The Impact of Audit Committee Attributes On Financial Reporting Quality: An Evidence from Listed Insurance Company in Nigeria

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Abstract

The aim of this study is to examine the impact of audit committee attributes on the financial reporting quality of listed insurance companies in Nigeria. The research employed an ex-post-facto design. Empirical analyses were conducted on 13 listed insurance companies in Nigeria over the period of 2012-2016. The proxy of the dependent variable of the study which is financial reporting quality is total accruals while the independent variables of the study were audit committee size, audit committee composition, audit committee meetings and audit committee diversity. Using ordinary least squares (OLS) multivariate regression analysis, the study observed that audit committee meeting has a negative and insignificant impact on firm financial reporting quality. Audit committee composition has a negative and insignificant impact on financial reporting quality. On the other hand, audit committee size has a positive and insignificant impact on firm financial reporting quality. More so, audit committee diversity has positive and insignificant impact on firm financial reporting quality. The paper recommended that the board of directors of insurance companies should take measures directed towards increasing the number of audit committee size and ensure richer diversity in the audit committee. Such will have a positive impact on financial reporting quality of insurance companies. It was also recommended that policy makers like the financial reporting council of Nigeria and Securities and Exchange Commission should amend their code of corporate governance to increase the size of audit committee and encourage diversity in the composition of audit committee.

Key words: Audit Committee Attributes, Corporate Governance and Financial Reporting Quality.

1.1 Introduction

Financial reporting is an avenue through which the management communicates the company's performance with people outside the organization. The objective of general-purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity (IASB, 2010). Section 334(1) of CAMA 1990 as amended makes it the duty of the directors to prepare the financial statement for each accounting year. The financial reports are based on estimates, judgment and model rather than exact depictions; the conceptual framework establishes the concepts that underlie those estimates, judgment and models (ICAN, 2014). Wide range of users of corporate financial statement relied on the information been provided by the companies. Thus, financial statement must possess certain attributes considered as financial reporting qualities for it to be of any help to such users. Siriyama&Albargi (2007) opined that, to achieve this level, financial reports must be faithfully represented, comparable, verifiable, relevant, timely and understandable. As it is defined in the conceptual framework for financial reporting of the FASB and the IASB, there are agreed upon elements of high-quality financial reporting. The qualitative characteristics of financial reporting quality include relevance, faithful representation, understandability, comparability, verifiability and timelessness. The primary responsibilities of Audit committee are to oversee the financial reporting, auditing processes and monitor management tendencies to manipulate earnings and other accounting malpractices (Omotosho, okpanachi, Adebenege, &Aniette,(2017).

Edogbanya&Kamardin (2015) have characterized a loose system of corporate governance as the major cause of massive collapses of high profiled companies both in Nigeria and at global level. Several cases of corporate scandals have been recorded such as Enron & world camp scandals in USA, Cadbury in Nigeria and many other cases at global level where bad corporate governance was held largely to blame. These call for the urgent need for more profound, robust and sound system of corporate governance to be put in place to address the devastating issue. Efforts have been made to address issue, such as the enactment of the Sarbanes-Oxley Act in July, 2002 in the USA, the Higgs and Smith Reports in 2003 in the UK and other follow-up reports that together make up the code (ICAN (2014).

In Nigeria, there was the code for corporate governance issued by the security and exchange commission which requires all public companies whose securities are listed on a recognized security exchange shall complied with the principles and provisions of the code and that the code shall form the basis of minimum standard of their corporate behavior (ICAN, 2014). In the same vein, financial reporting council of Nigeria (FRCN) approved the Nigerian code of corporate governance 2018. The code seeks to institutionalize corporate governance in Nigerian companies. The code is aimed at companies of varying sizes and complexity across industries. National insurance commission also issued Code of corporate governance for insurance industry in Nigeria 2009. Some of the recommendations made include the establishment of board committees such as risk committee and audit committee to explicitly state their functions and duties. Erasmus (2016) opined that corporate scandals have heightened the search for mechanisms that would enhance thequality of corporate financial reports and the entire financial reporting processes. Prior studies(example, Treadway Commission, 1987 and Blue-Ribbon Committee, 1999), reveal thatimprovement in the quality of financial reporting is often proposed as one of the major reasonswhy companies establish audit committees (Erasmus, 2016).The insurance industry is a highly specialized industry that gives greater security to the fortunes of common people and among the whole society (Chijoke, 2013). The primary objective of insurance is to create an avenue in which possible future risk can be hedge. Insurance represents a promise of future compensation relating to specific losses in exchange for periodic payments (premium).

