THE IMPACT OF AUDIT COMMITTEE SIZE ON THE QUALITY OF FINANCIAL REPORTING IN QUOTED NIGERIAN BANKS

TEMPLE MOSES
Department of Accounting,
Faculty of Management Sciences,
University of Port Harcourt,
Rivers State, Nigeria.
(Email: sirtemplemoses@yahoo.com , Phone: +2348037777173)

ABSTRACT
This paper statistically surveyed the influence of audit committee size on quality of financial reporting in quoted Nigerian banks. The study used five years documentary records gotten from the annual financial statements and accounts of fifteen banks whose stocks are traded in the Nigerian Stock Exchange as at December 31, 2014. Correlation research design was utilized and Jones (1991) modified model, which provided the measure for earnings management, was also used as the representation for quality of financial reporting. Furthermore, the test of hypothesis and other breakdown of data were empirically completed by SPSS statistic 22.0. The outcome of the study depicted that audit committee size has no significant impact on the quality of financial reporting in quoted Nigerian banks. Among others, this paper recommends that audit committee size should be considerably large, it should constitute a greater number of those that have knowledge of accounting and finance.

Keywords: Audit Committee, Audit Committee Size, Quality of Financial Reporting, Earnings Management

1.0   Background to the Study
Audit committee as a concept is based on the goals, functions and responsibilities given to committee members. According to Al-Thunebat (2006) audit committee is "the committee that is composed of non-executive directors in the establishment". This vital committee has therefore, remained a very substantial institution that helps the managers to enrich the clarity and decency of financial reporting. Specifically, resourceful committee ought to enrich the quality of economic disclosure by performing multitudinous duties such as making remarks, giving approval on accounting principles, evaluating the financial statement and ensuring that the internal control mechanisms are sustained.

1.1   Audit Committee
Audit committee refers to a working group chosen by a firm as a linkage between the managers and the outside assessors. The committee as a subcommittee of the governing body specializes in the provision of accurate and reliable financial statements. In 1967, "American Institute of Certified Public Accountant (AICPA)"proposed the institution of audit committee in companies. Nigeria witnessed the institution of this committee with the promulgation of "Companies and Allied Matters Act (1990) as amended in (2004)". This replaced the Company Act of 1968.
The responsibilities of audit committee are comprehensively captured in section 369 sub section 6 as stated below: "(i) ascertain whether the accounting and reporting policies of the company are in accordance with legal and agreed ethical practices (ii) review the scope and

planning of audit requirements (iii) review the findings on management matters in conjunction with the external auditors and departmental responses thereon: (iv) keep under the effectiveness of the company's system of accounting and internal control (v) make recommendation to the board in regard to the appointment, removal and remuneration of external auditors of the company, and (vi) authorize the internal auditor to carry out investigation into any activities of the company which may be of interest or concern to the committee."

1.2   Audit Committee Size (AC Size)

The magnitude of the committee is the sum of memberships of the group chosen by the governing bodies. This figure of memberships is taken as a sign of means accessible to the group. Where a large audit committee member exist, it is likely that possible challenges emanating from financial reporting task has the likelihood of being exposed and settled (Mohammed – Nor et al 2010). This depends on the situation where considerable number of the size of the committee rise the available means to the committee and enhances the superiority of control. In a study by Persons (2009) and Li *et al* (2008) it indicated "that the audit committee size affects corporate disclosures". Abbott, Parker and Peters (2004) investigated forty one companies that presented deceitful financial statement and eighty eight companies which yearly restated their results for nine years (i.e. beginning from 1991 to 1999). The findings depict that committee size has no considerable influence on quality of financial reporting. But in the work of Lin, Li and Yang (2006) indicated negative association amid committee size and financial reporting.

The exact sum of members of audit committee is particularly important as it affects the commitment of memberships to monitor management and detect deceitful behaviours. A bigger size of the audit committee can alleviate material differences throughout the tested equity submissions. Lipton and Lorsch (2011) remarked that the ability "of the audit committee" oversight function rises when the figure of its memberships increases. Yermack (1996) posits that, a lesser audit committee magnitude improves on firms' worth. This stand corresponds with Jensen (1993) assertion that a small sized audit committee enhances the efficiency with which the audit committee engages in oversight and control. However, Mansi and Reeb (2004) noted that an audit committee size that is large spends a considerable period and means to check the financial reporting process and internal control mechanism. These inputs suggest that size constitutes a significant factor for the effective performance of the group. Therefore, the committee's size should be appropriately stated.

