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Audit Committee Characteristics and Fair Value Disclosure of Listed Deposit Money Banks in Nigeria

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Abstract

The audit committee (AC) is considered an important subcommittee of the board responsible for ensuring quality financial reporting and compliance with regulatory provisions. This paper evaluates the relationship between AC attributes and fair value disclosure of listed deposit money banks in Nigeria. The study used data obtained from 2013 to 2017. Eleven (11) banks were selected as a sample from the population. In analyzing the data, the study employed panel data analysis. The random-effect model was used to evaluate the effect of the independent variables on fair value disclosure as indicated by the Hausman test. The results revealed a significant relationship between AC financial expertise and fair value disclosure while no significant relationship between other independent variables was revealed. The study recommends that the AC of listed deposit money banks in Nigeria should consist of a larger number of members with financial knowledge and experience for it to perform optimally.

Keywords: Audit Committee, Fair Value Disclosure and Financial Reporting Quality.

1.0 Introduction

Financial reporting communicates aggregate methods for estimating assets, revenues, liabilities, and expenses. One of the most difficult aspects of financial report preparation is deciding which method of estimation to utilize (Aliyu, 2019). The International Accounting Standard Board (IASB) and the Financial Accounting Standard Board (FASB) frameworks, which are heavily reliant on estimates, guide fair value disclosure (IFRS 13) on asset and liability measures. These estimations are based on the market model approach managerial assumptions and are used in the reporting process. As a result, the measurement of fair value might be exploited. Fair value measurement, according to Daifei et al. (2015), allows for creative manipulation of data, such as increased asset valuations, undervaluing liabilities, and provision for losses.

Corporate executives are in charge of the firm's activities, which includes wealth creation and, most crucially, the drafting of financial reports. The board's structure is critical for ensuring that investors receive the desired value, which has an impact on the objective application of the fair value measurement approach (Ian, 2010). Corporate governance is a set of financial and legal tools aimed at reducing conflicts of interest among top executives and other stakeholders (Vafeas, 1999). As a result, it is intended to protect shareholders from managers' opportunistic actions (Kyereboah et. al., 2005). Corporate governance also refers to the methods and structures used to manage and direct the affairs of institutions to increase shareholder value by improving corporate accountability and performance while also addressing the interests of other stakeholders.

Because it assists the board in carrying out its basic tasks of overseeing company management, the audit committee is seen as a critical component of corporate governance (Li et al., 2012; Bedard & Gendron, 2010). It is said that AC is crucial in monitoring management reporting disclosures and strengthening the internal control system (Dhaliwal et. al., 2010; Persons, 2009). As a result, effective AC improves financial reporting quality and helps to reduce information asymmetry between management and stakeholders (Li et al., 2012; Dhaliwal et al., 2010). Furthermore, by strengthening the disclosure procedures of published information, AC supports and enhances public confidence in the credibility and impartiality of financial reporting (Bedard & Gendron, 2010; Kelton & Yang, 2008).

Through the services they provide, financial institutions serve as a backbone for long-term economic growth. They provide an incentive for economic progress by acting as intermediation. The banking industry's efficiency and effectiveness over time is an indicator of a country's economic strength. The rate at which a bank extends credit to the general public for productive purposes determines a country's long-term viability and growth (Kolapo et al., 2012). As current global growths have demonstrated, stable banking systems are a crucial component of effective financial systems (Barth, Caprio Jr et al., 2001).

The industry's misuse of fair value measurement could have far-reaching effects (Hussam, 2009). Due to capital market incentives, managers may utilize their discretion to impact reported earnings and better performance. The discretionary aspect of fair value estimates in specific circumstances is a result of the increased usage of fair value accounting, particularly market to model rather than market to market. Fair value evaluation necessitates particularly specialized circumstances, such as well-developed and liquid financial markets (Daifei et al., 2015).

The Savannah Bank Plc, Society General Bank Ltd, Alpha Merchant Bank Ltd, and more recently the Skye Bank acquisition by Polaris Bank (all in Nigeria), The Trust Bank of Kenya, Consolidated Bank of Kenya Ltd, Capital Finance Ltd, and Continental Bank of Kenya Ltd, among others, have all experienced bank failures in emerging economies (Akpan, 2007). Given the severity of events that have sparked banks' efforts to comply with various consolidation criteria, as well as the experiences of a few system operators, there are concerns about the need to strengthen corporate governance in banks. This will boost public confidence and ensure the banking system's effectiveness and efficiency (Soludo, 2004).