1.2 Statement of the problem

Financial reporting quality is important for the capital market and accounting information users because it enhances their confidence in gauging a firm's financial performance (Feng,2014). However, despite the important role of comparability in financial reporting, there is very limited research on accounting comparability, mainly due to the lack of a valid empirical measure. Most of the available literature concentrate on the role of accounting standards in the production of financial reporting quality, and consider accounting standards as the major determinants of reporting comparability (Ihsan 2016, Mathew 2015, &Suadiye 2017). These studies investigate how the adaption of International Financial Reporting Standards (IFRS) affects financial reporting quality. However, several studies argue that accounting standards alone cannot fully determine financial reporting outcomes such as comparability (Leuz et al.2003). Many studies have now began to focus on other factors beyond accounting standards that affect financial reporting quality, such as the incentives of preparers and auditors, enforcement mechanisms ownership structure (Samaila 2014, Feng 2014, ,Ormin et al 2014, Ghafran 2013, & Mwangi 2018).

However, majority of these studies are conducted in developed economies. Empirical studies on the impact of audit committee attributes on the quality of financial reporting in the Nigerian context are very scanty. The available studies were conducted in the banking industries and the findings of these studies were mixed findings. Also, most of the studies, comprising those in advanced economies, used proxies to measure the quality of financial reporting.It is as a result of the dearth of the literature on audit committee attributes in Nigeria, the need to address the inconsistency of findings in the literature and the importance of audit committee to the efficient operation of Nigerian deposit insurance companies that this study aimed at investigating the impact of audit committee attributes on the financial reporting quality of listed deposit insurance companies in Nigeria. In order to achieve this objective, the following questions are raised:

1.3 Objective of the Study

1. To establish the impact of audit committee meeting on financial reporting quality of deposit insurance companies?
2. To evaluate the impact of audit committee composition on financial reporting quality of deposit insurance companies?

3. To examine the impact of audit committee size on financial reporting quality of deposit insurance companies?
4. To assess the impact of audit committee diversity on financial reporting quality of deposit insurance companies?

1.4 Hypothesis Development

$H0_1$: Audit Committee composition has no impact on the financial reporting quality of listed insurance firms

$H0_2$: Audit Committee size has no impact on the financial reporting quality of listed insurance firms

$H0_3$: Audit Committee meeting has no impact on the financial reporting quality of listed insurance firms

$H0_4$: Audit Committee Diversity has no impact on the financial reporting quality of listed insurance firms

2.0 Literature Review

2.1 Financial Reporting Quality

Financial reporting is the critical and significant mechanism employed by the management to achieve their stewardship function to shareholders and providers of finance. According to Mwangi (2018) financial reporting is a two-party transaction in which the issuers of the financial reports provide the report to the users, who in turn use the reports with the expectation that they will help them enhance their financial decisions.

According to Barde (2009) as cited in Samaila (2014) financial reporting entails disseminating accounting information to furnish current and potential users to enable them assess financial position and cash flow potentials of the firm. The objective of financial reporting is to provide financial information on the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers.

As a result of the valuable role that financial reports play in facilitating decision making of users, it is important that the reports should possess some unique characteristics that make it qualitative. Ghafran (2013) maintained that qualitative financial reports are the fulcrum that support effective decision making.

Mwangi (2018) maintained that Financial reporting quality is a subtle concept in the corporate governance literature, hence, there is no consensus so far among researchers on how best to define and measure it. Robinson and Munter (2004) define financial reporting quality as the precision with which financial reporting conveys information about the firm's operations or compliance of accounting standards of a particular country, or the extent to which the published financial statements and related disclosures capture the essence of the operations and financial position of the reporting entity.

2.1.1 Relevance

Relevance is closely associated with the term'susefulnessand materiality. Relevance illustrates the capability of making decisions by users. When information in financial reports influences users in their economic decisions, it is sad that this information has the quality of relevance. Also, when this information assists users to evaluate, correct, and confirm current and past events, it is useful.

