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IMPACT OF AUDIT COMMITTEE INDEPENDENCE AND EXPERTISE ON FINANCIAL REPORTING QUALITY OF LISTED COMMERCIAL BANKS IN NIGERIA

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ABSTRACT

The study aims at examine the impact of audit committee independence and expertise on financial reporting quality of listed commercial banks in Nigeria. The study covered a period of ten (10) years from 2013 to 2022. The study used panel data research design techniques for a sample of eight (8) commercial banks out of the fourteen (14) quoted banks on the Nigerian Exchange Group. The data for the study were collected from the annual accounts of the sampled banks through the measurements of the variables. The study found that audit committee independence (ACIND) has a negative significant impact on financial reporting quality (FRQ) and audit committee expertise (ACEXP) has a positive insignificant impact on financial reporting quality (FRQ). The major conclusion of the study is that as audit committee expertise increases, the quality of financial reports also increases. Therefore, the study recommends that commercial banks should invest more in training of its audit committee members and allow them to acquire professional qualifications.

Keyword: Audit, independence, committee expertise, financial reporting quality

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1.0 Introduction

Due to the sensitivity of corporate financial reports (annual reports), more especially that of commercial banks in Nigeria results to the extension of audit function to be carried out by audit committee in order to ensure the quality of the financial reporting is at the highest level of relevancy, correctness, completeness, accuracy and unbiased. The audit committee is more consistent in preparing and analyzing financial reports (Alyaarubi, Alkindi, & Ahmed, 2021). The audit committee of the board of commercial banks in Nigeria is an integral part of the control characteristics because it improves good controls and improves the safety of the quality of financial reports (Alabdullah, & Ahmed, 2020). That means, the audit committee is the corner-stone for evaluating financial reports, and it is one of the vital committees affiliated with the board of directors of commercial banks in Nigeria charged with monitoring financial reports and releases (Alabdullah, et al., 2021). The audit committee is also known as the heart of the Board of Directors on commercial banks (Thottoli, et al., 2019).

Audit committee could also enhance auditor's independence and most likely support the auditor rather than management in audit disputes and the level of support is consistent across members of the audit committee, regardless of whether the member is in a full-time or part-time position. In addition, audit committee could play a role in selecting auditors, determining their remuneration and in the disengagement of the auditors. Audit committee is anticipated to ensure that a business organization like commercial banks has sufficient internal control system, proper accounting policies, and independent external auditors that will prevent the incidence of fraud, non-compliance and promote high quality and timely financial reports.

Commercial banks as the case study provide backup liquidity to the economy, interprets monetary policy and provide some "value addition" in the banking sector by transferring funds from surplus to deficit sectors of the economy, also help to enhance development of international trade especially when acting as referees to importers, providing travelers' cheques and Business Travelling Allowance (BTA) to those going for international businesses.However, Commercial banks contribute positively towards economic growth, development and wealth creation, provide and encourage savings and investments, facilitate but speed up the process of economic development through making more funds available from resources mobilized in the economy. Against this background, this study intends to examine the impact of audit committee independence and expertise on financial reporting quality of listed commercial banks in Nigeria.

2.0 Literature Review

2.1 Conceptual Review

An Audit committee is defined as a committee established by an organization as a liaison between the board of directors and the external auditors, this committee normally has a majority of non-executive directors and is expected to view the organization's affairs in a detached and dispassionate manner (Habbash, 2020). The audit committee serves as a major communication intermediary between major parties in the financial reporting process (e.g. board of directors, corporate management, internal auditors and external auditors) by providing a key monitoring oversight function (via reviews to nominate auditors, scope of external and internal audit work, implementation of internal controls). It meets with the Company's external auditors to discuss accounting, auditing, internal control and financial reporting matters. The external and internal auditors have unrestricted access to the finance and audit committee. Also, the audit committee is charged with protecting investor interests by ensuring the high quality of financial information disclosed; monitoring accounting policy

choices; hiring, performance management, if appropriate and maintaining the independence of the external auditor; compliance with regulatory requirements; monitoring and oversight of the internal audit function; and evaluation of risk management practices (Goodwin, 2003).