Researchers have recently focused their emphasis on corporate governance in developing economies (see for example, Agoraki et al., 2010; McConnell et al., 2008; Lin et al., 2006; Smallman et al., 2005). However, in emerging nations, studies on audit committee attributes (expertise, size, frequency of meetings, and independence) and fair value disclosure have received little attention. As a result, this study examines the relationship between audit committee characteristics (expertise, size, frequency of meetings, and independence) and the choice of fair value disclosure (level 3 input) among Nigeria's publicly traded deposit money banks. As a result, the goal of this paper is to assess the relationship between audit committee characteristics (expertise, size, meeting frequency, and composition) and fair value disclosure of Nigerian listed deposit money banks.

2.0 Literature Review and Hypothesis Development

2.1 Concept of Fair value

Fair value is defined as "the amount for which an asset is exchanged or a liability is settled between informed parties in an arm's length transaction" by International Accounting Standard 39. (See, Mainoma & Adejola, 2010). As a result, the fair value might be defined as the market price at which another party is willing to buy an asset or settle a liability. Fair value can be assessed in three different methods, according to DaiFei (2014): The price in an active and liquid market (Level 1 assets) is the first method of calculating fair value, and it is considered a straightforward and reliable method for various assets and liabilities. Second, it is by utilizing the price of a comparable asset when the asset does not have an active market price (level 2), and third, it is by using managerial assumptions and judgment when the asset does not have an active market price (level 3). (Level 3). The third way is very subjective, and it may lead to asset overvaluation, liability undervaluation, and loss provisioning by self-interested management.

2.2 Theoretical Framework

According to Sutton (2009), the principal-agent relationship means that each party acts as a rational economic agent concerned with maximizing their utility in their mutual relationships. According to Daifei (2014), agency theory describes a situation in which managers and controlling owners have incentives to get private control benefits to achieve their wealth maximization goals. Level 3 assessments are based on unobservable inputs that are highly subjective and less verifiable, allowing for the masking of profit figures and the management of capital ratios, especially in the absence of active and liquid financial asset markets (DaiFei, 2014). Legal systems, legal enforcements, and investor safeguards, according to Daifei (2014), are mechanisms that restrain managers' incentives to opportunistically make accounting options that would have unfavourable consequences, hence minimizing the agency problem. Firms with high leverage ratios, especially those approaching the debt covenant limit, are more likely to employ Level 3 valuation inputs, according to agency theory, and because raising reported net income reduces the risk of default (DaiFei, 2014). As a result, it appears that corporate governance is critical in assessing Level 3 fair values, which are likely to represent the values with the most information asymmetry and uncertainty.

2.3 Audit Committee's Financial Expertise

Salterio (2001) discovered that AC members' accounting and auditing competence is positively connected to their willingness to assist auditors in corporate management disagreements. This suggests that AC members' financial awareness reduces the chance of earnings management. In addition, Beasley et al. (2009) found that AC improves incentives to adequately monitor managers through legal liability in reputational work, which is consistent with agency theory. As a result, financial competence is directly linked to higher-quality financial reporting (Krishnan & Visvanathan, 2008). Furthermore, Badalato et al. (2013) discovered that audit committees with both financial and accounting competence are better at determining earnings management as evaluated by accounting irregularities and anomalous accruals. Higher degrees of financial expertise, it is assumed, are useful to the audit committee.

Similarly, Eze and Nkak (2020) discovered that corporations that file audited reports late had much fewer audit committee members with financial expertise on their boards than those that file early. The study also found that financial knowledge on audit committees had a considerable favourable impact on the timeliness of company audited reports. Furthermore, Zhang and Zhou (2018) argue that financial knowledge on the audit committee can reduce the impact of the restatement on the voluntary adoption of clawback policies. When it comes to fraud-based clawbacks, accounting professionals are more in favour of them when they haven't been linked to any previous accounting scandals, however, both accounting and non-accounting financial experts are against them when they could be linked to previous financial scams. However, according to the findings of Sagitaria and Mita's (2019) study, audit committee financial expertise has no substantial impact on the company actual earnings management. According to the study, audit committee membership has not been able to improve audit committee financial skills to lower company actual earnings management.