2.1.2 Reliability

Reliability is another critical factor of financial reporting quality. In financial reporting, information must have the quality of reliability in order to be useful. This quality is achieved when information, which users depend upon, is free from bias and material mistakes. Reliability is analyzed based on the qualities of faithful, verifiable, and neutral information (Cheung, Evans & Wright, 2010).

2.1.3 Comparability

Comparability is the concept of allowing users to compare financial statements to determine the financial position, cash flow, and performance of an entity. This comparison allows users compare across time and among other companies in the same period. As Cheung, Evans & Wright (2010) remarked, Comparability demands that identical events in the two situations will be reflected by identical accounting facts and figures, different events will be reflected by different accounting facts and figures in a way which quantitatively reflects those differences in a comparable and easily interpretable manner‖. (Cheung et al.2010).

2.1.4 Understandability

Understandability is one of the essential qualities of information in financial reports. Achieving the quality of understandability is through effective communication. Thus, the better the understanding of the information from users, the higher the quality that will be achieved (Cheung, Evans, & Wright, 2010). It is one of the enhancing qualitative characteristics that will increase when information is presented and classified clearly and sufficiently.

2.1.5 Timeliness

Timeliness is another enhancing qualitative characteristic. Timeliness illustrates that information must be available to decision makers before losing its powerful and good influences. When assessing the quality of reporting in an annual report, timeliness is evaluated using the period between the year-end and the issuing date of the auditor 's reportsthe period of days it took for the auditor to sign the report after the financial year end (Beest, Braam, &Boelens, 2009).

2.1.6 Faithful Representation

Faithful representation is the concept of reflecting and representing the real economic position of the financial information that has been reported. This concept has the value of explaining how well the obligations and economic resources, including transactions and events, are fully represented in the financial reporting. Moreover, this quality has neutralityas a sub notion which is about objectivity and balance.

2.2 Audit Committee

Audit committee is one of the board committees required for firms quoted on the floor of Nigerian stock exchange (NSE) in line with listing requirements of the Securities and Exchange Commission (SEC) and the national code of corporate governance (2018). The existence of a risk committee under the board of directors is also recommended by OECD (2014). The failure of Enron in 2001 initiated a significant amount of additional audit committee regulation both in the US and elsewhere. In the US, the most obvious response was the Sarbanes-Oxley Act (US House of Representatives, Committee on Financial Services 2002), which focused on 'the protection of investors and consequent restoration of confidence in the nation's financial markets' (Elson &Gyves 2003). A key mechanism provided by the Act in pursuit of this objective was the creation of invigorated audit committees (Ghafran, 2013).

2.3 Audit committee Attributes

TheLiterature on Board Committees formation has suggested that the effectiveness and proper functioning of a Committee essentially depends on Committee characteristics (Akhtaruddin&Haron, 2010). As such, the ability of an audit committee to effectively and secure transparent financial reports that allow stakeholders make reliable decisions is a function of the committees functional and demographic characteristics. These characteristics include Size, diversity, composition and meetings.

2.4 Empirical Review of Literature

This subsection provides a review of relevant related studies conducted in Nigeria and abroad that are pertinent to the research objectives envisaged in the study. This provides a guide for hypothesis development. The research hypotheses are developed in a null form.

According to DeZoortet al. (2002) an independent audit committee promotes the best interests of corporate stakeholders. Mwangi (2018) maintains that Independence has been accepted as a good practice in corporate governance, but it still remains one of the most common variables in the audit committee research literature. However, in many aspects the audit committee independence literature produced mixed results which failed to prove the fulfilment of expectation on independent directors safeguarding the interests of investors.

Beasley, Carcello, Hermanson & Neal (2000) found companies that committed fraud had less independent audit committees compared to their counterparts that did not commit fraud. Klein (2002) found that audit committee independence was negatively associated with abnormal accruals and that reductions in audit committee independence were associated with large increases in abnormal accruals.

On the other hand,Ogoro&Simiyu (2015) found a significant negative relationship between audit committee independence and committee effectiveness. These results are consistent with those of Plumlee and Yohn (2010) who did not find any association between reduced financial statement restatement and the existence of majority independent directors. These mixed findings mandate this paper to formulate the first hypothesis of the study.

