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Board Attributes and Financial Reporting Quality of Listed Deposit Money Banks (DMBs) in Nigeria

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Abstract

This study examines the impact of board attributes on the financial reporting quality of listed Deposit Money Banks (DMBs) in Nigeria. The study utilized documentary data collected from annual report and accounts of the sampled Deposit Money Banks (DMBs) for the periods 2007 to 2018. The study used board size and board independence as proxies for board attributes, while discretionary accruals was used to measure financial reporting quality. Data was analyzed by means of descriptive statistics and regression. The study revealed that board size and board independence has positive but not significant effects on the quality of financial reports. Thus the study concluded that board attributes have positive and insignificant effects on the financial reporting quality of DMBs in Nigeria. The study therefore, recommended that in order for the Securities and Exchange Commission (SEC) and Central Bank of Nigeria (CBN) to improve the quality of financial reporting in DMBs in Nigeria, good corporate governance (CG) practices must be implemented, this should includes improving board attributes, especially the functional background of the directors and also the appointment of independent directors on the board should be based on the their reputation and accounting knowledge rather than emphasizing on the proportion to total number of directors on the board. In order to have proper monitoring by independent directors, SEC should also require additional disclosure of financial or personal ties between directors (or the organizations they work for) and the company or its CEO. By so doing, they will be more completely independent.

Keywords

Board Attributes, Board Independence, Board Size, Financial Reporting Quality, Deposit Money Banks

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1. Introduction

The beginning of the twenty-first century started with some scandals in important world companies, like Enron, WorldCom and Xerox in the United States, Parmalat in Italy and many other big companies around the world confirmed that there was opaqueness in financial reporting that had hitherto not been penetrated, among many other situations. In general, the stock prices of these companies were very high and suddenly they have fallen down. The reasons behind these bankruptcies are associated with fraud that derived from the manipulation of accounting statements. These situations impose some questions like why the board of directors did not do anything [1].

Financial reporting is the means of communicating information on the activities of the company to the users of accounting information; and the quality of financial reporting is a function of the quality of accounting standards and the corresponding regulatory enforcement of the standards [2]. Financial reporting quality can be influenced by three variables namely: standard setters' decision; accounting method used by management; and management judgment and estimates in applying the selected substitutes [2]. Therefore, enforcement is an important mechanism of enhancing financial reporting

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quality whose absence will make the best accounting standards incapable of providing credible and reliable accounting information to various users [3].

The introduction of code of corporate governance (CG) (2003) in Nigeria is expected to mitigate corporate scandals and other associated problems. However, corporate failures and scandals are increasing. For example the cases of Wema Bank Plc. and Spring Bank Plc. in Nigeria (the Case of Mismanagement of Capital) suffered from the poor corporate governance practice [4]. A committee was inaugurated to review the code of CG (2003) for further improvement. After the review, some new issues were raised; for example, differentiating between independent director and executive director, training of directors, evaluations of the board performance by an independent outside consultant, separation of functions of chairperson of the board and chief executive officer among others. Furthermore, the new amendments fixed in the new code of CG (2011) to improve the quality of reported financial information. Due to the short-comings and inconsistencies of the code of CG (2011), for example, the code of CG (2011) did not consider unquoted and private firms. Another similar code was launched in 2013 by the Financial Reporting Council of Nigeria (FRCN) which harmonized all CG codes in Nigeria. This new code of CG (2013) is applicable to all firms whether quoted or unquoted, private or public. The code of CG (2013) was introduced to strengthen the quality of financial report and previous' codes of CG shortcomings.

The weakness of CG is perhaps the most important factor blamed for the corporate failure consequences from the economics and corporate crises. There is much that can be done to improve the integrity of financial reporting through greater accountability, the restoration of resources devoted to audit function, and better CG policies. It has been established that investors require audited financial report of companies for them to be able to pass their judgment. There were quite a number of such audited financial reports that were totally misleading. Inadequate or even misleading financial statement is almost always involved in virtually any corporate failure. The impact of CG on the quality of financial reporting in the consumer goods industry in Nigeria was examined [5]. Also, the influence of CG mechanism on firms' performance in Nigeria was investigated [6]. The afore-mentioned studies did not consider board attributes in their studies. Thus, this study therefore, investigated the effect of board attributes on financial reporting quality of Deposit Money Banks (DMBs) in Nigeria.

