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An Empirical Analysis on the Financial Reporting Quality of the Quoted Firms in Nigeria: Does Audit Committee Size Matter?

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Abstract
This paper examined the relationship of audit committee size and financial reporting quality in Nigeria. The empirical study has performed using a sample of 189 companies and 664 year observation from the period of 2011-2015. One of the desirable features of corporate governance is to enhance financial reporting quality for facilitating efficient and effective resources allocation of economic decision making by corporate managers. Panel data regression was adopted and audit committee size was found positive and significant with financial reporting quality .Our results underscore the importance of the corporate governance recommendation as a mean of strengthening the monitoring and oversight role of audit committee plays in the financial reporting process. Finally the study offered recommendations to enhance financial reporting quality disclosure.
Keywords: Corporate Governance, Financial Reporting Quality, Audit Committee Size.

1.0 Introduction

Corporate governance is the system by which companies are directed and controlled. Corporate governance involves a set of association amongst a company's board, its shareholder and other stakeholders. Corporate governance also provides the arrangement through which the objectives of the company are set, and the way of attaining those objectives (Cadbury, 1992). Good corporate governance is a product of high financial reporting quality that would reduce the fraudulent disclosures of report from the annual financial statements (Norwani et al. 2011). Corporate governance cannot be separated from financial reporting quality Cohen et al. [2004]. Financial reporting quality is defined as the financial disclosure statements that will disclose the financial status in the annual report and strengthen the investors' confidence in making credible decisions about their organizations. The chief objectives of financial reporting is to portray the position and performance of the entity in question so that investors in equity and debt, among other stakeholders, can make credible and economic decisions based on accurate information regarding potential risks and returns (Deloitte, 2012; FRCN, 2015).

Financial reporting is considered as being of high quality if it possesses three attributes which include transparency, full disclosure and comparability. Transparency is referred to as the

revealing of information about events, transactions, judgment and estimates which allows users to see the result and implication of decisions, judgment and estimates of preparers. Full disclosure is related to the provision of all information necessary for decision-making while comparability means that similar transactions are accounted for in the same manner both cross- sectional arising among companies as well as over time (Barton&Waymire,2004).

Several factors could influence the quality of financial reporting among which are the audit committee. The effectiveness of the audit committee in overseeing the financial reporting process could depend on its size and the independence of members (Klein, 2002). The management opportunist conduct which could influence the quality of reporting may likely be moderated or reduced by an effective audit committee (Chandar, Chang, & Zheng, 2012; Liao & Hsu, 2013). The existence of an audit committee in an organization is beneficial to management, external and internal auditors since it enhances the quality of the internal control system (Musa & Oloruntoba, 2014). The audit committee tends to provide a positive signal about financial disclosure and help enhance shareholders' confidence in financial reporting quality (Islam et al. 2010). Recent research documents that audit committee size could be fundamental to high financial reporting quality (Fodio et al. 2013; Hassan, 2012).

The aim of this study is to ascertain whether audit committee size effectiveness could lead to high financial reporting quality. The significance of the audit committee size to the study is that they help in monitoring and overseeing the financial statements. Also, the committee assists the firm in maintaining the goal and objectives of meeting the shareholders wealth and increasing the investor confidence in the financial reporting quality. The theoretical and contextual contribution of the study is that there is a positive relationship between firm size and financial reporting quality in the annual report and this agrees with the agency and stakeholder theory viewpoint. This can be attributed to the fact that large firm demand and use better corporate governance mechanism in disclosing information to the advantage of the stakeholders (Barbu et al., 2014)

2.0 Literature Review

The predominant tool used by stakeholders, shareholders, investors and other creditors to assess a firm is the quality of the financial reports contained in the annual reports (Alzoubi, 2012). Thus, one of the goals of corporate governance reforms and implementation is to improve the quality of financial statements and the effectiveness of audit committees (Beasley et al., 2009; Cohen et al., 2004; Krishnan & Visvanathan 2009; Turley & Zaman, 2007). The rate at which accounting scandals occurred in recent times has therefore attracted the attention of scholars, academician, researchers and the global society into how the quality of financial reports could be improved (Babatunde & Akeju, 2016; FRCN, 2015).

Popova et al. (2013) investigated the relationship between mandatory disclosure and financial reporting quality using a sample of UK companies included in FTSE 350 index. The findings showed that the average mandatory disclosure index for the 5 year period is 91.51% (with

minimum 69.31% and maximum 100%) which is consistent with disclosure index by Omar et al. (2011) in conformity with the financial reporting quality. Ali (2014) examines the relation between corporate governance and financial reporting quality disclosure in a context of principal-principal conflicts and poor investor protection. The result showed that there is a positive relationship between corporate governance and disclosure of financial reporting quality but no relationship between financial reporting quality disclosures and cross listing. Hassan (2012) examined the extent of corporate governance and financial reporting quality by United Arab Emirates (UAE) listed corporations. The result revealed that the highest financial reporting disclosures are those dealing with management structure and transparency which are also found to be significantly different across the sectors in the UAE.

