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Audit Quality, Board Gender and Financial Risk Disclosure

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ABSTRACT

This study compares three models: Pooled OLS, fixed effect (FE) and panel EGLS random effects (RE) to examine the impact of corporate governance characteristics and IFRS7 financial instruments disclosure of 14 listed banks on the Nigerian stock exchange from 2008 to 2012. Empirical evidence suggests that Chi-square and F-statistics in both pooled OLS and FE models are significant thus, not suitable for appraising the model. When the Hausman test was applied to test for the effect, it is found that the null hypothesis of the correlated RE has a significant probability value of 1.0000. This result supports the conclusion that IFRS7 disclosure is related to board committee (BC), board accounting and board financial expertise and the type of gender in boards of the investigated banks in a random fashion. Based on this analysis, the RE model which report significant values on three of the independent variables (BC, 0.0014 and BE, 0.0000) at 1% and (GEN, 0.0056) at 10% level of significance is the model of preference. The findings are germane to executive management, stakeholders and policy makers in banks of developing and emerging markets that have embraced IFRS7 for their financial instruments disclosure. It is recommended that existing regulations in Nigeria on mandatory disclosure should be strengthened to compel listed banks in Nigeria to have at least 15% of women on board because of their positive contribution to disclosure requirements.

Keywords: Financial Risks, Audit Quality, Disclosure, Board Gender
JEL Classification: M4, M41, M42, D80

1. INTRODUCTION

The collapse of giant corporations such as WorldCom and Enron and the arraignment of their professional auditor's M/S Arthur Andersen as architects of the biggest audit fraud across the globe and the subsequent winding up of the audit firm as one of the then "Big 5" audit firm cast doubts in the auditing and accounting profession and the financial reports they produce (Adekunle and Asaolu, 2013). The companies' collapses were not only peculiar to developed countries as Nigeria a developing market without supportive legal and regulatory system of corporate governance also face some problems because of in adherence to good corporate governance practices (Adekunle and Asaolu, 2013; Mullineux, 2006). In the early nineties, the spread of financial institutions such as banks and finance houses led to cases of accounting and financial crisis which led to the collapse and eventual liquidation of 36 banks in 1997 (Amao and Amaeshi, 2008). Furthermore, the 2009 post-consolidation banking crises saw 10 Nigerian banks declared technically insolvent which led eight out of the 10 executive management team of banks to be sacked by the Central Bank of Nigeria (CBN) for cooking the books with the active connivance of their external auditors (Sunusi, 2010). The deficiency in corporate governance led to the loss of trust and confidence on the part of shareholders and other users in the banking sector leading to loss of engagement to thousands of employees hence confidence in the system (Adekunle and Asaolu, 2013).

These developments together with together with global economic and financial crisis led to increased attention on corporate governance and disclosure quality in the world economy (Al-Dhamari and Ismail, 2014; Adams and Mehran, 2003). Consequently, Nigeria has taken steps to align their corporate governance mechanism with international best practice by following IFRSs framework to strengthen stakeholder confidence (Gonzalez et al., 2014).

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Similarly, regulatory authorities such as the NSE, the Nigeria Deposit Insurance Corporation, the National Insurance Corporation of Nigeria and CBN, have since January 1, 2012 directed registered companies in Nigeria to adopt and disclose information using the principles based standards (Adegbite, 2012). Egedegbe (2009) observe that transparent and comparable information disclosure is the only way firm financials can give useful investment decisions to shareholders. Adegbite (2012) argue that transparency is the opium of good governance which thrives only with full disclosure of relevant information in financial statements.