The study is therefore divided into five sections. Section one is the introduction, section two deals with the review of related literature, section three captures the methodology of the study, section four deals with the results and discussions while section five deals on conclusion and recommendations.

2. Literature Review

This section review relevant and related literature on board attributes and financial reporting quality.

2.1. The Concept of Board Attributes

Board attributes have been defined by many authors in different ways. The main function of the board is to set company's goals and ensure that set objectives are achieved, i.e. to make sure that human and financial resources are properly utilized toward achieving the overall strategic goals of the firm effectively [7]. The structure and composition of the board of directors should have diversity of directors. The number of the directors in the board should not be less than five directors and the majority should be non-executive with at least one independent director. Some of the board characteristics considered is board size and board independence. Board attributes can be seen as a dynamic process which involves a strategy that leads to policy making and planning, monitoring and supervising executive performance, providing accountability which forms the basis for reviewing strategy [8].

The principles of agency theory imply that agents (that is management) may be reluctant to impose strict and binding mechanisms of corporate governance that may limit the agents' ability to act in their own best interest. As a result, there arises a need for stakeholders to have an entity on the inside to play a role in governing and monitoring the firm's actions on the stakeholder's behalf that is, the board of directors [9]. Prior research established that boards face a dual set of responsibilities which can, and do, compete with one another to serve as the board's primary area of focus [10, 11]. In particular, companies elect a board in order to provide operating guidance to the firm's management team and/or serve as a monitoring mechanism over firm management [10-12]. Boards focused on either monitoring management or providing guidance to management. Boards do not treat these two objectives as being mutually exclusive [11], nor is there a "one-size fits all" model applicable to all boards [13, 14]. As a result, there is clearly overlap in the characteristics of importance to both the monitoring and the guidance functions. Thus, the same basic characteristics are of significant importance regardless of the board's primary focus [11, 14, 15].

Board attributes is an aspect of CG and is generally regarded as a driving force in CG. It also determined the efficiency and otherwise of CG which is identified as a major factor responsible for corporate distress among companies in Nigeria. The role of the board in monitoring and strategic decision has gained wider attention in the developed nations

but remained neglected in the developing nations as a result of the developing nations placing little importance to the role of the corporate board in relation to monitoring and strategic decision especially financing decision.

2.2. Board Size

Determining the ideal board size for organizations is very important because the number and quality of directors in a firm determines and influences the board functioning and hence corporate performance. Board size refers to the total number of directors on the board of any corporate organization [16]. Board size is the total number of directors that a firm has in its board structure [17]. Large boards were supported on the ground that they would provide greater monitoring and advice [14, 18, 19]. Going by this, this study consider that firms benefit in having more directors for monitoring, resource provision and also to provide representation for different stakeholders in the firm.

2.3. Board Composition (Board Independence)

Board composition mean different thing to different authors. The composition may be easily differentiated into inside directors, affiliated directors and outside directors [9]. This distinction is derived from the extent of their participation in firm management. Inside directors are those directors that are also managers and/or current officers in the firm while outside directors are non-manager directors. Among the outside directors (also known as external or non-executive directors), there are directors who are affiliated, and others that are independent. Affiliated directors are non-employee directors with personal or business relationship with the company while independent directors are those that have neither personal nor business relationships with the company. Board composition involves both the size (number of directors that serve on the board) and director types (widely recognized dichotomy between inside and outside directors) [20].