Nyor (2013) examined the quality of annual reports and accounts of Nigerian firms from the perspective of users of accounting information. The findings showed that the quality of annual reports and accounts of Nigerian firms is only moderate. Hassan and Bello (2013) examined firm characteristics and financial reporting quality of quoted manufacturing companies in Nigeria and the finding revealed that there is a significant positive relationship between firm characteristics and financial reporting quality in Nigeria. Ling and Wang (2010) reported that companies that have independent audit committee are less likely to manipulate profits, disclose more information voluntarily and present high quality of financial reporting. Mohiuddin et al . (2012) opines that audit committee enhance internal control system and reduces asymmetry of information between management and shareholders while also improving high financial reporting quality. Garcia et al. (2012) posits that audit committee size would largely influence independence and reported that companies with more outsiders in the board favor independence audit committee to resolve the problem of asymmetry of information and thereby enhance financial reporting quality. Cohen et al. (2013) reported that audit committee with industrial and accounting expertise reports quality financial statements than those with accounting expertise. Audit committee size has association with the regulatory compliance of corporate governance code and reduces error in the financial statements Barko et al. (2006). Ghafran and O'Sullivan (2012) posit that an audit committee performs the role of scrutinization of financial statement disclosure and related information on clarity, completeness and reliability. This study adopted financial and non-financial quoted companies in Nigeria stock exchange in examining the relationship between audit committee size, firm size and firm profitability and their influence on financial reporting quality.

Anderson, Mansi and Reeb (2004) find that financial reporting is negatively related to audit committee size. Carcello and Neal (2003) find no association between audit committee size and financial reporting disclosure by management. Previous studies that are in the same spirit as those in Boone, Field, Knyazeva, knyazeva and Raheja (2013), Linck, Netter and Yang (2008) and Lehn, Patro, and Zhao (2009). Based on this back ground that the inconsistencies in the results the study will fill the gap.

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2.1 Hypotheses Development

2.2.1 Audit Committee Size

The important role of audit committee is to oversee the integrity of financial statements, the efficiency and effectiveness of internal control system and monitoring of both internal and external auditors. The existence of audit committee members could help to balance different views of management and external auditor and to provide high financial reporting reports (DeFoond& Jiambalvo, 1991). Bradbury et al. (2006) examine the impact of audit committee size on financial reporting quality on the listed firms on Singapore exchange in fiscal year 2010. The findings reveal that audit committee size with incremental independence leads to higher financial reporting quality. It is thus hypothesized that.
Audit committee size is positively associated with financial reporting quality.

2.2.2 Firm Size

The importance of firm size on disclosure in the annual report has been thoroughly investigated in prior research. Barbu et al. (2014) reported that a larger firm has the privileged to disclose more information than a smaller firm. Shareholders and the society at large expect a larger firm to report more information than smaller organization. Jensen & Meckling (1976) opined that tax liability and agency costs implication related with companies size may affect organizational disclosure decision.

2.2.3 Firm Profitability

The company with high profit will have the incentive to disclose financial statements in the annual report than the less profitable firm. Companies that are highly profitable have the tendency to maximize the shareholder wealth. Barko et al. (2006) finds no relationship with firm profitability. Carnifferman & Cooke (2002) found negative relationship while Chau &Cray (2002) found positive relationship.

3.0 Methodology

3.1 The Theoretical Framework

The model of the paper is premised on the agency theory where an agency relationship occurs when one or more principals engage another person as their agent to do a service at their behest. Notably, such an arrangement may result in the delegation of accountability by the principal which necessitates the placement of trust in an agent to act in the principal's best interest Jensen and Meckling(1993).This lead to conflict of interest between the managers and the shareholders that the need for an auditor. It is supported by the stakeholder theory. The stakeholder theory, originally defined by Freeman (1984) is a theory of organizational management and business ethics that addresses morals and values in managing an organization. In this theory, the concept "stakeholders" refers to managers, shareholders or other users of financial reports which are influenced, either directly or indirectly by the actions of the auditor. A fundamental characteristic of stakeholder theory is therefore to attempt to identify individuals and groups that states, organizations and companies are accountable to. This has also been part of the theory's challenge (Anheier, 2005).