H1: Audit committee financial expertise has a significant influence on fair value disclosures of deposit money banks in Nigeria.

2.4 Audit Committee Size

According to Florackis (2008), a board structure with more than seven members is unlikely to be productive. This is because a bigger number will cause communication, coordination, and decision-making procedures to become ineffective. As a result, top management would be in charge of the final decision. Nelson and Jamil (2011) discovered a link between the size of an AC and the management of earnings. These findings were validated by Rahman and Ali (2006), who used discretionary accruals as a proxy for earnings management, and Ismail et al., who utilized discretionary accruals as a proxy for earnings management (2008). The findings of Sharma and Kuang (2013) also revealed a substantial positive association between the size of the audit committee and earnings management. Similarly, audit committees with a modest size are more successful and can help with the implementation of excellent corporate governance procedures. The size of the audit committee has a similar effect as the board of directors (Baccar et al., 2013). However, several scholars have claimed that large audit committees are more effective, resulting in improved corporate performance (Reddy, Locke & Scrimgeour, 2010). Elnafabi (2019) also points out that the size of the audit committee has a considerable favourable impact on excellent corporate governance. Chukwu and Nwabochi (2019), on the other hand, found no link between audit size and corporate financial reporting in Nigerian insurance businesses.

H2: Audit committee size has a significant influence on the fair value disclosure of deposit money banks in Nigeria.

2.5 Audit Committee Meetings

Chukwu and Nwabochi (2019) discovered a negative correlation between the frequency of AC meetings and financial reporting timeliness. However, Raweh et al. (2019) found no significant link between meetings and reporting timeliness. AC's regular meetings provide timely protective and corrective processes for internal control deficiencies (Khlif & Samaha, 2016), making it capable of recognizing management's opportunistic inclinations and protecting the integrity of earnings and the quality of information reported (Bedard et al., 2004 In a similar vein, Price Waterhouse (1993) and the Nigerian Code of Corporate Governance (2018) recommend that audit committees meet at least four times a year, with special sessions scheduled as needed.

Ho: The frequency of audit committee meetings has no significant impact on the fair value disclosure of deposit money banks in Nigeria.

2.6 Audit Committee Independence

An independent auditor provides effective monitoring of management's financial statements and ensures financial reporting's reliability. This is in line with Nelson and Jamil's (2012) findings, which show that audit committee independence has an impact on earnings management as a proxy for financial reporting quality. Klein (2002) discovered a negative relationship between irregular accruals and the presence of outside directors on the audit committee, but no such link was discovered between earnings management and the stricter requirements of audit committee independence of 100 per cent. The findings are congruent with those of Meca and Ballesta (2009), who found that audit committee independence can restrain earnings management, enhancing investor confidence. However, Raweh et al. (2019) discovered no link between audit committee independence and financial reporting timeliness.

H3: Audit committee with more independent board members has a significant influence on Fair value disclosure.

2.7 Bank Profitability

Profitability is a metric used to assess a company's success. Profitability has been utilized as a control variable in previous research (see an example, Suttipun & Stanton, 2012; Alarussi, 2009; Lang & Lundholm, 1993). Profitability yielded a mixed bag of results. According to a previous study by Lang and Lundholm (1993), companies with lower profits provide more disclosure. Companies may utilize the condition of lower profit as a defensive mechanism against their stakeholders, claiming that lower profit means greater expenses were made available for additional financial and non-financial disclosures.

2.8 Bank Size

The majority of previous research has found a link between company size and disclosure. In this context, size refers to a bank's financial capability. As a result, the size of the bank can be used as a control variable.

3.0 Methodology

This study employed an ex-post facto research design, where data was obtained from annual reports and accounts of the deposit money banks listed in the Nigerian stock exchange. The population of the study consists of all the fourteen (14) listed deposit money banks in the Nigerian stock exchange market as of 31st December 2018. However, the study employed some criteria in selecting the sample such that deposit money banks with a foreign background and those who have not been listed as of 31st December, 2013, were filtered out, leaving only eleven (11) banks as a sample. The study adopts a post-positivist paradigm which is most appropriate for quantitative studies and a correlation research design was adopted as recommended by Creswell (2009). The study analyzed data extracted from the annual report of the eleven selected banks using multiple regression with the aid of STATA14 software covering a period of five (5) years (2013-2017). This period was selected because it fell within the effective date for IFRS 13 (fair value) implementation in an annual report published on or after 1st January 2013.