Furthermore, board composition refers to the distinction between inside and outside directors, and this is traditionally measured as the percentage of outside directors on the board [21]. Although inside and outside directors have their respective merits and demerits, most authors favour boards that are dominated by outside directors [22]. Board composition is the total number of directors brought from outside the company to sit on the board divided by the board size in a given period [17]. However, some stream of researchers refer to board composition as the number of non-executive directors on the board of a company [23-26]. In essence, board independence means majority of the board of directors are non-executive.

2.4. Financial Reporting Quality

Reporting is one way of demonstrating the accountability and transparency of a company. The annual report is the means of communication between companies and their stakeholders particularly on current activities of the companies to enable them make useful decisions. 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 [27]. The primary objective of financial reporting is to provide high-quality financial reporting information concerning economic entities, primarily financial in nature, useful for economic decision making [28]. Providing high quality financial reporting information is important because it will positively influence capital providers and other stakeholders in making investment, credit, and similar resource allocation decisions enhancing overall market efficiency [28]. Although both the FASB and IASB stress the importance of high-quality financial reports, one of the key problems found in prior literature is how to operationalize and measure this quality. Because of its context-specificity, an empirical assessment of financial reporting quality inevitably includes preferences among a myriad of constituents [29, 30].

Good quality financial reporting provides shareholders and other stakeholders in understanding and absorbing the information through financial statements and hence lowering the information asymmetry. Management could disguise the quality of financial reporting more difficult to be understood by investors and other stakeholders, so that they cannot assess future cash flow implications of accounting transactions. Some scholars found that increase in financial reporting quality can have an important economic implication such as increase investment efficiency [31, 32]. Thus, higher financial reporting quality will decrease information asymmetry, which can consequently enable investors to improve their ability to monitor managerial investment activities.

2.5. Empirical Review on Board Attributes and Financial Reporting Quality

The board is the firm's highest-level control mechanism, with ultimate responsibility of overseeing the activities of the firm [33]. The literature on restatement, fraudulent financial statements, and financial reporting quality in general indicates that the composition and characteristics of the board influence its effectiveness in this regard. Board size is another determinant of financial reporting quality, the larger the board the more complex it will be as regard decision making. The size of the board of directors is often used by some scholars to measure the quality of CG. In addition, it was suggest that larger boards are able to commit more time and effort to monitor management [34]. Another board

attribute is board independence which means majority of the board of directors are non-executive. The board must comprise executive and non-executive directors [7]. For any board to be independent, majority of the directors must be non-executive or independent directors. One of the most important factors influencing the integrity of the financial accounting process involves board of directors whose responsibility is to provide independent oversight of management performance and to hold management accountable to shareholders for their actions.

The impact of CG attributes on financial reporting quality in Iran was investigated using multiple regression analysis and the findings showed that there is no relationship between CG mechanisms (board size, board independence, ownership concentration, institutional ownership) and financial reporting quality [35]. The effect of board composition on the informativeness and quality of annual earnings was investigated [36]. The research covers a period of 5 years (2000-2004). The result revealed that the informativeness of annual accounting earnings is positively related to the fraction of outside directors serving on the board but not related to board size. The relationship between financial reporting quality and CG of Portuguese firms was investigated using multivariate regression model [37]. The research evidence showed that board composition changes and its degree of independence do not produce any influence on the quality of the accounting information in Portugal. Similarly, a study using 12 listed insurance companies for the period of 2004 to 2009 found a negative and significant relationship between board composition and firm performance measured by Tobin's Q and ROE [38]. This indicate that benefit of board independence, objectivity and experience expected from the representation of outside directors to influence board strategic decision appears to hold back managerial initiative through too much monitoring.

Furthermore, the impact of monitoring characteristics on financial reporting quality of the Nigerian listed oil marketing firms for the period 2000 to 2011 was examined [39]. Financial reporting quality is represented with the qualitative characteristics of financial statement. Multiple regression was used to analyzed the data and it was discovered that power separation, independent directors, managerial shareholdings and independent audit committee are all significant implying monitoring characteristics is influencing financial reporting quality of quoted oil marketing firms in Nigeria. In the same vein, the correlation between specific corporate governance attributes and the quality of financial reporting process of 50 non-financial Romanian entities listed on the Bucharest Stock Exchange for the period 2011-2013 was investigated [40]. The main finding of this study revealed that in the case of Romanian listed entities, the Board independence (BI) makes its unique contribution in influencing the quality of the financial reporting process.