Corporate scandals in Nigerian money market seems to suggest a missing link because often only the managers are seen to dominate the affairs of their respective companies. These clearly depict the wrong application of the provisions contained in the regulatory rules such as IFRS and CG that bestow responsibility of monitoring and control on the board of directors (Lorsch and MacIver, 2008). Report from World Bank (2006) reveals that disclosure by Nigerian banks was factually deficient, and the reliability of information extracted in the financial report attract many questions. Adekunle and Asaolu (2013) observe that some banks were caught falsifying figures to the CBN by misrepresenting their financials with the tacit approval of their external consultants. As a result, banks in Nigeria faces lots of challenges ranging from inadequate capital coming through foreign investments, firm legal and regulatory framework, corruption and civil unrest (IMF, 2013).

To boost disclosure practices of banks, the CBN in addition to the Securities and Exchange Commission (SEC) code of corporate governance came up with other measures aimed at forestalling re-occurrence of the crisis. The apex bank gave steps to include regular supervision, on-site inspection, given specific operational module for banks to adhere through circulars and issuance of new prudential guidelines (CBN, 2006).

Since disclosure is a precondition for transparency, figures in the annual reports serve as a medium through which banks communicate financial information on their activities to stakeholders, regulators, and employees (Sunusi, 2010; Zainon et al., 2014). According to the CBN (2010), mandatory disclosure is the requirement for financial institutions to prepare their accounting information and render authentic returns to regulatory authorities. This means that returns to the public should show true and fair view of financial position through adequate disclosure by banks. However, prior studies (World Bank, 2006; Wallace, 1988; Adeyemi, 2006; Nzekwe, 2009; Ofoegbu and Okoye, 2006; Umoren, 2009) discovered that the Nigerian financial reporting landscape falls short of expectations.

Previous studies (Adeyemi, 2006; Nzekwe, 2009; Okike, 2007; Ofoegbu and Okoye, 2006; Umoren, 2009; Wallace, 1988; World Bank, 2006) predominantly focused on non-financial enterprises. Only handful of papers (see Andres and Vallelado, 2008; Andres et al., 2012) studied the banking sector. Moreover, to our knowledge, only one paper studied the disclosure practices of Nigerian banks employing local accounting standards (Adekunle and Asaolu, 2013). The current calls for good governance and the role played by banks as catalysts for industrial expansion and need for IFRS disclosure uniformity makes this study of paramount importance (Levine, 2003). The CBN pronounce that weak corporate governance, late rendition of returns, and inadequate financial information disclosure were the root causes of all known bank collapses and eventual liquidation (CBN, 2006). Considering the alarming scenario, this assesses present disclosure practices of banks in Nigeria using IFRS7 financial instruments disclosure required items. The study's result is expected to climax the benefits of disclosure to bank management, present and prospective investors, regulators, and employees. This is important because there is no obvious warning signal used by regulators or bank management to monitor the health of Nigerian Banks (Okezie, 2010). Doguwa (1996) opined that bank inspection is a double "edged sword" where frequent may lead to waste of possessions due to oversight allowances and audit fees to CBN supervisory staff. However, none oversight supervision may result in eventual distress and liquidation.

2. LITERATURE REVIEW

Corporate governance is seen as the ways and manner in which shareholders not only get some value on their investments but also assured of their assets (Shleifer and Vishny, 1997). Agency theory argues that, if management is giving the benefit of operating independent of the board, they may make financing and investment decision, and pay out dividends that may be detrimental to shareholder's interests (Jensen and Meckling, 1976). Research on corporate governance documents several instances of mitigating conflict between managers and shareholders. These include monitoring and control by an active board of directors with the assistance of board committees (BC). Levine (2003) argues that corporate governance in banks play a special role as a result of the uniqueness of these enterprises regarding their regulatory complexities. Furthermore, Bhagat and Bolton (2008) views that good corporate governance leads to improved company performance. Hence, it is likely that good corporate governance framework in banks improves their financial and intermediating relationship with stakeholders (Wang, 2014).