Financial reporting quality does not only mean earnings or stock price changes, but is a multi-dimensional term that requires comprehensive measure (IASB, 2010). Beest et al. 2009, provides a non-exhaustive classification of methods widely used in prior studies to assess financial reporting quality, i.e., accrual models, value relevance models, and methods that operationalize the qualitative characteristics. Beest et al. (2009) measured the quality of financial reporting in terms of qualitative characteristics. They developed a quality assessment tool using a 21-item index comprising both fundamental (relevance and faithful representation) and enhancing qualitative characteristics (understandability and comparability). According to the IASB (2010), relevance and faithful representation are the fundamental qualities, whilst comparability and understandability are enhancing qualities. Understandability is the quality of information that enables users to perceive its significance.

2.3 Empirical Review of Literature

The effectiveness of any audit committee is described in terms of how well the audit committee carries out its prescribed or legal roles and responsibilities. Such committee is said to be effective if it is independent, competent, inquisitive and decisive. To achieve this, each member of the committee must show willingness to devote time and energy to the work of the committee. That is, each member must be active (Oladipupo, 2005). An effective audit committee would be enhancing their role to pursue the term of reference and objectives (Treadway Commission, 1987).

Rashidat, et al., (2022) investigated the influence of audit attributes on the financial reporting quality of twelve (12) listed Deposit Money Banks in Nigeria from 2012 to 2018. The study used a correlational research design. As a data analysis approach pooled OLS regression was employed. Audit committee independence, audit committee expertise, and audit tenure were employed as proxies for audit attributes, whereas financial reporting quality was utilized as a dependent variable in Nigeria utilizing discretionary accrual (DMBs). The study's population consists of fourteen (14) listed DMBs, whereas the adjusted population consists of twelve (12) listed DMBs. Panel data were extracted from the financial report based on the Modified Jones model. The panel data regression results demonstrated that audit committee independence and audit committee expertise had a favourable and significant impact on the financial reporting quality of Nigerian listed DMBs. As a result of the study's findings, audit committee independence and audit committee expertise have a significant propensity to enhance financial reporting quality. By the findings, the research suggests that bank regulators consider mandating professional qualifications, as proposed by the FRCN in the 2016 draft of the suspended NCCG, to improve the audit committee's expertise and diligence. It also suggests that audit committee independence should be focused on how to guarantee financial reporting quality properly reflects the honest and fair picture of the financial report to avoid misleading all of the consumers across the globe of accounting information.

Odjaremu and Jeroh (2019) examined the mediating effect of audit quality on the relationship between the effective audit committee and financial reporting quality. The research uses multiple regression analysis to test the relationship between the effective audit committee and financial reporting quality. The sample consists of 77 non-financial firms listed on the Saudi stock market between 2014 and 2021. Empirical findings show that studies on effective audit committees and financial reporting quality displayed mixed results. The study findings

indicate that audit quality has a mediation effect on the relationship between audit committee characteristics (more oversized Audit Committee, financial expertise, frequent meetings, gender diversity, independent members) and financial reporting quality. The study findings indicate that a change in audit committee effectiveness brings a change in audit quality, and a difference in audit quality brings a shift in financial reporting quality. his study has important implications for regulators and policy-makers to address the conflict between insiders and outsiders by promoting a higher standard of financial reports. The study also may be useful to investors, aiding them in financial decision-making and helping all stakeholders understand and trust the fairness and quality of financial information. In addition, it helps to understand the role that an effective audit committee plays in external audit quality and financial reporting quality. Finally, the study also contributes by bringing a new perspective on how external audit quality engages in monitoring by requesting financial reporting quality

Ajape et al. (2023) examined the effect of audit committees on quality of financial reporting. This study a cross-sectional with quantitative approach where the quantitative data was gathering via secondary data with Partial Least Square (PLS) approach. A sample size of 60 were select, (Financial companies 20, Industrial companies 20, and Service companies 20). The key source of sample companies in Muscat Stock Exchange (MSX). The findings showed that the audit committee positively large by a quality of financial reporting everywhere it was. The findings show that the audit committee has a significant impact on the quality of financial reports. This result indicates that the more audit committees, the higher the quality of financial reports.