More so, the impact of corporate governance on financial reporting quality of 40 companies listed on the Nigeria Stock Exchange (NSE) from 2006 to 2015 was investigated [41]. Board characteristics, audit committees, board independence, board size and growth were used as corporate governance variables. The results of the multiple regression analysis revealed that corporate governance improves the financial reporting quality in Nigeria. In contrast, the impact of corporate governance on financial reporting quality of 15 quoted companies quoted on the Nigerian Stock Exchange market under the consumer goods sector in Nigeria for the period 2012-2016 was investigated [42]. Corporate governance was proxied by board size and audit committee independence and financial reporting quality was represented by audit delay. In testing the research hypothesis, the study adopted simple regression technique and the findings revealed that audit committee independence does not exert significant effect on audit delay of corporate firms. Also, board size has a significant negative relationship with audit delay of corporate firms in Nigeria. In addition, the impact of board characteristics on financial reporting quality of 37 listed manufacturing firms on the Nigerian Stock Exchange from 2013-2017 was investigated [43]. Descriptive and inferential statistics were employed to summarize the data and to draw inference on the population studied and the Generalized Linear Model Regression in testing the hypotheses stated. Findings revealed that board expertise was statistically significant and positively related to financial reporting quality at 5% level of significance, while board independence and board diversity was found to be insignificantly related to financial reporting quality at 5% level of significance.

2.6. Theoretical Framework

In investigating the effect of board attributes on the financial reporting quality of DMBs in Nigeria, two theories are found relevant. These are the agency and stakeholder theories.

2.6.1. Agency Theory

Agency theory having its roots in economic theory was developed by [44]. Agency theory is simply the relationship between the principal and the agent such as shareholders and the company executives or managers. In the agency theory, shareholders who are the owners or principals of the company, hires the gents to perform work. Principals delegate the running of business to the directors or managers, who are the shareholder's agents. The agency theory states that shareholders expect the agents to act and make decisions in the interest of the

principal. On the contrary, the agent may not necessarily make decisions in the best interests of the principals [44]. According to the agency theory, the basic agency problem in modern firms is primarily due to the separation of ownership from management. The roles of board can be explained within the framework of agency theory whereby the contract between principal and agent allows the agent to conduct the business on behalf of the principal [33]. Agency theory suggests that shareholders require protection because management (agents) may not always act in the interests of the absentee owners (principals) [33, 44].

2.6.2. Stakeholder Theory

Stakeholder theory suggest that managers in organizations have a network of relationships to serve this include the suppliers, employees and business partners. And it was argued that this group of network is important other than owner-manager-employee relationship as in agency theory [45]. The theory argued that the firm is a social person and therefore, is responsible and accountable not only to the shareholders but to numerous other stakeholders. The management of companies has the responsibility of furnishing report that satisfies not only the interest of the shareholders but also employees, suppliers, government and the general public.

Considering the objective of the study which is to examine the effect of board attribute on the financial reporting quality of DMBs, the agency theory, as well as, the stakeholder theory best explained the study.

3. Methodology

The population of this study consists of 15 listed DMBs on the floor of the Nigeria Stock Exchange-NSE during the period of 2007-2017. However, due to availability of data, 6 DMBs were selected for the study using purposive sampling technique which represents 40% of the population. Secondary data were collected from the annual report and accounts of the sampled DMBs for various years. Descriptive research design was used for this study and information on board attributes and financial reporting quality can best be obtained by examining the annual report and accounts of the sampled DMBs. There are two sets of variables covered by this study. These are the dependent and the explanatory variables. The dependent variable is the financial reporting quality measured using discretionary accruals [46]. This uses the standard deviation of the residuals or error term as a measure of financial reporting quality and the large value of the residual implies a considerable level of discretionary accrual thereby resulting to a poor quality financial reporting [35, 47].

