

# **THE INFLUENCE OF AUDIT COMMITTEE ATTRIBUTES ON THE QUALITY OF FINANCIAL REPORTING EVIDENCE FROM NIGERIAN BANKS**

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## **Abstract**

*This study aims at examining the influence of audit committee attributes on the quality of financial reporting (QFR) in Nigerian banks. The study adopts a content analysis method in realizing the above objectives. The researcher-constructed measurement check-list was used in extracting data from audited annual reports of ten selected banks for the period 2006 to 2013. The dependent variable of study was the QFR, which was measured using the IFRS qualitative characteristics model. The independent variables consist of audit committee attributes and control variables (board attributes) were gleaned from the corporate governance section of the annual reports. Inferential statistics, namely; correlations and regression analyses were used in analyzing the data and testing the hypotheses raised in the study. The regression analysis result shows a t-value of 1.861 at 5% probability level, against the t-cal of 2.111. Specifically, the result shows that audit committee independence ( $p = .017$ ), meeting attendance ( $p = .040$ ), audit committee size ( $p = .059$ ) and the existence of a written charter ( $p = .007$ ) significantly influence the QFR in Nigerian banks. Accordingly, we conclude that certain audit committee attributes namely; independence, meeting attendance, size and the existence of a written charter exert significant influence on the QFR than other attributes.*

*Keywords: Audit committee, Audit committee attributes, quality financial reporting, Nigerian banks*

## **INTRODUCTION**

The persistent fraudulent financial practices and the resultant corporate failures, especially in the Nigerian banking sector, has raised a lot of concern among investors, regulators and other stakeholders in the corporate environment. The concern is provoked by the decline in the credibility of audited financial reports and many unethical practices uncovered in the many reported financial scandals, such as Oceanic Bank PLC, Afribank PLC, Intercontinental Trust Bank PLC, and several other Nigerian banks. The consequences of this development are manifold. As noted by Sanusi (2010), these fraudulent acts of presenting fictitious financial statements and lack of adherence to corporate governance principles have led to massive loss of funds by investors and lack of trust by the investing public in the companies quoted on the floor of the Nigerian Stock Exchange.

This development has heightened the search for mechanisms that would enhance the quality of corporate financial reports and the entire financial reporting processes. Prior studies (example, Treadway Commission, 1987 and Blue Ribbon Committee, 1999), reveal that improvement in the quality of financial reporting is often proposed as one of the major reasons why companies establish audit committees. This is because audit committees are often seen as having the potentials of reducing the chances of fraud and fraudulent practices, thus enhancing the quality of financial reporting. Although prior studies have examined the relationship between audit committee attributes and the quality of financial reporting; most of these studies were based on data and sample from developed economies. Empirical study on the influence of audit committee attributes on the quality of financial reporting in the Nigerian context is very scanty. Also, most of the studies, including those in advanced economies, used proxies to measure the quality of financial reporting. This current study overcame these limitations. The study is expected to contribute towards equipping regulatory and supervisory agencies with knowledge of the attributes which greatly influenced the QFR in the context of Nigerian economy and the banking sector in particular. Such knowledge will guide them in future review of the regulatory framework towards addressing the problem of fraudulent reporting in Nigeria.

## **REVIEW OF RELATED LITERATURE AND DEVELOPMENT OF HYPOTHESES**

### **Independence (ACIND)**

The independence of members of a supervisory governance structure (like an audit committee) from executive management has been widely regarded as a necessary precondition for its effectiveness and supervisory quality (Lee, 2011). The UK Code of Best Practice, issued by the Cadbury Commission (1992) defined independent audit committee member (director) as one who is independent of management and free from any business or other relationship which

could materially interfere with the exercise of their independent judgment, apart from their fees and shareholding.

In the USA, the Sarbanes-Oxley Act (SOX, 2002) regards independent directors as those having no 'significant interest' with the company. The Act defines 'significant interest' as: 1) not being a former employees of the company, 2) not being a former executive directors, 3) not being the clients or the suppliers of the company, 4) not occupationally related with the company, 5) not recommended or appointed on the basis of personal relations, 6) have no close relation to any executive director, and 7) do not have a significant share or represent major shareholder. Section 301 of SOX (2002) stresses that to enhance the independence of audit committees, it must be formed by independent directors, who must not receive consultation fees or reward, and must not take part in any related transactions with the company or its subsidiary. In Nigeria, the CAMA (2004), as well as codes of corporate governance have identified independence as one of the main attributes of audit committees (SEC, 2003; CBN, 2006). The codes also require that, in order to further enhance independence, the position of the audit committee chairman should be separate from the board chairman or the managing director.

There is a general expectation that the independent directors of the audit committee can improve the corporate governance environment and effectively assist in the supervision of the company's financial reporting process. Although several studies have produced a correlation between audit committee independence and some proxies of quality financial reporting (e.g. Beasley, 1996; Abbott & Parker, 2002; Klein, 2002; Carcello & Neah, 2003), others seem not to accept the argument that audit committee has any effect on the quality of financial reporting (e.g. Peasnell, Pope and Young, 2000; Bronson, Carcello, Hollingsworth & Neal (2006). Accordingly, it is hypothesized that:

*There is no significant relationship between the independence of audit committee and the quality of financial reporting in Nigerian banks.*

### **Audit Committee Accounting Expertise (ACACCEXP)**

Section 407 of SOX (2002) requires the Securities Exchange Commission (SEC) to adopt rules mandating that audit committees of public firms contain at least one member who is deemed a financial expert. The SOX's initial definition of financial expert was one who had education or experience in accounting or auditing. However, many companies criticized this initial definition of a financial expert for being overly restrictive and severely limiting the pool of qualified financial experts (Bryan-Low 2002; cited in Abernathy 2013). According to Abernathy (2013) SEC responded to these concerns by expanding the definition of the audit committee financial expert to include non-accounting financial expertise.