Samuel (2012) investigated the impact of audit committees' attributes on financial reporting quality of Banks in Nigeria. Modified Jones model (1991) provided the measures of earnings quality, which were used to proxy for financial reporting quality. The audit committee attributes investigated were: independence, financial expertise, frequency of meetings, and multiple directorship. The population of our study is all the twenty-two (22) quoted banks on the Nigerian Stock Exchange as at 31st December, 2010 filtered to eleven (11) banks considering only banks declared healthy by the CBN and having the relevant data required for the study. Secondary data were used obtained from secondary sources, i.e., annual reports and returns filed with SEC. The research design used is correlation research design. The effectiveness of Audit committee attributes is one of the significant themes in corporate governance debates. The study contributes to the debate by examining empirically whether audit committee attributes are associated with financial reporting quality in Nigerian banks. By using a measure of financial reporting quality, Jones (1991) model this study is one of the few studies that overcome the imprecision inherent in the abnormal accruals/earnings management. The study shows that after controlling for bank size and bank market penetration, the percentage of audit committee members having financial expertise is positively related to financial reporting quality. The study also finds some evidence of a positive relationship between the independence, frequency of meeting and multiple directorship of the audit committee and financial reporting quality.

Zubair (2015) posits that the recent corporate financial crises in different jurisdiction have necessitated the need for a sound corporate governance system. Thus, audit committee is one of the major corporate governance mechanisms design to ensure the effectiveness and efficiency of the board in monitoring and controlling the management and the operations of the banks with an eye of achieving the desired level of performance. This paper assessed the effect of audit committee characteristics on the financial performance of deposit money banks in Nigeria. Robust Ordinary Least Squares (OLS) multiple regression technique of data

analysis was used in the sample of 7 banks for a period of 10 years (2004-2013), using secondary data. The paper after controlling for firm size found a significant positive relationship between financial performance (ROA) and the characteristics of the audit committee. That is, the attributes of the audit committee of the deposit money banks (especially, independence and financial expertise) have significantly improved the financial performance of the banks during the period of the study. The paper also found that the size of the audit committee and the frequency of the committee's meetings have not significantly influence the financial performance of the banks.

Kabiru and Usman (2021) investigated the effect of audit committee characteristics on the financial reporting quality of Deposit Money Banks (DMBs) in Nigeria. The study used correlational research design. The source of data was secondary data which were collected from the published annual financial reports of the studied DMBs in Nigeria. The population/sample size was 14 DMBs in Nigeria. A period of eleven years was covered from 2009 to 2019. The secondary data collected were analyzed using multiple regression analysis which was carried out using STATA software. Findings from the analysis show that frequency of audit committee meeting and audit committee female gender have positive and significant effect on the financial reporting quality of DMBs in Nigeria while audit committee financial expertise has significant negative effect on the financial reporting quality of DMBs in Nigeria. However, it was reported that audit committee independence has no significant effect on the financial reporting quality of DMBs in Nigeria.

2.3 Theoretical Framework

2.3.1 Agency Theory

According to the agency theory, the separation between managers as agents of the firm from owners (shareholders) create clash between interest of management and shareholders. Managers normally try to exploit their personal interest even at the expense of shareholders. This conflict of interest between managers and shareholders give birth to the earning management which affects the disclosure of financial statement. Managers are reasonable about preparing financial statements, so they exercise their discretionary powers when they report the earnings to influence firms' performance which can benefit their personal interest according to Jensen and Meckling (1976) as cited by Al-own and Alhadab (2017). As argued by Bilal et al., (2018) agency theory requires an audit committee to reduce cost by overseeing the financial reporting quality process and improving the quality of financial statements. Similarly, in accordance with agency theory as cited by Sunarto (2009) in Ayu and Ahmar (2013),motivations of accruals management can be categorized into two categories: opportunistic and signaling. In opportunistic motivations, management through aggressive accounting policies generates higher earnings than the actual ones. Second, in signaling motivation, management presents financial information about earnings which are exaggerated to give prosperity signal or earnings which grow relatively or remain stable to shareholders. As argued by Hassan, (2015) the agency theory advocates that the nature of ownership has positive association with good earnings quality.