Having respect to Nigeria, the "Companies and Allied Matters Act" of 1999" as modified in 2004 stipulates "that the Audit Committee of a public limited liability company should be composed of a maximum of six members representing equal number of directors and shareholders". Note that effective audit committee size is important if efficient corporate financial reporting is to be obtained. This is because considerable audit committee members may produce knowledge and experience useful in embarking upon the provision of enhanced economic disclosure quality.

1.3   Quality of Financial Reporting

The aim of financial statements is to make available reliable information to assist users in taking stand. Kamaruzaman *et al.* (2009) stated that financial statements should be able to show pertinent, dependable, comparable and comprehensible information. It is therefore, useful to take a critical look at the different arguments aimed at diverse assessments and molds posited in the yearly disclosure (Jonas and Blanchet, 2000). The IASB (2003) reports

that those who use financial information ought to be easy to understand the facts provided effortlessly. The achievement of this lies in full disclosure of the annual report and a greater state of openness. The quality of financial reporting encourages openness and produces annual reports that are sound through adequate reporting. Economic disclosure remains the foremost avenue of interconnecting economic facts to those outside the firm assesses the economic wellbeing of a company in a bid to oversight management actions and contributes in making economic decisions (Warren and Reeve, 2004).

The "CBN (2009) defines full disclosure requirement as the compulsory financial operational and management information which financial institutions ought to lay bare as they present their periodic accounts to the authorities in charge and also to members of the public". Series of researchers have probed the quality of company information reporting. Take for instance, (Ofoegbu and Okoye 2006; Naser and Nuseibeh, 2003; Chau and Gray 2002; Joshi and Ramadhan, 2002; Ho and Wong 2001 and Owusu – Ansah 1998). Each of these studies had different research settings, different explanation and description of the predictor variables, different disclosed guide structure and different arithmetical breakdown. The general results concerning the acquiescence state of firms and the correlation existing between disclosure level and several company characteristics remain variegated.

Information reporting in annual reports of companies can be ascertained through the application of many approaches: Huang (2005) and Gray (2001) and Inchaustic (1997) made use of worksheet in assessing the constituents of the yearly disclosure. McNally, Eng and Hasseldine (1982) and Barako (2007) determined financial reporting through the survey of annual report users. However, Barrett (1975) combined "a content analysis of annual report and a survey approach". The present work adopted both content analysis and a survey approach by examining the superiority of economic disclosure through "earnings management as measured by discretionary accruals".

1.4   Earnings Management

Agreeing with Dechow, Sloan and Sweeney (1995:193) in Murwaningsari (2008:364) explained earnings management to mean the handling of remunerations both internal and external limits of tolerable accounting philosophies in general. Copeland (1968) alluded that earnings management means and includes the monotonous collection of accounting quantity or recording guidelines in a precise form, the consequence of which is to present a chain of revenue through a lesser distinction from tendency than would else would have surfaced. Earnings management is defined by Scott (2004)   as the selection of accounting policy by those who have control over financial accounting standards which exist naturally and has the capacity to maximize their utility and also increase their company's market value.

Barnea*et al.* (1976) see it by way of thoughtful diminishing of variations around certain state of revenue accepted being standard for the company. In views of Merchant and Rockness (1994) it is seen as any act on the side of organization which touches stated revenue and offers no accurate financial benefit to the business. This according to them, in the long-run may be harmful. Having regard to the work of Healy and Wahlen (1999:368) cited in Llukani (2013:135), *"Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial report to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers"*

Schipper (1989) sees it to be a determined meddling in the exterior financial reporting procedure, with the mindset of earning certain secluded achievement". In the same vein, Mulford and Comiskey (1996) views it as the vigorous handling of secretarial outcomes so as to generate a transformed dint of corporate accountability. However, in this study it is described as the actions of the managers geared towards distorting "*the quality of financial reports*" so as to mislead the susceptible users of financial information. These actions of managers involve the manipulation of financial reports by adopting every accounting means at their disposal.

1.5   Aim and Objective of the Study
The aim of this paper is to statistically examine the relationship between audit committee size and quality of financial reporting in quoted Nigerian Banks. The objective of this paper is to determine the impact of audit committee size on the quality of financial reporting in quoted Nigerian Banks.