The model is given as:

$$ACC_t = \beta_O + \frac{\beta_1 OCF}{TA_{t-1}} + \frac{\beta_2 OCF_t}{TA_{t-1}} + \frac{\beta_3 OCF_{t+1}}{TA_{t-1}} + \frac{\beta_4 \Delta REV}{TA_{t-1}} + \frac{\beta_5 PPE_t}{TA_{t-1}} + U_t$$

Where:

ACC_t = Total Current Accrual

OCF_t = Operating Cash Flows of the Current Period

OCF_{t-1} = Operating Cash Flows of the Previous Period

OCF_{t+1} = Operating Cash Flows of the Next Period

TA_{t-1} = Total Assets of the Previous Period

ΔREV = Charge in Revenue

PPE_t = Level of Property, Plant and Equipment

μ_t = Stochastic error term

All the variables are scaled by lagged total asset.

The independent variable is board attributes represented by board size and board independence. Board size is measured by the number of directors on the board, while board independence is measured by dividing the number of outside or non-executive directors by the aggregate number of directors on the board [47]. The control variables included in the model are size and age. Size is measured by taking the natural log of total assets [2, 47]. Age was proxied as the number of years passed since listed [2, 47].

Thus, the model based on the variable of the study is stated as follows:

$$FRQ_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 BI_{it} + \beta_3 FSIZE_{it} + \beta_4 AGE_{it} + \varepsilon_{it}$$

Where:

FRQ = Financial reporting quality

BS = Board size

BI = Board independence

$FSIZE$ = Size of the company

AGE = Age of the company

β_0 = Parameters to be estimated (is the average amount the dependent variable increases when the independent increases by one unit, other independents variables held constant).

e_{it} = Error term assumed to satisfy the standard OLS assumption.

β_1-β_4 = Partial derivatives or the gradient of the independent variables.

4. Results and Discussions

Table 1. Descriptive Statistics.

	Obs	Mean	Std. Dev.	Min	Max
Frq	60	0.6331667	0.0232041	0.5763571	0.6850644
bs	60	16.18333	2.746287	12	21
bi	60	0.6331667	0.0552802	0.53	0.82
age	60	21.8333	15.00753	3.00	47
fsize	60	9.34709	0.2475629	8.404763	9.853737

Source: STATA Output 14.0

Table 1 presents the descriptive statistics of the data for the variables of the study. The table showed that the sampled DMBs during the period has an average financial reporting quality (frq) of 63.32% with standard deviation of 2.32% with minimum value of 57.64% and maximum value of 68.51%. The standard deviation of 2.32% implies that the data do not vary as it is lower than the mean value. Table 1 also showed that the average board size (BS) of the sampled DMBs is 16, with standard deviation of 3, and the minimum and maximum board size of 12 and 21 members respectively. The standard deviation of 3 implies that there is low variation because it is lower than the mean value. Furthermore, Table 1 showed that on average 63% of the composition of the board of the sampled DMBs are outside/independent directors (BI) during the period of the study, from the mean value of 0.6331667 with standard deviation of 0.0552802. The minimum and maximum board independence is 53% and 82% respectively. This implies DMBs comply with the requirement of the CBN code of CG during the period under review, because the results indicated that outside/independent directors are more than the executive/inside directors on the boards. It is also evidenced from Table 1 that age has a mean value of 22 years and a minimum and maximum of 3 and 47 years respectively. This means that all the sampled companies were listed before the 2006 financial year. Finally, firm size, measured by the natural logarithm of total assets has a mean of 9.34709, but the standard deviation of 0.2475629 suggests a low level of dispersion in size during the study period because it is lower than the mean.

Table 2. Regression Result.