This broader definition of audit committee financial expertise has given rise to a stream of academic research investigating the association between the type of financial expertise on the audit committee and the quality of financial reporting (e.g. Krishnan 2005, Carcello *et al.* 2006, Defond *et al.* 2005, Bédard *et al.* 2004, Xie *et al.* 2003). The findings of these studies are consistent with the expectation that an audit committee member with financial/or accounting expertise enhances committee performance. However, Rich (2009) found no empirical evidence of a change in financial reporting quality following the appointment of an audit committee accounting expert. The author argued that firms with strong governance that appoint an accounting expert into their audit committees will experience larger post-appointment improvements in reporting quality than do firms with weak governance. The strong governance firms here are defined by more income-decreasing discretionary accruals, larger increases in earnings response coefficients, and higher quality accruals. Further, Carcello *et al.* (2006) argue that firms with strong corporate governance may exert stronger control over the firm's financial reporting decisions, irrespective of the activities of the audit committee; thereby reducing the impact of audit committee accounting expertise on the firm's reporting quality. But DeFond, Hann and Hu (2005) opined that audit committee's responsibilities often require significant accounting sophistication: in that they involve assessing the reasonableness of complex financial matters such as the company's accounting reserves, and management's handling of proposed audit adjustments suggested by the external auditors. Therefore, audit committee should consist of members with accounting or financial background who can ask relevant questions and thus decrease the possibility of earnings management and the errors in financial reporting; which ultimately increase the quality of financial reports. Therefore, in this study, the effect of accounting expertise on financial reporting is examined through the following hypothesis:

*There is no significant relationship between accounting expertise and the quality of financial reporting in Nigerian banks.*

### **Audit Committee Industry Experience (ACINDEXP)**

It is important that audit committee members have experience which fitted into the organization's context. Kang, Kilgore and Wright (2011) defined industry experience in terms of having been in the same industry for at least twenty years. As noted by Dhaliwal *et al.* (2010), industry experience could have a great impact on audit committee's effectiveness in overseeing the financial reporting process of the organization, and thus enhances the integrity of the financial statements. They argued that the business and industry knowledge possessed by audit committee members can complement the domain-specific knowledge of accounting expertise,

to promote accounting quality. Also, Cohen, Krishnamoorthy and Wright (2008) noted that audit committee members with industry experience are likely to have a superior ability to understand, interpret, and assess the quality of financial reports than members with no industry experience. The existing studies on audit committee are inconclusive on what types of expertise are assisting audit committees in fulfilling their responsibility over the financial reporting processes. Based on the foregoing, it is hypothesized that:

*There is no significant relationship between audit committee industry experience and the quality of financial reporting in Nigerian banks.*

### **Audit Committee Frequency of Meeting (ACMEET)**

The number of audit committee meetings has been used frequently as proxy for diligence and activeness of audit committee in corporate governance literature (McMullen and Raghunandan, 1996; Song and Windram, 2004; Al-Lehaidan, 2006). Prior studies on the relationship between the frequency of meetings and the quality of financial reporting, has so far, produced mixed results. For instance, while Bryan, Liu and Tiras (2004) and Koh *et al.* (2007) are in agreement that audit committee that meets regularly improves the transparency of reported earnings and therefore enhance earning quality (proxy for financial reporting quality), Yang and Krishnan (2005) and He, Wright, Evans and Crowe (2007) found no evidence of a significant relationship between the number of audit committee meetings and earnings management (another proxy for financial reporting quality). Contrary to this position, McMullen and Raghunandan, (1996) document that companies with less audit committee meetings are often found to have problems of financial reporting. O'Sullivan, Percy and Stewart (2008) confirm that audit committee meeting frequency is positively associated with the disclosure of forward-looking information in financial statements. In their report on the study of the collapse of firm of Andersen & Co, Chen and Zhou (2008) noted that the frequency of audit committee meeting is an important mechanism in enhancing good corporate governance practice.

It is argued that, the ability of the audit committee to uncover any financial irregularity and resolve problems in the financial reporting process will depend largely on the frequency with which the committee meets to consider issues affecting the company. However, the various corporate governance codes (both the US and Nigeria), have not made any categorical statement on the frequency of audit committee meetings. To examine this relationship in the context of Nigerian banks, the following hypothesis is formulated:

*There is no significant relationship between the frequency of audit committee meetings and the quality of financial reporting in Nigerian banks.*

### **Audit Committee Meetings Attendance (ACMEETATT)**

Besides regular meetings, the level of attendance of the meetings by the audit committee members can also determine the activeness of the audit committee. The frequency of meetings may be high, but if the attendance levels are poor, this may impair the effectiveness of the audit committee. Therefore, it is expected that the higher the level of attendance of audit committee members, the more active and participative the audit committee would be, and therefore the better the quality of financial reporting. Thus the relationship between meeting attendance and the quality of financial reporting is also examined in this study, using the following hypothesis:

*Ho<sub>5</sub>: There is no significant relationship between the meeting attendance and the quality of financial reporting in Nigerian banks.*

### **Audit Committee Size (ACSIZE)**

This refers to the number of directors on the audit committee. The size of an audit committee may have effect on its effectiveness and ultimately on the quality of financial reporting. The BRC (1990), the US-SEC (1999) and SOX (2002) recommend that audit committees consist of a minimum of three directors. The CAMA (2004) however recommends a maximum of six directors for audit committees in Nigeria. In the US, most of the audit committees are comprised of three or four directors; three to six directors seems to be the optimum number for an audit committee (Pricewaterhouse, 2005).

