions that presents a widespread explanation of the state of affairs in the short and long run of a firm to those who use these financial statements.

In recent times, weak internal control and fraudulent activities among others that are visible within companies have posited an inimical cordiality to the general public. Many studies may have been carried out in this area but none has been done especially after the CBN Banking reforms in 2009 by the then governor of Central Bank Alhaji Sanusi Lamido Sanusi. This is a worrisome phenomenon and it makes the present study imperative and necessary at the moment as it seeks to fill the gap by investigating critically in what way audit committee physiognomies effect the quality of financial reporting in quoted Nigerian Banks from 2010 – 2014.

1.2 Aim and Objective of the Study

The core aim of the dissertation is to statistically examine the relationship between audit committee characteristics and quality of financial reporting in quoted Nigerian Banks. Specific objectives of the study is to ascertain the effect of audit committee independence on the quality of financial reporting in quoted Nigerian Banks.

1.3 Research Question

Thus, in pursuance of the aim and specific objective of the study, the study poses the research question to guide the research focus:

- What is the effect of audit committee independence on earnings management in quoted Nigerian Banks?

1.4 Research Hypothesis

The formulated research hypotheses were drawn from the relevant literatures and were tested in this dissertation:

Ho_1: Audit committee independence has no significant effect on earnings management in quoted Nigerian Banks.

1.5 Significance of the Study

The significance of this study rests on its expected theoretical implication.

Theoretical Benefit: Theoretically, it has become very conspicuous to declare that the literature on audit committee characteristics and the quality of financial reporting in Nigeria lacks empirical backing (Tsegba and Herbert, 2013). Therefore, this study will provide a useful model for explaining financial reporting quality in quoted Nigerian Banks through identified audit committee characteristics. This will produce empirical facts that will bridge the existing gap in the knowledge domain on the subject matter.

1.6 Operational Definition of Terms

The ensuing terminologies stood explained operatively for the purpose of clarification of the study variables.

1. **Audit Committee:** Consist of people chosen from among the board of directors whose responsibility is to ensure that auditors' independence is kept.

2. **Audit Committee Independence:** Auditors impartial disposition in decision making in the cause of auditing and financial reporting.

3. **Financial Reporting:** "This represents the exactness with which financial reporting conveys information about the firms operation in particular, its expected cash flows that informs equity investors" (Francis *et al*.2005).

2.0 METHODOLOGY

2.1 Population of the Study

Study population is made up of entirely fifteen banks whose shares are traded in the Nigerian Stock Exchange (NSE) as at December 31, 2014. The year 2014 was chosen as the reference period for the gathering of the required data. This is consequent upon the fact that when the data gathering for the study began, 2014stood as the newest period when complete financial statement data were readily obtainable for the listed banks.

Table 1: Population and Sample of the Study

S/N	BANKS
1.	Access Bank
2.	Eco Bank
3.	Diamond Bank
4.	FCMB
5.	Fidelity Bank
6.	First Bank
7.	GTB
8.	Skye
9.	Stanbic IBTC
10.	Sterling
11.	UBA
12.	UBN
13.	Unity Bank
14.	Wema
15.	Zenith Bank

2.2 Methods of Data Analysis

In view of the research design and in agreement with the aim and objectives of the study stated in chapter one, the Pearson Correlation was used to calculate the regression coefficient in the model specification while the linear regression was used to estimate the effect of the explanatory variable (i.e. Audit Committee Characteristics) on the response variable (i.e. "Quality of Financial Reporting) represented by earnings management and measured by discretionary accruals".

2.3 Operational Measurement of Variables

Variables applied in this research remained measured as shown in table 3.1 below:

Table 2: Variables Measurement

Variables	Label	Measurement
Criterion Variable		
Discretionary accruals	DAC	Determined by means of Jones(1991) modified model
Predictor Variables		
Audit committee independence	ACI	Assigned one (1) if all the members remain independent and if otherwise assigned zero (0).
Audit committee size	ACS	proportion of memberships
Audit committee number of meetings	ACM	Aggregate of meetings held in a period
Audit committee financial expertise	ACF	Assigned one (1) if some of the members have relevant and recent financial experience and assigned (0) if otherwise.

$$TA_{it} = PBTE_{it} - CFO_{it} \quad \ldots\ldots\ldots\ldots\ldots\ldots (1)$$

Where;

TA_{it} = Total Accruals of Bank i at time t

$PBTE_{it}$ = Profit before taxation and extraordinary activities of bank i at time t

CFO = Cash flows from operation of bank i at time t.