Frq	Coef.	Std. Err.	t	P>|z|
cons	0.5697955	0.0986792	5.77 0.000	
bs	0.0005521	0.0013845	0.40	0.692
bi	0.0864047	0.0596406	1.45	0.153
age	0.0006209	0.00022 24	2.79	0.007
fsize	-0.0014794	0.0104899	-0.14	0.888
F value		6.78		
Prob > F		0.0002		
R-squared		0.3304		
Adj R-squared		0.2817		

Source: STATA Output 14.0

Multiple regressions have been used to test the relationship between board attribute and financial reporting quality in Nigeria. Table 2 showed the coefficient of determination (R^2) of 0.3304 which signifies that 33% of total variation in financial reporting quality of DMBs in Nigeria is caused by board size, board independence, age of banks and the size of the banks. Similarly, the result of the F- statistics value of 6.78 and its corresponding P-value of 0.0002 implies that the model is fit. Table 2 also showed that board size has a positive and insignificant effect on the financial reporting quality of sampled DMBs in Nigeria this evidenced by the coefficient of 0.0005521 with t-value of 0.40 which is statistically not significant at all levels of significance (P-value of 0.692). This suggests that, as board size increases by 1 member, financial reporting quality decrease by 0.05521%, but the result is statistically not significant at all levels. The study therefore, inferred that size of the board of banks in Nigeria has no significant influenced on financial reporting quality during the period under review. The finding is however consistent with prior studies [35, 47].

The results from Table 2 also showed that, board independence has a positive effect on the financial reporting quality of the DMBs in Nigeria, from the coefficient of 0.0864047 with t value of 1.45 which is not statistically significant at all levels of significance (P-value of 0. 0.153). This suggests that, the independent directors have the ability to monitor and control the excesses of the executive directors, thereby protecting and defending the interests of the shareholders and other stakeholders. In addition, this study finds that the increase in the percentage of non-executive directors on the board has a positive effect in determining the quality of earnings of DMBs in Nigeria. The finding is in line with previous [36, 47].

Furthermore, Table 2 showed that age has a positive and significant effect on the quality of financial reporting at 1% with positive coefficient. This confirms that as a reputation variable, the older the firm, the greater the shareholders' confidence in its strength, growth and survival. In addition, size of the firm measured by the natural log of the total asset expectedly has negative relationship and is statistically not significant at all the level of significance. This means that larger firms produce more reliable and qualitative information in their financial statements /higher quality financial report than the smaller ones. This implies that an increase in the size of the firm by one unit, other variables remaining constant, will decrease the financial reporting quality. The implication of this findings are that, if banks regulators in Nigeria do not improve on the attributes of the board of DMBs in Nigeria, there could be problem that may likely be thread to the financial reporting quality of the banks.

5. Conclusion and Recommendations

This study investigated the effect of the board of directors' attributes (size, and independent) on the financial reporting quality of deposit money banks in Nigeria during the period 2006-2017. Based on the results obtain from the analysis the study concludes that there is positive and not significant statistical relationship between the attributes of the boards and financial reporting quality after controlling for the firm size and the age of the firm. Specifically, the study concludes that both board size and board independence has positive and insignificant impact on the financial reporting quality during the study period. From the findings and conclusion, the study recommends that in order for the SEC and CBN to improve quality of financial report in deposit money banks, good corporate governance practices must be implemented, this should includes improving board attributes, especially the functional background of the directors. On the hand the study recommends that the CBN should ensure or put in place robust supervisory and regulatory policies that could directly affect financial reporting quality of the banks and also the directors on the board of DMBs in Nigeria. Moreover, the appointment of independent directors on the board should be based on their reputation and accounting knowledge rather than emphasizing on the proportion to total number of directors on the board. In order to have proper monitoring by independent directors, SEC should also require additional disclosure of financial or personal ties between directors (or the organizations they work for) and the company or its CEO. By so doing, they will be more completely independent. This financial reporting system not only improve the quality of financial information but also provide a conducive environment to its shareholders by increasing their confidence and thus leads to more informed decisions.

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