The expectation is that a large audit committee would enhance the effectiveness of the committee and ultimately the quality of financial reporting of the firm. However, Yermack (1996) and Eisenberg, Sundgreen and Wells (1998) argue that larger boards/committees reduce the firm's value. It is also argued that a large audit committee increases the resources available to the audit committee and improves the quality of its oversight; and thus makes it more likely that potential problems in the financial reporting process will be uncovered and resolved. Accordingly, the following hypothesis is put forward:

*There is no significant relationship between the size of audit committee and the quality of financial reporting in Nigerian banks.*

### **Existence of Audit Committee Charter (ACCHART)**

Audit committee authority literature indicates that there is a wide variation of responsibilities that could be performed by the audit committee (Kalbers and Fogarty 1993). This therefore underscores the importance of a written audit committee charter to help audit committee members to understand their specific roles and responsibilities. The Blue Ribbon Committee (BRC) in the US, as well as the UK's Combined Code on the effectiveness of the audit

committee both require that every audit committee should have written terms of reference defining their scope of operations, their functions, process and procedure and, importantly, as a basis for their evaluation. According to Kalbers and Fogarty (1993) the existence of clear audit committee charter/terms of reference provides power for authoritative decision-making and therefore, the audit committee can be active in performing its oversight role and carrying out other responsibilities.

The expectation therefore is that the existence of a formal written charter, which specifies the functions, role and responsibilities of the audit committee, will make its members more active in carrying out their responsibilities over financial reporting process; and this will lead to improvement in financial reporting quality. Accordingly, we hypothesized as follows:

*There is no significant relationship between the existence of audit committee charter and the quality of financial reporting in Nigerian banks.*

## **THE CONCEPT OF QUALITY FINANCIAL REPORTING**

The main objective of financial reporting is to provide information concerning economic entity, primarily financial in nature, useful for economic decision making (IASB, 2008; Beest, Braam & Boelens, 2009). Financial reports provide information about the management's stewardship; the entity's assets, liabilities, equity, income and expenses (including gains and losses), contributions by and distributions to owners as well as cash flows (Beest, *et al.*, 2009). This information is usually in the form of annual financial statements such as the statement of financial position; the income statement or statement of comprehensive income; statement of cash flows and statement of changes in equity as well as notes to the accounts (IASB, 2008, 2010).

The concept of quality financial reporting has commanded considerable research interest around the world. However, researchers, practitioners or regulators have not been able to provide a clear definition of what constitutes 'quality financial reporting' (Pomeroy and Thomson, 2008; cited in Miettinen, 2008). SOX (2002), for instance, require audit committees and auditors to discuss the quality of the financial reporting methods of the company, and not just their acceptability. However, the Act did not define what constitutes 'quality' in financial reporting.

Rather than define "quality" (in financial reporting), prior literature has focused on factors which tend to inhibit the attainment of high quality financial reports, such as earnings management, financial restatements, and fraud. They rather used the presence of these factors as evidence of a breakdown in the financial reporting process or low quality financial reporting (Xie *et al.*, 2003; Abbott, Parker and Peters (2004) Davidson, Goodwin-Stewart and Kent, 2005;



Rahman and Ali, 2006). Also, earlier studies have used compliance of financial reporting with accounting and auditing standards as proxy for quality of financial reporting (Beasley, 1996; Abbott, Park and Parker, 2000; Song and Windram, 2004).

The challenge, however, is that, if there is a lack of consensus on what constitutes "quality" in financial reporting, then it would be difficult to evaluate the function of audit committee with regards to financial reporting oversight. Jonas and Blanchet (2000) suggest a framework that dissects quality of financial reporting into a number of components including relevance, reliability, comparability, consistency and clarity. These components or attributes were upheld by the International Accounting Standards Board (IASB), in their framework for financial reporting, for which they described as the qualitative characteristics of financial reporting (IASB, 2010). This study adopts these attributes in defining and measuring quality financial reporting.

## **METHODOLOGY**

### **The Study and Data**

The study adopts a content analysis method in relating the attributes of audit committee to quality financial reporting. Data relating to these attributes were extracted from annual reports of selected banks for the period 2006 to 2013. The choice of this period was informed by a number of reasons. Firstly, the CBN's code of corporate governance came into effect in year 2006; with emphasis on the effectiveness of banks' audit committees and other corporate governance mechanisms. Secondly, a major reform took place in the Nigerian banking sector between year 2004 – 2005; when the capital base of deposit money banks was increased to N25b, leading to merger of banks and the emergence of mega-banks in Nigeria. This exercise ended formally in December 2005; hence year 2006 is often described as the beginning of the post-consolidation period. Finally, Nigeria banks adopted the international financial reporting standards (IFRS) in year 2012. Hence, the period 2006 to 2013 was selected to cover the pre and post-IFRS periods, as well as take cognizance of the post-consolidation period when corporate governance practice in the Nigerian banking sector was given greater impetus.