The evidence provided by empirical studies is rather interesting on the association between audit committee size and financial reporting quality. Prior studies such as Hoitash and Hoitash (2009) Zaman *et al.* (2011) found a positive association between the audit committee size and financial reporting quality. On the other hand Yang and Krishnan (2005) and Kent *et al.* (2010) found a negative association between audit committee size and earnings management. Some studies such as that of O'Sullivan (1999); Abbott *et al. (*2004) and Baxter & Cotter (2009) show no significant association between audit committee size and financial reporting measures. As such, the study forms the second hypothesis as follows

Xieet al. (2003) found that increased audit committee activity (the number of committee meetings) is associated with reduced levels of earnings management and therefore engendering a high financial reporting quality. Bryan, Liv and Tiras (2004) posited that audit committees that meet regularly improve the transparency and openness of reported earnings and therefore improve earnings quality.

Huang et al. (2011) argues that women are more sensitive to establishing communications and helping others, hence, are less likely to do unethical actions such manipulation of earnings, timeliness lag in reporting financial information, withholding vital information and reporting over ambitious income. Huang and Thiruvadi, (2010) found that Audit committees that have at least one female director function differently than all male audit committees. On the basis of the above, the last hypothesis of the tudy is formulated as thus.

3.0 Methodology

This paper adopts an ex-post facto non-survey research design to investigate the impact of audit committee attributes on financial reporting quality of listed insurance firms in Nigeria. The period of study is 5 years from 2012-2016 based on the availability of audit committee information in the annual reports of the research working population. The population of the study consist of the totality of listed insurance firms in Nigeria. There are currently 30 insurance firms that are listed on the floor of the Nigerian stock exchange (NSE Fact book, 2016). The study places emphasis on panel historical data that will be sourced through the annual reports of companies.

FRQ = β0it + β1ACSit + β2ACCit + β3ACMit + β4ACDit + β5SIZEit t + εit

Where

FRQ **= Financial Reporting Quality**, ***β0it*****:** Regression intercept of Bank *I* in period *t*, ***β1-βn***: Regression coefficient of variables, ***ACS***= Audit committee size, ***ACC***= Audit committee Composition, ***ACM***= Audit committee meetings, ***ACD***= Audit committee Diversity, **ε** = error term

4.0 Results and Discussion

4.1 Descriptive Statistics

Table 1. Descriptive Statistics

Variable	Mean	Std Dev.	Min	Max
Frq	-1.82e+07	1.17e+08	-7.22e+08	2.42e+08
Acm	3.8	.971468	1	7
Acc	.5416923	.1106313	0.4	1
Acs	5.246154	1.015978	4	9
Acd	.2249231	.0986966	0	0.5
Size	7.375385	.7736522	6.6	9.87

Source: Computed By the Author Using (STATA Version, 13)

Table 4.1 above shows the result of summary descriptive statistics on the research variables. The summary statistics provides the pattern of data distribution of the research variables. It could be seen that FRQ has a mean of -1.82 indicating that the average financial reporting quality of listed insurance firms in Nigeria is negative. More so, the maximum FRQ is 2.82 while the minimum FRQ is -7.22. The average Audit committee meeting is 3 while the maximum meeting is 7. This implies that most listed insurance firms hold less than 4 statutory meetings a year. Audit committee composition has a mean of 0.54 with a maximum value of 1. Audit committee size and diversity on the other hand has a mean of 5.2 and 0.22 respectively.

4.2 Correlation Analysis

Table 2. Correlation Matrix

Variable	Frq	Acm	Acc	Acs	Acd	Size
Frq	1.0000					
Acm	0.0129	1.0000				
Acc	0.1788	-0.1073	1.0000			
Acs	0.0962	-0.0127	-0.0900	1.0000		
Size	-0.3699	-0.0320	0.3182	0.2464	-0.0847	1.0000

Source: Computed By the Author Using (STATA Version, 13)

Table 2 shows the result of pairwise correlation analysis between the research variables. The correlation analysis shows the Level of association between the research variables. The highest correlation is 0.3 between audit committee size and audit committee Composition. This indicates a positive and significant correlation. All the audit committee attributes have a positive correlation with FRQ with the exception of audit committee composition. The highest negative correlation is between audit committee size and audit committee diversity to the magnitude of 0.4190.