The modified Jones model is shown below:

$$DAC_{it} = \frac{TA_{it}}{A_{it-i}} - \left(\beta 0 + \beta_{1t}\frac{1}{A_{it-1}} + \frac{\beta_{2t}\,\Delta GE_{it} - \Delta NL_{it}}{A_{it-1}} + \beta 3t\,\frac{PPE_{it}}{A_{it-1}}\right) + \varepsilon \quad \ldots\ldots (2)$$

Where:

DAC_{it} = Discretionary accrual of bank i at time t

TA_{it} = Total accruals of bank i determined by subtracting Profit/loss before taxation, exceptional and extraordinary items and cash flows from operation for year t.

A_{it} = Asset at the commencement of the year

ΔGE_{it} = Variation in Gross earnings as of time t –1 to t

ΔNL_{it} = Change in the analysis of total loans and Advances and non-performing loan as of time t–1 to t to reflect variation in Net Loans (ΔNL)

PPE = Gross property, plant and equipment

Σ = error term/random term

Gross Earnings (GE) = Interest Income (IINC) + Fee Commissions (FCOM) + Foreign Exchange Income (FOREXINC) + Trusteeship Income (TINC) + Investments Income (INVINC) + Share Income (SHINC) + Other Income (OINC) …………….…… (3)

Net Loan (NL) = Total Loans (TL) – Non-Performing Loans (NPL) …………………… (4)

2.4 Model Specification

The analytical model considered in this study took elements of audit committee (independence, size, number of meetings and financial expertise) as predictor variables and earnings management proxied by discretionary accruals as criterion variable. The study specified model, on attempt to ascertain the influence of audit committee characteristics on quality of financial reporting of quoted banks in Nigeria as follows:

$$DAC = f(ACI, ACS, ACM, ACF) \quad \ldots (5)$$

$$DAC = \beta_0 + \beta_1 ACI + \beta_2 ACS + \beta_3 ACM + \beta_4 ACF + \Sigma \quad \ldots (6)$$

Where:

DAC	=	Discretionary accruals
β_0	=	Intercept
$\beta_1 - \beta_4$	=	Coefficient of predictor variables
ACI	=	Audit Committee Independence
ACS	=	Audit Committee Size
ACM	=	Audit Committee Number of Meetings
ACF	=	Audit Committee Financial Expertise
Σ	=	Error term/random term

3.0 RESULTS AND DISCUSSION

This segment analyzed and interpreted the outcomes gotten from the tests conducted on the data collected for the study. This is followed by drawing relevant inferences from the analysis as well as the test of hypotheses formulated for the study. The investigator adopted the Pearson Correlation statistical tool and linear regression analysis was centered on the use of SPSS statistic 22.0. Regarding the period of this dissertation stretching from 2010 to 2014, the table presents the minimum, maximum and mean values in addition to the standard deviation of variables employed in our statistical models.

Table 3: Descriptive Statistics

	N	Minimum	Maximum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
ABVDAC	75	.0019	.8743	.124523	.0146902	.1272212
ACI	75	.0000	1.0000	.933333	.0289973	.2511236
ACS	75	6.0000	7.0000	6.066667	.0289973	.2511236
ACM	75	2.0000	5.0000	3.853333	.1034423	.8958362
ACF	75	.0000	1.0000	.933333	.0289973	.2511236
Valid N (listwise)	75					

Starting with the mean which represents the normal state of variables, it can be discovered above that Discretionary Accruals (DAC) which is in its absolute values can be seen to possess an average mean of 0.124523.The Audit Committee Independence which was denoted with the help of dummy variables (1 and 0) shows an average output of 0.933333 which is highly close to 1.

3.1 BIVARIATE ANALYSIS

This shows the level of association between employed variables and the direction of movement amongst them. The Table 4 below is extracted from the SPSS statistic 22.0 output (see Appendix ii-iii in the main research work).

Table 4: Extract of the Correlation Matrix of the Explanatory and Response Variables

Variables	*ACI*	*ACS*	*ACM*	*ACF*
Pearson correlation	-0.017	0.008	-0.001	-0.128
Sig. (2-tailed)	0.887	0.943	0.993	0.275
N	75	75	75	75

Table 4 indicates a negative and insignificant correlation amid audit committee independence and discretionary accruals judging by the negative output of -0.017 at 0.887 significant level which is greater than 0.05 level of significance. This signifies that the discretionary/abnormal accruals are not meaningfully influenced by independence of the committee and despite the insignificance, there is an existence of a negative relationship. Summarized as an increase in independence of audit committee is unlikely to change the discretionary accruals of the employed listed banks and decrease in audit committee independence is not going to rationally increase the level of discretionary accruals.

3.2 Regression

The study further moves to find the influence of the predictors on the criterion by carrying out a regression exercise as displayed below in Table 5 which is a summary of the model estimate extracted from the SPSS statistic 22.0 output (see Appendix iv-vii in the main research work).