3.1 Model of the Study

The following model is presented for this study:

$FVD_{it} = AC_0 + AC_1 ACE_{it} + AC_2 ACS_{it} + AC_3 ACM_{it} + AC_4 ACI_{it} + £_{it}$…………………….. (1)

Where:

AC_0 = is constant for all banks over the period,

FVD_{it} = fair value disclosure; net financial asset designated at fair value level 3

ACE_{it} = Audit committee expertise

ACS_{it} = Audit committee size,

ACM_{it}= Audit committee meetings.

ACI_{it} = Audit committee independence

$£_{it}$ = Error term for all banks for the period

Table I: Summary of measurement of variables:

Variables	Acronym	Measurement	Source
Fair Value Disclosure	FVD	Net financial asset designated at fair value level 3	(Daifei et al., 2014)
Audit committee financial expertise	ACE	Measured as a dummy variable stating 1 if the audit committee has a member who currently has (or had previously) work experience as certified chartered accountants, chief financial officers, financial controllers, or any other major accounting positions in each accounting period and 0 for otherwise	(Bouaziz ,2012)
Audit committee size	ACS	Measured as a total number of committee members	(Beasley, 2009)
Audit committee meetings	ACM	Measured as a total number of times, the committee holds meetings during an accounting period	(Cohen, 2014)
Audit committee Independence	ACI	Measured using a dummy variable stating 1 if the audit committee members are all non-executive directors that were appointed at the AGM in each accounting period and 0 for otherwise	(Ame, 2013)
Profitability	ROA	Net income divided by total asset for the period: ROA (Naira)	(Sulaiman et al., 2014)
Bank size	TA	Log of total asset	(Buniamin, 2010)

4.0 Results Presentation and Discussion

Table 4.1 Descriptive Statistics

Variable	Min	Max	Mean	Std. Dev.	Obs
FVD	.0078	8.999	1.9415	2.6471	55
ACE	1	8	2.4545	2.12401	55
ACS	4	7	5.6364	.88952	55
ACI	2	6	4.3636	1.0948	55
ACM	.33	.83	.51364	.12775	55
ROA	-6.35	29.48	7.2934	7.7108	55
TA	.3	15.42	2.2605	3.0273	55

Sources: Author computation using STATA14 (Appendix)

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Table 4.1 indicates that fair value disclosure (FVD) has maximum and minimum values of 8.999 and .0078, mean and standard deviation values of 1.9415 and 2.6471 respectively. The mean value depicts that on average, banks disclose a value of 19% for the period of this study. The standard deviation value depicts the movement of FVD between the minimum and maximum values. The value of 2.6471 implies a higher rate of deviation from the mean because the standard deviation is higher than the mean. The table further indicates that audit committee expertise (ACE) has minimum and maximum values of 1 and 8 and mean and standard deviation values of 2.4545 and 2.12401. The mean of 2.4545 implies that on average ACE facilitates the disclosure of FVD by 24.5%. The standard deviation value depicts how ACE fluctuates between the minimum and maximum value, the standard deviation value of 2.12401 implies a wider margin between the standard deviation and mean because the standard deviation is higher than the mean.

In addition, the table also showed the value of the mean and standard deviation of audit committee size (ACS) of 5.6364 and .88952 respectively. This implies that the ACS contributes an average of 56% to FVD. The standard deviation showed a lower rate of deviation from the mean. Table 4-1 also showed the mean and standard deviation of audit committee independence as 4.3636 and 1.0948 respectively. This implies that the ACI contributes on an average of 43.6% to FVD. The standard deviation value indicates a lower rate of dispersion between the mean and the standard deviation. Finally, the table showed a mean and standard deviation value of 0.51364 and 0.12775 for audit committee meetings. This indicates that ACM contributes on an average of 5% to FVD in Banks. The standard deviation showed a lower rate deviation from the mean.