The Basel 11 committee's recommendation on banking supervision (BCBS) brings more pressing need to study, understand and improve bank governance (Andres and Vallelado, 2008). Of specific significance in BCBS is an issue of the board directors and executive managers being the central hub in augmenting good corporate governance efficiency. Basel 11 opines that, corporate governance disclosure in financials is obligatory to forestall information asymmetry, gives a sound financial system which is a source of pride to all financial institutions. The governance offers a sound financial superstructure which is the foundation of a country's economic development (Andres and Vallelado, 2008). This is plausible because the nature bank products and their type of services make their corporate governance highly unique with the clear framework (Belkhir, 2009). Because they are highly leveraged, banks are saddled with triple roles of safe custodianship; deposit taking and payment guarantee to their customers who assist them to reduce systemic risks (Andres and Vallelado, 2008; Levine, 2003).

According to Kantudu (2006), disclosure is commitment device that is aimed at reducing a company's cost of capital with integrity and not self-serving. This author observes that banks have incentives to r manipulate or even withhold information in case of poor performance. To effectively reduce their cost of capital, banks have to disclose information in a non-selective and truthful manner (Verrecchia, 2001). Disclosure whether mandatory or voluntary is the readiness by firms to disclose information irrespective of its realization if they are accurately applied (Hodgdon et al., 2009). Prior studies analyze relationships between corporate governance attributes and disclosure ability of IAS/IFRS principles to provide useful information to investors for their business judgments (Andres and Vallelado, 2008; Belkhir, 2009; Kantudu 2006; Umoren, 2009). This study is significant because it focuses on financial instruments disclosure which deals with "risk factors" in the annual report (Hopwood, 2009).

2.1. IFRS 7 Financial Instruments Risk Disclosure

The IFRS7 framework was issued in August 2005 and became operational on January 1, 2007, after modification to incorporate financial instruments evaluation. Past empirical studies measured the level of compliance with mandatory disclosure requirements in annual reports (Hodgdon et al. 2009; Street and Gray, 2001). The most common approach is the Cooke's index method (Hodgdon et al. 2009). According to Cooke (1989), these method gives equal value to each disclose item. It thus, reduce subjectivity and bias (Owusu-Ansah and Yeoh, 2005). Hence, information disclosed information is scored "1" and if not, it is scored "0." This is also frequently denoted as a dichotomous method. The disclosure index for each company is relative, defined as the ratio of mandatory information provided by the bank in a specific year "t" to maximum likely score appropriate for the bank. This method is defined using the formula:

$$CS_J = \frac{T\sum_{i=1}^{m} d_i}{M = \sum_{i=1}^{n} d_i} \quad (1)$$

Where:

CS_J = Total compliance score for each company in which $0 \leq CS_j \leq 1$

T = Total number of items disclosed (d_i)

J = Name of the company under consideration

$M \leq n$; where m is the total number of applicable items the company j is to disclose

2.2. The Independent Variables

Earlier studies use different corporate governance proxies to document disclosure in the annual report (Hodgdon et al., 2009). This study uses corporate governance characteristics found to effect disclosure of banks in developed markets to test whether they equally can stimulate disclosure of banks in developing capital markets such as Nigeria (Andres and Vallelado, 2008; Andres et al., 2012).

2.2.1 Board size (BS)

According to Monks and Minow (2011), larger boards devote ample time and put in significant effort unlike small boards in overseeing and controlling management. Xie et al. (2003) argue that earnings management is unlikely on larger boards. Similarly, Yu (2008) reveal the inability of small boards to perceive earnings misstatement. Previous studies found a significant positive association between BS and information disclosure (Abdul Rahman and Ali, 2006; Andres and Vallelado, 2008). In contrast, Xie et al. (2003) found a negative relationship. Other studies also found the informational advantage of BS to institutional investors (Gompers et al., 2003; Dahlquist and Robertson, 2001). Based on the above discussion, the following hypothesis is proposed.

H_1: There is a significant positive relationship between BS and IFRS 7 disclosure.