4.3 Normality test

Table 3: Skewness and Kurtosis Test for Normality

Variable	Pr(Skewness	Pr(Kurtosis	adj chi2(2)	Prob>chi2
Frq	0.0000	0.0000	64.05	0.0000
Acm	0.7224	0.0610	3.80	0.0000
Acc	0.0000	0.0010	21.83	0.0000
Acs	0.0128	0.0513	8.66	0.0131
Acd	0.6107	0.1246	2.73	0.2553
Size	0.0000	0.0001	33.49	0.0000

Source: Computed By the Author Using (STATA Version, 13)

Table 3 shows the test of normality conducted on the research variables. A value higher than 0.05 indicates that the data is insignificant and normally distributed. It could be inferred from the table that Financial reporting quality proxied by total accruals is abnormally distributed. LikewiseAuditcommittee size and size. On the other hand, audit committee diversity and meetings on other hand are insignificant implying that they are normally distributed.

4.4 Regression analysis

Table 4.4 OLS Regression ResultR-squared

Prob > F	= 0.0290
R-squared	= 0.18.62

FRQ	COEF	ROBUST STD ERR	T	P>|t|	95% CONF	INTERVAL
Acm	-2824807	1.45e+07	-0.19	0.846	-3.19e+07	2.62e+07
Acc	-7.55e+07	1.45e+07	-0.53	0.596	-3.59e+08	2.08e+08
Acs	2.75e+07	1.53e+07	1.80	0.078	-3139580	5.82e+07
acd	1.48e+08	1.64e+08	0.90	0.371	-1.81e+08	4.77e+08
Size	-5.98e+07	1.96e+07	0.90	0.003	-9.91e+07	-2.05e+07
Cons	2.97e+08	1.61e+08	1.84	0.070	-2.55e+07	6.19e+08

Source: Computed by the Author Using (STATA Version, 13)

The study employed a panel data. As such a panel regression based on fixed effect and random effect. Subsequently, a hausmann specification test was employed which give a result of 0.7079 prompting the researcher to employ the random effect results. The researcher then employed the langrangian multiplier which yielded a coefficient of 1.000 showing that OLS regression is more appropriate.

The regression model had a Prob >F of 0.0290 Indicating the goodness of fit of the model. The R-square of the model which is the coefficient of determination was 18.62% indicating that 18% of the variation in the model is caused by the explanatory variables.

Findings

Based on the review of literature and the analysis of data collected, the paper made the following findings:

1. Audit committee meeting has a negative and insignificant impact on financial reporting quality of listed insurance firms in Nigeria.
2. Audit committee composition has a negative and insignificant impact on financial reporting quality of listed insurance firms in Nigeria.
3. Audit committee size has a positive and insignificant impact on financial reporting quality of listed insurance firms in Nigeria
4. Audit committee diversity has a positive and insignificant impact on financial reporting quality of listed insurance firms in Nigeria.

5.0 Conclusions and Recommendations

This study explores the impact of audit committee attributes on the financial reporting quality of listed deposit insurance companies in Nigeria. The result of data analysis depicted that audit committee attributes have a mixed impact on financial reporting quality of listed insurance companies with unpredictable degree of significance. ACM (Audi committee meeting) has a negative and insignificant impact, whereas ACC (Audit committee composition) has a positive and insignificant impact. In the same vein, ACS (Audit committee size) has a positive and insignificant impact, while ACD (Audit committee diversity) has a positive and insignificant impact.

This paper suggests a significant implication to practitioners and policy makers. The paper recommends that policy makers and board of directors of insurance companies should take all the necessary measures that will increase the number of audit committee members as it has a positive impact on financial reporting quality. It's also suggested that, the Nigerian code of corporate governance (2018) should be amended to prescribe best practices for committee Size and committee diversity as they have a positive impact on financial reporting quality.

The paper also recommends that more studies should be conducted with longer time frame and in other sectors of the economy so as to validate the findings of this study and make contribution to the available body of knowledge.

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