The major constructs examined in this study is the quality of financial reporting (QFR). This was measured using the qualitative characteristic model, as espoused by the IASB in the IFRS regime.

The population of study consists of all deposit money banks operating in Nigeria as at 31<sup>st</sup> December, 2013; which, according to CBN report totaled twenty two. From the population of twenty two (22) banks, a sample of ten (10) banks was selected for the study, through a filtering process. The filtering technique took cognizance of banks that were considered 'healthy' by the



CBN. A researcher-constructed measurement checklist was used in extracting the data from the annual reports of the studied banks. The construction of the checklist draws from Beest *et al.* (2009) and IASB (2008). The checklist was divided into three main sections. Section A consisted of issues relating to the quality of financial reports - based on the IFRS qualitative characteristics. Section B was made up of items relating to the attributes of audit committee, while section C contains items relating to board's characteristics (for control variables). Section A of the checklist was on a three point scale. An item which adequately meets the IFRS qualitative characteristics criteria was assigned the value of '3'; if it is fairly met, the value of '2' was assigned; while '1' was assigned if it does not, or meets in a very little way. Section B and C were scored based on the definition and measurement of the individual variable, as explained in the relevant sections of this thesis. Data for the completion of section A of the checklist cut across all sections of the annual reports, while data for sections B and C were gleaned from the corporate governance report and director's report sections of the annual reports.

### Dependent and Independent Variables

The main dependent variable in this study was the quality of financial reporting. This was measured using the IFRS qualitative characteristics model. This model is stated as follows:

$$QFRFE_{k,t} = f(RL_{k,t} + FR_{k,t} + UN_{k,t} + CM_{k,t} + TM_{k,t} + \varepsilon_t) \dots\dots\dots (1)$$

Where:

- $QFRFE_{k,t}$  = The **F**undamental and **E**nhancing qualitative characteristics of financial reports for bank k in year t
- $RL_{k,t}$  = Relevance characteristic scores for bank k in year t
- $FR_{k,t}$  = Faithful representation characteristics scores for bank k in year t
- $UN_{k,t}$  = Understandability characteristic scores for bank k in year t
- $CM_{k,t}$  = Comparability characteristic scores for bank k in year t
- $TM_{k,t}$  = Timeliness characteristic scores for bank k in year t
- $\varepsilon_t$  = Error term in year t.

### Independent Variables and Measurement Criteria

The independent variables for this study consist of all the audit committee attributes identified in this study, while the board attributes constitute the control variables. Audit Committee independence was measured by the proportion of independent/non executive directors on the audit committee; For accounting expertise dummy '1' was assigned if the AC consist of at least one member with professional qualification in Accounting; and also if the audit committee chairman is financially literate and '0' if otherwise. Industry experience was measured by the

proportion of audit committee members with board membership in the banking industry for a reasonable number of years. Audit committee meeting was measured by the actual number of audit committee meetings held during the year; meeting attendance was measured by the proportion of meetings attendance by audit committee members to the total number of meetings held during the year; while the size of audit committee was measured by the number of directors on the audit committee at the year end. With respect to audit committee charter, this was measured by the existence of a written charter to guide the members of the audit committee in their functions. In this respect, a dummy '1' was assigned if there is a written charter/terms of reference and '0' if otherwise.

### Model Specification

From the foregoing, the model for this study is stated as follows:

$$\begin{aligned} \text{QFR}_{kt} = & \beta_0 + \beta_{1t} \text{ACSIZE} + \beta_{2t} \text{ACIND} + \beta_{3t} \text{ACACCEXP} + \beta_{4t} \text{ACINEXP} \\ & + \beta_{5t} \text{ACMEET} + \beta_{6t} \text{ACMEEATT} + \beta_{7t} \text{ACCHART} + \beta_{8t} \text{BDSIZE} \\ & + \beta_{9t} \text{BDIND} + \beta_{10t} \text{BDACCEXP} + \beta_{11t} \text{BDINDEXP} + \beta_{12t} \text{BDMEET} \\ & + \beta_{13t} \text{AUDITOR} + \beta_{14t} \text{LNSIZE} + \varepsilon \dots\dots\dots (2) \end{aligned}$$

### ANALYSIS AND DISCUSSION OF FINDINGS

The relationships hypothesized in the model are tested statistically in two stages. First, we operationalised and measured the quality of financial reporting (dependent variable). Secondly, the various attributes (independent variables) are run against the dependent variables (QFR), using descriptive statistics, correlation analysis and a multiple regression model.

#### Operationalisation of the Quality of Financial Reporting (Dependent Variable)

According to IASB (2008), financial reporting can be operationalised under the fundamental and enhancing qualitative characteristics; based on the IFRS qualitative characteristic model. Two variables, namely; relevance and faithful representation, measure the fundamental qualitative characteristics; while understandability, comparability and timeliness measure the enhancing qualitative characteristics. The average mean score for relevance is 10.875; faithful representation is 13.875, giving the total mean score for fundamental characteristics as 24.613. The total mean score for understandability, 10.650; comparability, 12.700 and timeliness is 1.113; giving a total for enhancing characteristics as 24.463. The overall mean score for all the characteristics is 49.075. Thus, against expected mean score of 66 on a 3-point scale, this signifies a reasonable high quality.