2.2.2. BE

BE may be necessitated more by the idea to have women financial experts' in some committees of the board (Arute et al. 2015). According to Vafeas (1999), boards make use of standing committees in satisfying its responsibilities. The existence of specialized sub-committees such as audit, governance, and risk management and remuneration committee indicate greater persistence on the part of board directors. The Nigerian code of corporate governance vests the power of creating committees in the hands of board directors. However, three committees: Audit committee, risk management committee and governance and remuneration committee are expressly mentioned as paramount (SEC, 2011). Based on the above discussion, it is hypothesized that:

H_2: There is a significant positive relationship between audit committee and IFRS 7 disclosure.

2.2.3. Board meetings (BM)

BM frequency is a positive pointer of the efficiency of board directors. Users of financial report perceive the irregular meeting as lack of commitment by members to oversee reporting process. Xie et al. (2003) show that frequent meeting is associated with reduced levels of earning management. Bryan et al. (2004) argue that regular meetings improve transparency and improve earnings quality. Zhang et al. (2007) use some sessions, to measure financial reporting quality. Ruzaidah and Takiah (2004) find that good financial reporting company directors meet more frequently. In contrast, Vafeas (2005) found a negative relationship. Bedard et al. (2004) and Lin et al. (2006) find no association. Based on this discussion we hypothesized that:

H_3: There is a significant positive relationship between BM frequency and IFRS 7 disclosure.

2.2.4. Board expertise

Boards of directors according to dependency theory are vital sources of advice to executive management (Daily et al., 2003). Xie et al. (2003) argue that financial expertise is critical information disclosures of accounting misstatements. Bedard et al. (2004) observed that the presence of expertise in BE have a negative relationship with earnings management. Karamanou and Vafeas (2005) found the positive market reaction to the appointment of financial expertise in management earnings forecast disclosure. Based on the discussion, we propose the following hypothesis:

H_4: There is significant positive relationship between board expertise and IFRS 7 disclosure.

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2.2.5. Audit quality

The report of big 4 audit firm to shareholders and other interested parties has a significant influence on IFRS7 disclosure in annual reports (Ahmed and Nicholls, 1994; OECD, 2012). Big4 professional firms have more knowledge, requisite skills and expertise to detect fraudulent account manipulations and ensure accurate information disclosure than smaller firms. Big audit firms spend more to protect their reputation as consultants and quality auditors. Ahmed and Nicholls (1994) found audit quality to significantly influence information disclosure in financial statements. In contrast, Osma (2008) fail to find any significant impact on disclosure. Based on this discussion, we hypothesized that:

H_5: There is a significant positive relationship between audit quality and IFRS 7 disclosure.

2.2.6. Board gender

The banking industry in Nigeria follows the corporate governance regulation of developed economies on gender equality on boards. However, the consequences of the switch are still not clear (Abdullah et al., 2015). Studies argue that women directors are effective in attracting and retaining female employees and linking companies with resources (Hillman et al., 2007). Thiruvadi and Huang (2011) found the appointment of female directors in U.S. companies to enhance market returns compared to males. Other studies observed that females in emerging capital market boards negatively relays with earnings misstatement (Abdullah and Ku Ismail, 2013). On the contrary, Lee and James (2007) found a negative market response to the appointment of women director on board. In Nigeria, the SEC code of corporate governance is not specific on the appointment of women on board. Based on this argument, we propose the following hypothesis:

H_6: There is significant positive relationship between women on board and IFRS 7 disclosure.

3. EMPIRICAL METHODS

The population this study are the 19 banks currently quoted on the NSE out of which 14 actively trading with the full financial report for 5 years from 2008 to 2012 are drawn. Data are regressed using Eviews Version 9 to see the extent of disclosure using the unweighted scoring approach (Barako, 2007). This method is preferred because to its assumption that each disclosure item is equally important thus avoiding subjectivity and bias. It also provides a neutral evaluation of required items (Owusu-Ansah and Yeoh, 2005).