1.6   Research Question
Thus, in pursuance of the aim and specific objective of the study, this paper poses the research question below to guide the research focus:
- ❖ What amount does audit committee size impact on earnings management in quoted Nigerian Banks?

1.7   Research Hypothesis
The formulated research hypothesis was drawn from relevant literatures and was tested in the dissertation:

Ho_1:   Audit committee size has no significant impact on earnings management in quoted Nigerian Banks .

1.8   Significance of the Study
The significance of the study rests on its expected practical implications. On the practical implication, the study will produce reliable empirical evidence that will encourage Nigerian Banks to be attuned with the global paradigm shift from tangible resources and with audit committee size, it is anticipated that this will enhance the competitive states of Nigerian Banks in the global market where auditing has been made compulsory for corporate entities. The study could also be beneficial in providing them (corporate management) useful insight as they seek to take advantage of corporate reporting in increasing their productivity, profitability, investment and business growth.

1.9   Definition of Terms
Audit Committee: Audit committee refers to a working group chosen by a firm as a linkage between the managers and the outside assessors.

Audit Committee Size: The Audit Committee Size is the sum of memberships of the Audit Committee chosen by the governing bodies.

Quality of Financial Reporting: The quality of financial reporting talks about how good or useful a financial report is, it encourages openness and produces annual reports that are sound through adequate reporting in order to assist users in taking stand.

Earnings Management: in this study, Earnings Management is described as the actions of the managers geared towards distorting "*the quality of financial reports*" so as to mislead the susceptible users of financial information. These actions of managers involve the manipulation of financial reports by adopting every accounting means at their disposal.

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, 2014 stood as the newest period when complete financial statement data were readily obtainable for the listed banks. The banks include: Access Bank, Stanbic IBTC, Eco Bank, Sterling Bank, Diamond Bank, UBA, FCMB, UBN, Fidelity Bank, Unity Bank, First Bank, Wema Bank, GTB, Zenith Bank, and Skye Bank.

2.2   Methods of Data Analysis

In view of the research design and in agreement with the aim and objective of the study stated, 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 Size) 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 1 below:

Table 1: Variables Measurement

Variables	Label	Measurement
Criterion Variable		
Discretionary accruals	DAC	Determined by means of Jones(1991) modified model
Predictor Variables		
Audit committee size	ACS	proportion of memberships

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

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:

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

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

GE = IINC + FCOM + FOREXINC + TINC + INVINC + SHINC + OINC   (3)

Where,

GE = Gross Earnings

IINC = Interest Income

FCOM = Fee Commissions (FCOM)

FOREXINC = Foreign Exchange Income

TINC = Trusteeship Income (TINC)

INVINC = Investments Income (INVINC)

SHINC = Share Income (SHINC)

OINC = Other Income (OINC)

NL   =   TL – NPL   (4)

Where,

NL = Net Loan

TL = Total Loans

NPL = Non-Performing Loans

2.4   Model Specification

The analytical model considered in this study took elements of audit committee size 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 size on quality of financial reporting of quoted banks in Nigeria as follows:

$$\textbf{DAC} \;=\; \textbf{f (ACS)} \qquad\qquad \textbf{(5)}$$

$$\textbf{DAC} \;=\; \boldsymbol{\beta_0} + \boldsymbol{\beta_2}\ \textbf{ACS} + \boldsymbol{\Sigma} \qquad\qquad \textbf{(6)}$$

Where:

DAC	=	Discretionary accruals
β_0	=	Intercept
$\beta_1 - \beta_4$	=	Coefficient of predictor variables
ACS	=	Audit Committee Size
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 hypothesis 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 2: Descriptive Statistics

	N	Minimum	Maximum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
ABVDAC	75	.0019	.8743	.124523	.0146902	.1272212
ACS	75	6.0000	7.0000	6.066667	.0289973	.2511236
Valid N (listwise)	75					

It could be seen above that Audit Committee Size (ACS) has an aggregate average of approximately 6 for all banks, which depicts that the Committee houses 6 members, although it varied in the case of Sterling Bank as their committee size consists of 7 members, all sampled banks of study possessed the minimum committee size of 6.