## Descriptive Statistics

Table 1: Descriptive Statistics for the 10 Study Banks for 2006 - 2013

Variable	Mean	Std. Dev.	Min	Max.	Skewness	Kurtosis
<b>Panel A: Continuous Variables</b>						
QFR <sub>FE</sub>	49.0750	7.04556	22.00	59.00	-1.360	2.484
ACIND	1.7174	.08299	1.50	1.80	-.841	.581
ACACCEXP	1.8500	.35932	1.00	2.00	-1.998	2.043
ACINDEXP	.6403	.09282	.50	.84	-.096	.072
ACMEET	3.7250	.76266	2.00	6.00	.339	2.027
ACMEETATT	.8625	.08778	.50	1.00	-.803	2.208
ACSIZE	5.9250	.67082	.00	6.00	-8.944	80.000
ACCHART	1.7500	.43574	1.00	2.00	-1.177	-.631
BDSIZE	14.4625	2.28890	10.00	20.00	.832	.810
BDIND	1.5760	.08037	1.42	1.80	.641	.630
BDACCEXP	1.3460	.03662	1.26	1.42	-.164	-.150
BDINDEXP	.6825	.03634	.64	.80	.388	.062
BDMEET	6.1125	1.63036	3.00	12.00	1.881	4.438
BDMEETATTEND	.8597	.08357	.52	.97	-1.556	3.155
LNASSETS	13.4802	1.00488	8.80	14.96	-1.416	4.615
<b>Panel B: Dummy Variables</b>						
Variable	Percentage	Min.	Min.			
ACCHAIRIND	1.0000	1.00	1.00			
ACCHAIRACCEXP	1.0000	1.00	1.00			
ACCHART	0.8750	0.00	1.00			
AUDITOR	0.7500	0.00	1.00			

Panel A of Table 1 shows the descriptive statistics for the continuous variables, while panel B presents the details of the dummy variables. The table indicates that QFR (dependent variable) has a mean value of 49.0750. This represents an absolute value of the summation of a cross sectional values of the twenty two quality indices, measured on a three-point scale.

Panel A shows that the proportion of independent audit committee members ranges between 0 and 1, with a mean value of 0.7174. Although most corporate governance codes

demands that audit committees be consist entirely of independent/NEDs, the strict definition of 'independence' (example SOX, 2002) makes 100% attainment somewhat difficult. Accordingly, a mean score of 0.7174 (or 72%) is considered a very reasonable measure of independence. This value is higher than the independence score of Australian study (0.38) and Saudi Arabia's 0.63 (Al-Lehaidan, 2006). The second measure of independence has a mean score of 1.00. This implies that all banks in our study have independent audit committee chairman, separate from the board chairman.

In terms of accounting expertise, the table indicates a value range of between 0 and 1, with a mean value of 0.8500. This implies that about 85% of the banks have at least one accounting expert in their audit committee. This mean value is higher than what is obtainable in some prior studies. For instance, Baxter (2007) reported a mean value of 0.3226 for accounting expertise in Australian firms. Corporate governance best practices suggest that, because audit committees are charged with responsibility for tasks which require high degree of accounting sophistication, the committee should consist of at least one member with professional qualification in accounting (SOX, 2002). Thus, a mean value of 85% is considered very reasonable. With regards to industry experience, the results show a value range of between 0 and 1, with a mean value of 0.6403. This implies that over 64% of audit committee members in our sample frame have relevant experience which spans 20 years and beyond.

Audit committees in our study banks met between 2 and 6 times, with an average of approximately 4 times in a year. This mean score is higher that the Australian figure of 3.02 reported by Baxter (2007). In terms of meeting attendance, the values range between 0 and 1, with a mean average of 0.86. The above 80% level of meeting attendance is an indication of activeness on the part of audit committees. Wan-Hussin and Haji-Abdullah. (2009) in their study of 68 Malaysian firms, concluded that the level of meeting attendance by audit committee members is higher for good quality companies over the poor quality ones.

The size of audit committee in Nigerian banks ranges between 1 and 6 members, with an average of approximately six (5.9) members. Most of the corporate governance codes on audit committee do not specify the number of members that is ideal for an effective audit committee. However, CAMA (1990, as amended to date) requires audit committee in Nigerian companies to consist of six members. The mean size of 6 complies to a great extent with the requirements of CAMA (1990). Also, it is higher than the audit committee size in Australian and Saudi Arabian firms which, according to Al-Lehaidan (2006), has an average committee size of 2.9 and 3.0 respectively.

The existence of written charter/terms of reference for the audit committees records a value range of between 0 and 1, with a mean score of 0.7500. This implies that about 75% of

the banks in our sample frame have written charter/terms of reference to guide the members. The descriptive statistics discussed so far indicate relative high mean values for most of the audit committee attributes investigated, compared to results of prior studies. The possible explanation for this variation is that banking industry in Nigeria is highly regulated; hence their management and board always strive to meet the regulatory requirements on audit committee in order to avoid being sanctioned.