PricewaterhouseCoopers (PwC) argue that there is a total of 12 IFRS7 disclosure required items in a typical balance sheet (PwC, 2013). Nigeria adopted IFRS on January 1, 2012, but banks voluntarily comply with the principles-based standards before mandatory adoption because of its inherent benefits (Sunusi, 2010). The 12 disclosure items include interest rate risks, assets, and liability (group), income and expenses, investment and securities, asset and liability (maturity), off-balance sheet items, and asset and liability (concentration). Others are risks (general), loan and advances, other activities, collateral securities, and related party transactions.

3.1. Model Specification and Variable Measurements

The model in this study is based on proxies specified for. IFRS7 disclosure which is the dependent variable and the independent variables which are BS, board expertise BE, BC, BM and audit firm size (AFS) while the control variable is board gender (GEN) (Table 1).

$$\text{IFRS } 7_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 BE_{it} + \beta_3 BC_{it} + \beta_4 BM_{it} + \beta_5 AFS_{it} + \beta_6 GEN_{it} + \varepsilon_{it} \quad (2)$$

4. EMPIRICAL ANALYSIS

Having looked at the research methodology, model specification and measurements of variables, the paper proceed with the regression analysis in Section 4. 1.

4.1. Regression Analysis

This study runs three distinct models {pooled OLS [OLS], fixed effect [FE] and random effect [RE]} to compare and select the model of best fit which explains the relationship between the independent variables and dependent variables. The selection criteria use the redundant fixed effects to test the null hypothesis of no time-specific effect of estimates. Abu et al. (2013) argue that if the test shows the presence of effects, it is likely that OLS estimator is not a good estimator of choice in the cross section over the period. Moreover, when the Hausman test was applied, it found that the hypothesis favors the RE estimates are more effect and preferable to FE estimates. The rule is that, if the Chi-square or F-Statistic value is significant, this means that the FE model is appropriate and can be reported otherwise, the RE model should be explored.

Table 2 shows the results of the OLS estimations. This model is not consistent as it does not consider the constant and unobservable heterogeneity of banks in the sample and endogeneity of the independent variables. The results show a non-linear relationship between BS and disclosure and between BC and disclosure which is inconsistent with our hypothesis. Thus, bank disclosure decreases as the number of directors and BC increases. This result goes for small boards as oppose to larger boards (Yermack, 1996). The OLS result in model one does not consider the likelihood of correlation among the explanatory variables (Cameron and Trivedi, 1980). Hence, Model 2 reports fixed effect model of the independent variables. In this Table 2, four IVs are found to be statistically significant at 10% level. However, the Prob (F-statistics) is highly significant with a value of 0.0000. Applying the redundant effect assumption, it means that this model is not appropriate. Hence, the study goes for the RE model.

Table 2 also shows the RE test of the independent variables. In this model, three independent variables are found to be statistically significant at 1% level. Similarly, the Prob (F-statistics is significant with a value of 0.00000. Applying redundant effect assumption almost similar result is obtained with those of fixed effect model. We further subject this result to an additional test known as the Hausman test to choose between the preferred model between fixed and RE models. The result of the correlated RE model gives a P value or Chi-square value of 1.0000 indicating that the RE is an appropriate model. The result shows no presence of

Table 1: Variable measurement

Variable	Measurement
IFRS 7 disclosure	Total disclosure index score
BS	Total number of directors on board
BE	Number of trustees with accounting/financial management
BC	Number of committees of the board
BM	Number of board meetings per annum
AFS	Dummy "1" if audited by a Big 4 (Deloitte, PwC, KPMG, Ernst and young) or "0" otherwise
Board gender	Number of women on board

BS: Board size, BE: Board expertise, BC: Board committees, BM: Board meetings, AFS: Audit firm size