2.3.2 Stewardship Theory

According to this theory, managers are expected to be good steward of organizational resources. They are not to misappropriate the organizational resources at this will adversely affect the attainment of other non-financial motives, such as the intrinsic satisfaction of successful performance and the need for achievement and recognition. This theory therefore, requires the directors of a company to be accountable for their stewardship over the company's resources, subject to the report from an independent auditor to the members that

the accounts show a true and fair view.As cited by Madison (2014), Stewardship theory is also about the employment relationship between two parties the principal (owner) and the steward (manager), (Davis et al., 1997; Donaldson and Davis, 1991). It examines this relationship from a behavioural and a structural perspective. Theory suggests that stewards will behave in a pro-social manner, behaviour which is aimed at the interest of the principal and thus the organization (Davis et al., 1997; Zahra et al., 2009). This behaviour is fostered by the quality of the relationship between the principal and steward and the environment and ideals of the organization (Corbetta& Salvato, 2004; Davis et al., 1997).From the above theory, it is clear that managers of the banks are not expected to pursue other objectives different from that of the organization. Effective audit committee and risk management committee oversight will ensure proper check and balance toward achievement of the organizational objectives.

3.0 Methodology

Ex-post facto research design which involves measuring the effect of pre-selected independent variables of the study on the study dependent variables. The listed Nigerian deposit money banks on the floor of the Nigeria Stock Exchange as at 31st December 2022, which comprise of fourteen banks will form the population of the study. The study will adopt census sampling technique to arrive at the sample size. A two-point filter will be used in arriving at sample size. First, the required data must be available for all the study period. Second, the bank must be listed during the study period. Hence, one bank i.e., Jaiz Bank will be filtered out accordingly. This is due to insufficient data within the scope of the study. Sources of data for the study will be from secondary sources. Data will be mainly sourced from the selected listed deposit money banks' annual financial reports and accounts, Nigerian stock exchange's fact book and other information relevant to the study. The panel data to be collected will be analyzed using Ordinary Least Square (OLS) to run regression using STATA as a tool of analysis. The study will employ multiple regression technique to determine the impact of the independent variable on the dependent variables. The robustness test like the Hausman test, heteroskedasticity test, multicollinearity test will be conducted to improve the validity of the result.

4.0 Results and Discussion

4.1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
FRQ	100	.040044	.072056	0	.4355
ACIND	100	.56849	.0751794	.3636	.7143
ACEXP	100	.323654	.0958387	.1667	.6667
LEV	100	.334858	1.518953	0	11.0561
FSIZE	100	12.12456	.42679	11.1945	13.5345

Source: Author's Computation using STATA 14

Table 4.1 shows that the observation column represents the number of observations for each variable. It indicates how many data points were used in the analysis. The mean column is the average or mean value of the variable across all observations. The standard deviation column measures the amount of variation or dispersion of a set of values. It provides a sense of how

spread out the values are around the mean. The minimum value observed in the dataset for each variable. The maximum value observed in the dataset for each variable.

FRQ has a mean frequency of approximately 0.040, with a standard deviation of 0.072. The frequency values range from 0 to 0.4355. The mean of ACIND indicator value is around 0.5685, with a standard deviation of 0.075. The values for this variable range from 0.3636 to 0.7143. ACEXP has a mean value of 0.3237, with a standard deviation of 0.0958, a minimum and maximum values of 0.1667 and 0.6667 respectively.Regarding the control variables, LEV has a mean value approximately 0.3349, with a relatively high standard deviation of 1.5189. The leverage values range from 0 to 11.0561 for the minimum and maximum respectively. Also, FSIZE has a mean value of 12.1246, with a smaller standard deviation of 0.4268, a minimum and maximum values of 11.1945 and 13.5345 respectively.