The control variables investigated in this study also recorded high mean values. Panel A of Table 1 shows that on average the board of the study banks has 15 members, with a minimum figure of 10. This is higher than Australia figure of 3 minimum and an average of 6 members reported by Baxter (2007); or a mean size of 7 in Kiel and Nicholson (2003).

On average, 58% of the board members were independent directors. The results also show that all the banks in our study complies with the corporate governance code which requires that, in order to further enhance independence, the audit committee chairman should be separate from the board chairman. The value for this variable is constant for all the banks in our study, which shows 100% compliance.

The proportion of board members with professional accounting qualification ranges between 0 and 1, with an average score of 0.38. Comparatively, this is higher than the Australia figure of 0.23 reported by Baxter (2007). In terms of industry experience, the results show that 68% of the board members have reasonable industry experience, which we defined earlier as 20years and above. This pool of experience also affects the audit committee industry experience (ACINDEXP). This is because audit committee members are drawn from among the board members.

The boards of the study banks met on average of 6 times in a year, with an average of 86% attendance rate. This high frequency of board meetings and very good attendance rate also reflect on the audit committees which, as shown in the previous section, also recorded high mean values for these variables.

The firm size, as measured by the total assets, gave very high values for skewness and kurtosis. A transformation process, using natural log reduces the skewness and kurtosis to -1.416 and 4.615 respectively; with the mean score of 13.48.

### **Correlations Analysis**

As stated in the previous sections, this study seeks to find out the relationship between audit committee attributes and quality of financial reporting in Nigerian banks. This is more of association study than a causal relationship, hence Pearson Correlation analysis was considered more appropriate in analyzing this relationship. The results are presented in table 2.

Table 2: Pearson Correlations Analysis for the 10 Study Banks 2006 – 2013

	QFR	ACIND	ACACCEXP	ACINDEX	ACMEET	ACMEETAT	ACSIZE	ACCHAT	BDSIZE	BDIND	BDACCEXP	BDINDEXP	BDMEET	BDMATT	AUD	LNASST
<b>QFR</b>	1.000															
<b>ACIND</b>	.381**	1.000														
	.000															
<b>ACACCEXP</b>	.536**	.165	1.000													
	.000	.144														
<b>ACINDEXP</b>	.323**	.236*	.123	1.000												
	.003	.035	.279													
<b>ACMEET</b>	.141	.166	.079	.248*	1.000											
	.213	.140	.489	.027												
<b>ACMEETAT</b>	.250*	.354**	.132	.168	.171	1.000										
	.026	.001	.242	.137	.129											
<b>ACSIZE</b>	.348**	.065	.268*	.171	-.041	.184	1.000									
	.002	.569	.016	.129	.719	.103										
<b>ACCHAT</b>	.610**	.356**	.485**	.133	.209	.265*	.195	1.000								
	.000	.001	.000	.240	.062	.018	.083									
<b>BDSIZE</b>	.266*	.133	.162	.126	.030	-.129	.072	.206	1.000							
	.017	.239	.150	.264	.790	.255	.524	.066								
<b>BDIND</b>	.043	.011	.058	-.106	-.088	.201	-.161	-.022	-.375**	1.000						
	.703	.923	.610	.351	.436	.074	.155	.849	.001							
<b>BDACCEXP</b>	.053	-.080	.175	-.137	-.103	.106	.142	.214	-.629**	.188	1.000					
	.640	.480	.120	.226	.362	.350	.208	.056	.000	.095						
<b>BDINDEXP</b>	-.196	-.109	-.223*	.367**	-.053	-.015	-.241*	-.416**	-.107	-.013	-.232*	1.000				



	.082	.336	.047	.001	.644	.894	.031	.000	.345	.909	.038					
<b>BDMEET</b>	.251 <sup>*</sup>	.233 <sup>*</sup>	.094	.349 <sup>**</sup>	.107	.073	.077	.272 <sup>*</sup>	.596 <sup>**</sup>	-.157	-.414 <sup>**</sup>	.093	1.000			
	.025	.037	.407	.001	.346	.519	.496	.015	.000	.165	.000	.409				
<b>BDMEETAT</b>	.029	.200	.007	-.054	.205	.247 <sup>*</sup>	-.122	.099	.011	.112	-.118	-.205	.024	1.000		
	.796	.076	.950	.636	.068	.027	.280	.382	.921	.324	.298	.068	.830			
<b>AUDITOR</b>	.384 <sup>**</sup>	.254 <sup>*</sup>	.159	.505 <sup>**</sup>	.212	.171	.298 <sup>**</sup>	.218	.193	-.095	-.104	.110	.213	-.115	1.000	
	.000	.023	.160	.000	.059	.129	.007	.052	.086	.404	.359	.332	.058	.310		
<b>LN ASSETS</b>	.540 <sup>**</sup>	.142	.197	.487 <sup>**</sup>	.182	.020	.113	.288 <sup>**</sup>	.368 <sup>**</sup>	-.140	-.162	.067	.315 <sup>**</sup>	.039	.465 <sup>**</sup>	1.000

\*\* . Significant at 1% level; \* . Significant 5% level (2-tailed). N= 80

Table 2 shows the results of the correlation between the independent variables and the dependent variable. To achieve this result, the correlation coefficients were first checked for the presence of high collinearity among the variables. From the correlation coefficients shown in the table, no high correlation is found among the independent variables; hence collinearity does not appear to create a threat to the interpretation of the correlation coefficients.