Table 2: Model results

Variable	Model 1 (OLS)	Model 2 (FE)	Model 3 (RE)
C	0.0000	0.0000	0.0000
BS	0.0025***	0.9566	0.3450
BC	0.0031***	0.0792*	0.0014***
BM	0.2089	0.3352	0.6093
BE	0.0000***	0.0001***	0.0000***
AFS	0.0117**	0.0907*	0.8630
GEN	0.0005***	0.0052***	0.0056***
R^2	0.63	0.85	0.63
Adjusted R^2	0.59	0.79	0.59
Durbin-Watson stat	1.61	1.98	1.61
Prob (F-statistic)		0.00	
Hausman-Chsq			1.00
Prob (f)		0.00	

Source: Authors' computation, BS: Board size, BE: Board expertise, BC: Board committees, BM: Board meetings, AFS: Audit firm size, GEN: Gender, ***, **, * indicate that the parameter estimates is statistically significant at 1%, 5% and 10%, respectively

effects in the estimated model. This result confirms the superiority of the RE model over and above the OLS and fixed effect models.

5. EMPIRICAL FINDINGS

This study's results show no significant relations between BS and disclosure in reflecting higher accounting quality of IFRS7 financial instruments disclosure for banks that comply with the disclosure requirements (Barth et al., 2008). We argue that the association between the BS and disclosure is contingent upon the collaborative benefit of director's skills, expertise and cost arising out of management decision as the number of director's changes. As the coefficient of BS is negative, and the probability is significantly positive, it appears that disclosure takes on a V shape as BS becomes so large (Street and Grey, 2001). The same argument is adduced for BC (Arute et al., 2015).

The findings of the study indicate that high-level disclosures lead to the more transparent financial statement that is useful to investors and other users (Pownall and Schipper, 1999). Our finding shows that IFRS7 financial instruments disclosure and the presence of women on board in banks of developing economies could constrain some potentially harmful managerial actions that are shrouded in secrecy concerning accounting policies and practices being followed by management (Hope, 2003a). Thus, banks wishing to signal transparency and accountability have the chance to communicate their disclosure practices under IFRS7 financial instruments disclosure and the presence of more women on board (Hope, 2003a).

Our regression analysis suggests that female directors create the economic value of information requirements to shareholders (Abdullah et al., 2015). The positive results are a signal of the benefits which accrued to females on boards of banks. More than half of the banks studied did not have any women on board, and only one-third had a woman (Abdullah et al., 2015). The presence of women on board may also contribute to the level of significance obtained on the expertise of board members consistent with findings in other studies (Abdullah et al., 2015). Audit quality proxy by big 4 audit firms has a significant positive relationship with disclosure as expected. This may be due to their active role as effective monitors with vast experience in international auditing and the need to protect their name, reputation and to attract more clientele (Ahmed and Nicholls, 1994).

6. CONCLUSIONS

This study empirically tests the three models of data analysis to determine the relationships between the dependent and the independent variables. The result shed some light as regard the implication of using only a single model to make generalizations. Specifically, we find an inverse relationship between some of the corporate governance variables and the disclosure pattern of banks in Nigeria concerning information asymmetry reduction. We concluded that only the Houseman fixed effect specification test reports an insignificant probability value confirming the relationship between BC, board accounting and financial expertise and board gender with IFRS 7 disclosure by Nigerian listed banks. Based on our empirical findings, we conclude that corporate governance and disclosure regulation are the answer in today's globalized, complex banking industry. We further conclude based on existing evidence that the challenges in governance regulation of banks are peculiar to that industry which may not be relevant to the corporate governance of other companies or institutions. For instance, some corporate governance mechanisms are weak which resulted in information asymmetry to be more severe. This may impede the monitoring of managers which may lead to the advent of new conflicts of interest between the regulator and stakeholders. Bank board play a significant role in monitoring managers or advising them on design and implementation of strategies. These also confirm our hypothesis that certain characteristics of corporate governance such as board accounting/financial expertise and board gender reflect the motivation and monitoring abilities of boards in their supervisory and advisory duties. We, therefore, recommend that regulatory authorities urgently look into the possibility of the regulatory amendment in line with developed economies on gender diversity to provide for at least 15% of mandatory women participation in corporate boards given their significant positive contributions.

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