Table 5: Extract of the Model Estimates

Variables	R	R- Square	B	Std. Error	F	T	Sig.
ACI	0.017	0.000	-0.008	0.059	0.020	-0.143	0.887
ACS	0.008	0.000	0.004	0.059	0.005	0.072	0.943
ACM	0.001	0.000	0.000	0.017	0.000	-0.009	0.993
ACF	0.128	0.016	-0.065	0.059	1.208	-1.099	0.275

Utilizing audit committee independence by way of the explanatory variable and discretionary accruals by way of the response variable. From the table above, the R which represents the correlation coefficient shows a poor explanation of 0.017, while the more crucial variable R square shows an output of 0.000, which signifies that changes associated with the response variable (discretionary accruals) is not captured by the changes in the explanatory variable (Audit committee independence).

Put differently, 100% changes in the response variable are accounted for by other factors not captured in the study. This consequentially resulted in the Analysis of Variance table (ANOVA) showing an insignificant regression at the 0.887 level, while the coefficients show that Audit committee independence displays a negative movement as signifies by its coefficient of -0.008 and has a very low shock level as shown by its standard error of 0.059 and was found to be statistically insignificant based on its t-statistics coefficient of -0.143 at the 0.887 level of significance which is more than 0.05 level of significance

3.3 Hypotheses Testing

The employed variables are statistically tested below as shown in their null form:

Hypothesis One:

The first hypothesis of the present study posits that Audit committee independence has no significant effect on earnings management in quoted Nigerian Banks. Utilizing the regression output above, and judging by the significance level of 0.887 which is greater than the 0.05 significance level as depicted in the regression Table 5, the study therefore accepts the null hypothesis and concludes that audit committee independence has no significant effect on earnings management in quoted Nigerian Banks during the period of the study.

3.4 Discussion of Findings

Analyzing the findings for the sound sway of the predictor variables on the response variable, the negative coefficient of the independence of the committee(ACI) on earnings management represented by discretionary accruals (DAC) suggests that Nigerian banks with committee that are independent of management tends to have less income smoothing in their economic disclosure. Conversely, banks with audit committee that is less independent of management gear towards producing more financial reporting that is based on targets. However, this study reveals that independence of audit committee in Nigerian banks is yet to significantly reduce earnings management prevalent in the sector.

Precisely, based on the hypotheses tested, it was established that audit committee independence has no significant effect on earnings management in quoted Nigerian Banks during the period of the study. This finding contradicts the findings of Yadirichukwu and Ebimobowei (2013) that investigated audit committee and timeliness of financial reports empirical evidence from Nigeria. The aims of their study was to examine the effect audit committee and timeliness of financial reports for thirty five (35) companies listed in the Nigerian Stock Exchange (NSE) for the period 2007 – 2011. Their data were analyzed by means of germane analytical test, pooled least square and granger causality test; their findings suggest that audit committee independence is significantly associated with timelessness of financial reports. The disagreement could be as a result of statistical tools used, period of study and study scope.

The present discoveries stand in agreement with the discoveries of Soliman and Ragab (2014) who examined audit committee effectiveness, audit quality and earnings management. An empirical study of listed companies in Egypt. Their study aimed at examining the relationship flanked by the audit committee effectiveness, audit quality and earnings management practices of more active fifty Egyptian businesses whose shares are traded in the Egyptian stock exchange of the non-financial sector for the period of 2007 – 2010, using modified Jones model. Their findings showed committee independence has significant negative association with discretionary accruals as a proxy for earnings management.

4.0 Conclusion

In line with the analysis and testing of the impact of audit committee characteristics as the explanatory variable on the quality of financial reporting of banks whose share are traded in the Nigeria Stock Exchange from 2010 – 2014 as the response variable, the study concludes that: Audit Committee independence has no significant effect on earnings management in quoted Nigerian Banks during the period covered by the study

Nevertheless, results and also findings from the analysis carried out have implications to policy makers, and management of the quoted Nigerian banks. The foremost implication of the findings of this research is that, if committee members are allowed to do their oversight functions without undue interference by the management then income smoothing will be reduced to the barest minimum and thereby boost the quality of financial reporting.

4.1 Recommendations

In line with the discoveries and the conclusion highlighted above, the ensuing commendations are postulated:

i. The study recommends that the managers and administration of quoted banks in Nigeria should subscribe to ethnical code of good corporate governance.
ii. Committee members should be able to adequately comprehend the banks financial statement as this is very fundamental.
iii. The study recommends orientation and reorientation of audit committee members to guarantee significant influences on financial reporting quality.
iv. Monitoring establishments should establish satisfactory penalties against banks for noncompliance as regards to disclosure necessities. These penalties should be weighty enough to act as warning for fraudulent financial disclosure.

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