3.1 BIVARIATE ANALYSIS

This shows the level of association between employed variables and the direction of movement amongst them. The Table 3 below is extracted from the SPSS statistic 22.0 output (see Appendix ii-iii in the main research work).

Table 3: Extract of the Correlation Matrix of the Explanatory and Response Variables

Variables	*ACS*
Pearson correlation	0.008
Sig. (2-tailed)	0.943
N	75

Judging by the output in Table 3 above, the aforementioned could be revealed that audit committee size (ACS) displays a positive but insignificant relationship with Discretionary Accruals (DAC) adjudicating by its positive Pearson coefficient of 0.008 and its significant level of 0.943 which is greater than the 0.05 significant level. It implies that Audit Committee Size (ACS) will not probably result to an upsurge in Discretionary Accruals (DAC) and a reduction in committee size will probable lead to an upsurge in Discretionary Accruals of the study banks.

3.2 Regression

The study further moves to find the influence of the predictor on the criterion by carrying out a regression exercise as displayed below in Table 8 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 4:   Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	ACS[b]	.	Enter

a. Dependent Variable: ABVDAC

b. All requested variables entered.

Table 5:   Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.008[a]	.000	-.014	.1280850

a. Predictors: (Constant), ACS

Table 6:   ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	.000	1	.000	.005	.943[b]
1	Residual	1.198	73	.016		
	Total	1.198	74			

a. Dependent Variable: ABVDAC

b. Predictors: (Constant), ACS

Table 7:   Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.099	.360		.274	.785
	ACS	.004	.059	.008	.072	.943

a. Dependent Variable: ABVDAC

```
REGRESSION
  /MISSING LISTWISE
  /STATISTICS COEFF OUTS R ANOVA
  /CRITERIA=PIN(.05) POUT(.10)
  /NOORIGIN
  /DEPENDENT ABVDAC
  /METHOD=ENTER ACM.
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Table 8: Extract of the Model Estimates

Variables	R	R- Square	B	Std. Error	F	T	Sig.
ACS	0.008	0.000	0.004	0.059	0.005	0.072	0.943

Utilizing Audit committee size by way of the explanatory variable and Discretionary Accruals by way of the response variable. From the Table 8 above, the R which denotes the correlation coefficient displays a low explanation of 0.008 or 0.8% while the more crucial variable R square shows an output of 0.000, which signifies that approximately 100% of variations in the response variable (Discretionary Accruals) is captured by other factors not covered by the study. The Analysis of Variance table (ANOVA) shows an insignificant regression at the 0.943 level, while the coefficients show that Audit committee size shows a positive movement as denotes by its coefficient of 0.004 and has a low standard error of 0.059 and was found to be insignificant based on its t-statistics coefficient of 0.072 at the 0.943 significance level which is greater than 0.05 significance level

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

Hypothesis: The hypothesis states that Audit committee size has no significant impact on earnings management in quoted Nigerian Banks. Utilizing the coefficient Table 7 above and

judging by the significance level of 0.943 which is greater than the 0.05 significance level, the study therefore does not reject the null hypothesis and consequently concludes that Audit committee size has no significant impact on earnings management in quoted Nigerian Banks during the study period.

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. Again, the positive coefficient of committee size on discretionary accruals discloses that banks with large audit committee size are likely to considerably lessen earnings management. However, the insignificance of this variable confirms that audit committee size is not a major determining factor of qualitative reporting.

Likewise, it was discovered that Audit committee size "has no significant impact on earnings management in quoted Nigerian Banks during the period of the study. This finding is also consistent with Soliman and Ragab (2014) who found that no substantial relationships exist amongst audit committee size and the levels of discretionary accruals in a study carried out to examine the effectiveness of audit committee, quality of audit and earnings management: an empirical study of listed companies in Egypt. The finding of the present study went further to equally agree with the finding of Krishanan and Visvanathan (2008) who found that there is a significant negative association between committee size and earnings management.

4.0   Conclusion

In line with the analysis and testing of the impact of audit committee size 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 as stated below that:
- ❖ Audit committee size has no significant impact on earnings management in quoted Nigerian Banks during the period covered by the study.

5.0   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 ethical 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 audit committee characteristics examined in this study should be given maximum attention as none of them was able to produce less earnings manipulation.
   iv.   The study finally recommends greater number of members who have knowledge of accounting and finance rather than basically one expert on the committee may be advantageous to stockholders.

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