Furthermore, tolerance and variance inflation factors (VIF) were also used to check for multi-collinearity. According to Gujarati (2003), the VIF critical value is 10, above which the variable is said to be highly collinear. The VIF for all the independent variables were consistently smaller than 10; while the tolerance values are below 1. This further indicates a complete absence of multi-collinearity in this analysis (See appendix H for VIF results).

Table 2 shows a significant positive correlation between audit committee independence and the dependent variable. This implies that the independence of audit committee members will have a great impact on the quality of financial reporting. This result is at variance with prior studies such as Davidson, Xie & Xu's (2004) and Baxter's (2007), which find no association between audit committee independence and financial reporting quality. It is however corroborated by the findings of Bradbury (2006).

The correlation coefficient of ACACCEXP and QFR also shows a significant positive correlation at 1% level of probability. This implies that there is a significant association between accounting expertise of audit committee and the quality of financial reporting. This result is supported by prior studies such as Xie *et al.* (2003); Abbott *et al.* (2004); Bedard *et al.* (2004) who found that boards and audit committees that include members with financial background are associated with less earnings management. Similarly, the coefficient correlation between ACINDEXP and QFR shows a significant positive correlation at 1% probability level. This report is contradicted by Bedard's *et al.* (2004) who found no association between earnings quality and industry or firm-specific experience.

Contrary to expectations, the frequency of audit committee meetings has no positive association with the quality of financial reporting. The correlation coefficient of this variable against the dependent variable shows a no significant correlation. This result is consistent with prior studies such as Beasley *et al.* (2000) and Vafeas (2005). The result however, is contradicted by the findings of Xie *et al.* (2003); Song and Windram (2004); Bryan *et al.* (2004) and Suarer *et al.* (2012) which suggest that if audit committee meets regularly, it improves the monitoring activities over financial reporting and thus improves the quality of accounting information. Similarly, the results also indicate no significant positive correlation between the

level of meeting attendance by audit committee members and the quality of financial reporting. This result is at variance with the findings of Wan-Hussin and Haji-Abdullah (2009).

Audit committee size (ACSIZE) shows a significant positive correlation with the quality of financial reporting at 5% level of probability. This suggests that there is a significant relationship between the size of audit committee and the quality of financial reporting. The result is contradicted by the USA's study by Xie, Davidson and DeDalt (2003) which showed no significant association between the size of audit committee and aggressive earnings (proxy for financial reporting).

The correlation between the existence of audit committee charter (ACCHART) and the dependent variable also gives a positive result at 1% probability level. This implies that the existence of a written audit committee charter or terms of reference to guide the audit committee members can contribute significantly to improvement in the quality of financial reporting. This result is supported by Al-Lehaidan's (2006) study, who reported that firms with an audit committee with a written charter are more likely to select a high quality external auditor, compared to those without written charter.

Expectedly, the results show some significant correlations between the dependent variable and some of the control variables. The board size records a significant positive correlation with the quality of financial reporting. Also, the frequency of board meetings and the type of auditor engaged by the bank also show significant correlation with the dependent variables. Further, the size of the bank, represented by the natural log of the assets, also shows a significant correlation with the dependent variable. The implication of this is that, in addition to audit committee attributes, board attributes such as board size, frequency of board meeting, the type of auditor and the size of the bank, also influence the quality of financial reporting.

### **Regression Analysis**

This study examines the effect of multi variables (independent variables) on the quality of financial reporting (dependent variable); thus, multiple regression method is considered ideal for the study. As noted by Hutcheson and Sofroniou (1999), the ordinary least square (OLS) regression is often considered to be a suitable tool when analysis involves multi variables, consisting of dummy and continuous variables, as in this study. However, as can be noticed from the descriptive statistics in Table 1, many of the variables in this study show very high values for skewness and kurtosis, which implies that they are not normally distributed. According to Abdul-Rahman and Ali (2006), data is considered to be normally distributed if the standard skewness is within  $\pm 1.96$  and standard kurtosis is  $\pm 2$ . In spite of the application of transformation methods, the normality of some of the variables could still not be achieved. This

violation of normality makes the use of OLS regression model unrealistic. Greene (2007) admonished that whenever the condition of normality is violated, OLS estimates are inefficient. To avoid the limitations associated with the use of OLS regressions therefore, the composite exponential regression model was used in this study. The result is presented in 3.

Table 3: Regression Results between Audit Committee Attributes and QFR

Variable	Unstandardized Coefficients		Standardized Coefficients		Sig. (P-value)
	B	Std. Error	Beta	t-value	
Intercept	2.272	1.145		2.111	
ACIND	.102	.042	.219	2.440	.017**
ACACCTEXP	.033	.192	.018	.172	.864
ACINDEXP	-.003	.018	-.013	-.153	.879
ACMEET	.068	.169	.036	.400	.691
ACMEETATT	.047	.022	.188	2.092	.040**
ACSIZE	.337	.175	.167	1.924	.059***
ACCHART	.118	.042	.309	2.810	.007*
BDSIZE	.007	.010	.092	.651	.517
BDIND	.291	.179	.140	1.630	.108
BDACCEXP	-.018	.550	-.004	-.032	.975
BDINDEXP	.099	.484	.022	.205	.838
BDMEET	-.007	.011	-.064	-.620	.537
BDMEETATT	-.086	.170	-.043	-.507	.614
AUDITOR	.003	.048	.007	.068	.946
LNASSETS	.059	.016	.358	3.678	.000