Table 4.2 Correlation matrix

	FVD	ACE	ACS	ACI	ACM	ROA	TA
FVD	1.0000						
ACE	0.6546	1.0000					
ACS	-0.4992	-0.3519	1.0000				
ACI	0.3683	0.0869	-0.6604	1.0000			
ACM	0.0372	0.4033	0.0689	-0.3936	1.0000		
ROA	-0.0038	-0.3637	0.0761	0.0377	-0.2577	1.0000	
TA	0.0334	0.0451	0.0566	0.1396	-0.0178	0.1997	1.0000

Source: Author's computation using STATA14 (Appendix)

Table 4.2 discloses the correlation matrix between the control and independent variables with fair value disclosure (FVD) among listed deposit money banks in Nigeria. It shows the relationship between all hypotheses variables in this study and fair value disclosure. From the table above, there are few correlations amongst the variables in the model at 1% and 10% significant levels. The highest correlation is 0.6546 between audit committee expertise (ACE) and FVD. Therefore, there is no serious multicollinearity problem.

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Linear regression

Table 4.3 Random Effect Model Result

Variables	Coef.	SE	p	Z			
ACE	.795348	.2322598	0.001	3.42			
ACS	-.7711066	.5122224		0		.132	-1.51
ACI	-4.173152	.078049	0.250	-1.15			
ACM	.0150784	.0044425		0.847	0.19		
ROA	-.0033583	.0044425		0.450	-0.76		
TA	.0485772	.0110398		0.000	4.40		
_cons	6.327911	3.251356		0.052	1.95		

The analysis of linear regression is employed as a statistical technique to investigate the relationships that arise amongst the dependent and independent variables comprising ACE, ACS, ACM, ACI and control variables which are profitability and total asset for eleven listed deposit banks in Nigeria. The table below reveals the analysis of the result for the random effects model in the study.

As indicated in Table 4.3, the R square in the model is 0.4178. This implies that the model describes 0.4178 per cent of the difference in FVD and is considered as an acceptable outcome. In an additional finding, the outcomes in Table 4.3 display the two variables in the study that are discovered to be significant with FVD. The variables are audit committee expertise (ACE) (0.05, $p < 0.05$) and total asset (TA) (0.000, $p < 0.05$).

Nevertheless, other variables such as audit committee size (ACS) (0.132, $p>0.05$), audit committee independence (ACI) (0.250, $p>0.05$), audit committee meetings (ACM) (0.847, $p>0.05$) and profitability (ROA) (0.450, $p>0.05$) failed to make a significant contribution as FVD predictor; thus, the significance values higher than 0.05 were revealed to be statistically insignificantly related to FVD.

This suggests that audit committee expertise does influence FVD based on analysis done in this study. This implies that an audit committee with more members who have financial knowledge tends to influence FVD of listed banks in Nigeria. Similarly, the total asset does influence FVD of listed deposit money banks in Nigeria. Therefore, it implies that larger banks tend to disclose the fair values of their asset and liabilities compared to smaller banks.

In addition, the study found no significant relationship between AC size and FVD which is in tandem with the study of Yang and Krishman (2005) as they analyzed the relationship between the audit committee and earnings management in the US and found that audit committee size has a negative significant relationship with earnings management and also in consonance with the work of (Lin et al., 2006).

Similarly, the study found no significant relationship between AC independence which is in line with the findings of Chtourou et al. (2001) who investigated corporate governance and earnings management using two groups of US Firms, one with relatively high and one with relatively low levels of discretionary accruals in the year 1996 and showed that income increasing earnings management is negatively associated with a larger proportion of outside members who are not managers in the Firms.

Finally, the study found no significant relationship between AC meetings with FVD which is in tandem with the study conducted by Xie et al. (2003) who found that the frequency of audit committee meetings is negatively associated with current discretionary accruals.

5.0 Conclusions

The audit committee plays a pivotal role in the quality of financial reporting and is vested with the responsibility of entrenching improved disclosure practices. Financial institutions have been a sensitive economic industry that ensures the stability of a nation's economy. This important institution must be guarded against manipulative practices by top management most especially using managerial assumptions (fair value hierarchy level three) in the valuation of an asset that has no active market price which could be misused. This could endanger depositors' money, investment of shareholders and adversely affect the nation's economic growth and stability. The findings of this study revealed a significant relationship between AC financial expertise and fair value disclosure. Therefore, the audit committee should have more members with financial knowledge as it has a positive significant impact on improving disclosure practices. The regulatory bodies should ensure that a larger proportion of members of the audit committee has financial knowledge or experience to enhance the effective performance of the audit committee which in turn improves the quality of financial reporting.

Future research should incorporate other corporate governance variables such as risk management and committee attributes. The data for this research covers only listed deposit money banks. Further studies can consider all non-financial companies listed on the Nigerian stock exchange market.

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