4.2. Correlation Analysis

Table 4.2: Correlation Matrix

Variables	FRQ	ACIND	ACEXP	LEV	FSIZE	VIF
FRQ	1.0000					
ACIND	-0.1908	1.0000				1.02
ACEXP	0.1640	0.0201	1.0000			1.24
LEV	0.5702	0.0160	0.1160	1.0000		1.02
FSIZE	0.0562	0.1060	0.3541	0.0437	1.0000	1.21

Source: Author's computation using STATA 14

Table 4.2 shows that the diagonal elements represent the correlation of each variable with itself, which is always 1.0. For example, the correlation of FRQ with itself is 1.0, and the correlation of ACIND with itself is also 1.0 and for all the other variables. The correlation between FRQ and ACIND is -0.1908, indicating a weak negative correlation. The correlation between ACIND and ACEXP is 0.0201, suggesting a very weak positive correlation. Correlation does not imply causation, and these values only describe linear relationships.

4.3 Regression Analysis

Table 4.3: Fixed Effect Model (Generalized Least Square)

FRQ	Coefficient	Std. Error	z	P>|z|
Constant	-0.1804	0.2081	-0.87	0.386
ACIND	-0.1956	0.0743	-2.63	0.008
ACEXP	0.1073	0.0642	1.67	0.094
LEV	0.0258	0.0037	7.01	0.000
FSZIE	0.0103	0.0142	0.73	0.468
Wald chi2(6)	70.42			
Prob > chi2	0.0000			
Hausman	0.0000			
Hettest	0.0000			
Autocorrelation	(F1, 9) 30.366			
Pesaran's Test	5.133			

Source: Author's Computation using STATA 14

Table 4.3 provides information about the estimated coefficients, their standard errors, z-values, and associated p-values, as well as additional statistics for evaluating the overall model fit. The table further shows that ACIND has a coefficient value of -0.1956, standard error value of 0.0743, z score value of -2.63 and a P value of 0.008. this means audit

committee independence has a negative significant impact on financial reporting quality, implying that a decrease in ACIND holding other variables constant will increase the FRQ of listed deposit money banks in Nigeria. ACEXP has a coefficient value of 0.1073, a standard error of 0.0642, z score value of 1.67 and a P value of 0.094 which means that audit committee expertise has a positive insignificant impact on FRQ holding other variables constant.

As for the control variables, leverage has a coefficient value of 0.0258, standard error value of 0.0037, z score value of 7.01 and a P value of 0.000 which means that debt sought by the listed banks has a positive significant impact on FRQ. FSIZE has a coefficient value of 0.0103, standard error value of 0.0142, z score value of 0.73 and a P value of 0.468 which means that firm size has positive insignificant impact on FRQ implying that size of the banks is not a determinant for quality of financial reports.

Autocorrelations are often associated with time-series data. In this case, it suggests that there are no autocorrelations estimated, and the analysis involves 10 groups.The Wald chi2 statistic is 70.42, and it is associated with a p-value (Prob > chi2) of 0.0000. This p-value is used to test the hypothesis that all coefficients (except the intercept) are simultaneously equal to zero. The Hausman specification test (0.000) chose fixed effect model, however, after running the heteroskedasticity test (0.000) for FE, the p value indicate presence of the Hettest, hence the autocorrelation (F1, 9) 30.366 and cross-sectional independence tests (5.133) were further conducted. The generalized least square was found to be appropriate model presented.

5.0 Conclusion and Recommendation

The study examined the impact of audit committee independence and expertise on financial reporting quality of listed commercial banks in Nigeria.The negative coefficient suggests that as audit committee independence decreases, the financial reporting quality of some commercial banks tends to increase. The positive coefficient suggests that an increase in audit committee expertise is associated with an increase in the financial reporting quality of some commercial banks in Nigeria. The study recommended that, the listed commercial banks should have a minimum number of independent directors in the structure of their boards which will lead to quality of financial reports.

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