**Panel B: Model Summary**

R	.808
R <sup>2</sup>	.652
Adjusted R <sup>2</sup>	.571
Std. Error of the Estimate	.10934
F-Statistic	8.007
P-value	.000

\*Significant at 10% level; \*\*Significant at 5% level, \*\*\*Significant at 1% level

Table 3 shows that the value for  $t$  ( $t$ -cal) is 2.111; but the table value for  $t$  at 5% probability level is 1.861. Therefore, the null hypothesis is not supported. Accordingly, we conclude that there is a significant positive relationship between the audit committee attributes in this study and the quality of financial reporting. This result is supported by several prior studies such as Yang and Krishnam (2005); Ali (2006); Wan-Hussin and Haji-Abdullah (2009). It is however contradicted by Baxter's (2007), which found no correlation between audit committee attributes and quality financial reporting in Australian firms.

From the above results, the regression equation (3), which was stated as:

$$QFRFE = f(ACSIZE+ACIND+ACACCEXP+ACINDEXP+ACMEET+ACMEETATT+ACCHART+BDSIZE+BDIND+BDCCEXP+BDINDEXP+BDMEET+BDMEETATT+AUD+FIRMSIZE+\epsilon;$$

becomes as follows:

$$QFRFE = f(\beta_{.102} + \beta_{.033} + \beta_{-.003} + \beta_{.068} + \beta_{.047} + \beta_{.337} + \beta_{.118} + \beta_{.007} + \beta_{.291} + \beta_{-.018} + \beta_{.099} + \beta_{-.007} + \beta_{-.086} + \beta_{.003} + \beta_{.059}).$$

Although the  $t$ -value gives a verdict of a significant positive relationship between audit committee attributes and quality financial reporting, a critical look at the  $p$ -values of the various attributes indicates that only audit committee independence ( $p= .017$ ), meeting attendance ( $p= .040$ ), the existence of a written charter ( $p= .007$ ) and audit committee size ( $p= .059$ ), show significant positive relationship with the dependent variable at 1%, 5% and 10% significant levels respectively. This implies that, although these other attributes, namely; audit committee accounting expertise, industry experience, and frequency of meetings show a significant relationship under the correlations analysis, but because these are not supported by the regression results, the strength of their relationship could not be sustained.

The model summary in panel B of table 6 shows the coefficient of determination ( $R^2$ ) is .652. This implies that about 65% of the changes in the quality of financial reporting can be explained by the combined effect of the seven audit committee attributes examined in this study, namely: audit committee independence (ACIND), audit committee accounting expertise (ACACCEXP), audit committee industry expertise (ACINDEXP), audit committee frequency of meeting (ACMEET), audit committee meeting attendance (ACMEETAT), audit committee size (ACSIZE) and the existence of a written audit committee charter (ACCHAT).

The adjusted  $R^2$  (R-Square) gives a value of 0.571 (or 57%) shows that the model is a fair estimate of the relationship between the variables in this study. This figure is fairly comparable with those in similar studies. For instance, Li (2008) who recorded an adjusted R square of 62%. The F-statistic of 8.0070 and  $p$ -value of 0.000 implies that the collective attributes of audit committee affect the quality of financial reporting in Nigerian banks.

## CONCLUSIONS

The purpose of this study was to examine the influence of audit committee attributes on the quality of financial reporting (such as audit committee independence, accounting expertise, industry experience, frequency of meetings, meeting attendance, size, and the existence of audit committee charter). The corresponding hypothesis states that there is no significant relationship between audit committee attributes and the quality of financial reports in Nigerian banks. The audit committee attributes were examined individually; giving rise to seven hypotheses ( $H_{01} - H_{07}$ ). The inferential statistics were used in testing these hypotheses. The dependent variable (QFR) was measured using the qualitative characteristics model, and these attributes (independent variables) were run against the dependent variable, in a multi-regression analysis.

Under the correlation analysis, the coefficient of all the variables, except frequency of meetings (ACMEET), showed significant positive correlation with the dependent variable. However, under the regression model, only the coefficient of four variables namely: ACINDEXP, ACMEETATT, ACSIZE and ACCHART maintained their positive significant association with the quality of financial reporting. This implies that these attributes, namely: audit committee independence, audit committee meeting attendance, audit committee size and the existence of audit committee charter substantially influence the quality of financial reporting.

These results are collaborated in some instances, by prior studies, while also contradicted by others. Thus we conclude that there exist a significant positive relationship between some of the audit committee attributes and the quality of financial reporting in Nigerian banks.

## LIMITATIONS OF THE STUDY

Despite the potential strengths of this research, a number of limitations are worth mentioning. First, this study focused on only ten money deposit banks in Nigeria. The choice of the banking sector was informed by its peculiarity. However, the sample size of ten banks was because of data availability; and this may not be representative enough for all the banks in Nigeria. Second, non-banking institutions and micro-finance banks were not included in the study. Therefore, it is not possible to generalize the results of this study to the non-banking institutions or all the banks in Nigeria. Finally, this study relied on annual reports obtained from the banks' websites for the data used in testing the research hypotheses. It was not possible to visit the banks to obtain the hard copy version of the annual reports, to authenticate the internet versions. This could also act as a hindrance to the generalization of the results of this study.



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