The agency and stakeholder theory perspective of financial reporting quality suggest that no single element should be assured as having the dominant influence on financial reporting quality explained in the study as audit tenure. This requires that different stakeholder should carefully analyzed their actions so as to determine the effects of their action and their impact on the perspective of financial reporting quality reason be that audit provide assurance to investors, creditors, managers, shareholders and other stakeholder thus providing confidence on financial reporting

3.2 Data Collection and Sample Size

The study is based on a sample of quoted firms on the Nigerian Stock Exchange from 2011-2015. The researcher collected the data from the annual report of financial and non-financial companies in Nigeria due to its degree of wide spread acceptability and sense of reliability by organizational stakeholders (Deegan and Rankin, 1997; Haniffa and Cooke, 2005). Companies with unavailable data as at the point of data collection were deleted to arrive at the final sample of 189 companies with 664 year observations which is appropriate for the sample (Krejcie and Morgan, 1970).

3.3 Measurement of Variables

Table 1

Variables and their Measurement

Explanatory variables	Measurement	Sources
Financial Reporting Quality (FRQ)	Dichotomous variable if in the list 1 otherwise 0	[Alrazi et al., 2009; Elijidoten, 2009]
(AUDIT COMMITTEE SIZE) ACSIZE	Total numbers of audit committee board director to numbers of directors.	[Ahmed& Duellman, 2006; Ismail et al., 2008]
Profitability (PROF)	Earnings per share	Barako, Hancock, & Izan, [2006].
Firm Size (FSIZE)	natural log of total assets	[Wan Hussin, Che-Adam, Lode, & Kamardin, 2005]

3.4 Model Specification

In order to test the above hypothesis, the model is structured based on the panel regression analysis.

$FRQ_{it} = \beta_0 + \beta_1 ACSIZE_{it} + \beta_2 FSIZE_{it} + \beta_3 PROF_{it} + \varepsilon_{it}$

Where

FRQ = Financial reporting quality;

ACSIZE = Audit committee size;

FSIZE = Firm size;

PROF = Profitability

4.0 Descriptive Statistics and Data Analysis

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
FRQ	664	0 .68	0 .18	0.21	1
ACSIZE1	664	5.38	1.09	2	6
FSIZE	664	16.43	1.98	9.38	21.78
PROF	664	0.08	0.38	-8.10	0 .92

The analysis of the descriptive statistics for the dependent variable (financial reporting quality) and the independent variable (audit committee size) is presented here. It can be deduced from the table that the mean disclosure score was 0.68 (68%) with a minimum score of 0.21 (21%) and a maximum score of 1 (100%). The finding shows that on average the sampled firms had above average disclosure score as measured using the index. Furthermore, the study finds that on the whole, 20.27% of the shares of the sampled firms were in the hands of audit committee size (ACSIZE). In addition, the mean for the log of total assets (FSIZE) is 16.43. The mean total assets for all companies is comparable to Amran and Che Ahmad (2010) that reported a value of 12.73 and is much larger than Che-Ahmad and Osazuwa (2015) that that reported a mean total assets of 7.65. The average return on equity (PROF) is 0.08. The mean ratio for profitability is comparable to study by Che-Ahmad et al. (2003] that reported a return on equity ratio of 0.29

4.1 **Correlation Analysis**

Table 3. Correlation Analysis

Variable	FRQ	ACSIZE	FSIZE	PROF
FRQ	1.00			
ACSIZE1	0.06	1.00		
FSIZE	0.06	0.34	1.00	
PROF	0.08	0.16	0.13	1.00

In the course of the correlation analysis it was observed that the independent variable has a low correlation with the dependent variable, suggesting that the variables do not appear to be measuring the same thing. The result shows absence of multicollinearity between the variable.

5.0 RESULTS and Discussions

5.1 Panel Data Regression

Table 4. Panel data regressions

Variables	Pooled OLS	Fixed Effects	Random Effects
CONSTANT	0.57 (9.47)***	-1.94 (-3.48)*	0.55 (0.00)***
ACSIZE	0.07 (1.02)	0.13 (2.09)**	0.07 (0.83)
FSIZE	0.03 (1.03)	0.11 (4.48)**	0.05 (0.24)
PROF	0.36 (1.94)**	0.14 (0.73)	0.28 (0.12)
R^2	0.01	0.04	0.01
Breuch and Pagan Lagrangan Multiplier test		27.28 (0.00)	
Hausman Test (χ2)		24.72 (0.00)	
F-stat	2.81 (0.03)	8.29 (0.00)	
Wald chi 2			6.35 (0.09)

Notes: The coefficient values are presented with the t-statistics in the parenthesis, *p<.10; **p<.05; ***p<.01

Variable definition:
ACSIZE = Audit committee size
FSIZE = Firm size
PROF = Profitability

In estimating the model, the dependent variable is financial reporting quality measured by the extent of disclosure for the respective years. The Breuch Pagan Langrangian Multiplier test shows the chi-square at (χ^2=27.28, p-value=0.00). Thus, the null hypothesis is rejected. The rejection of the null hypothesis indicates that the variance of random effect is not equal to zero. The next stage involves comparing the fixed effect and the random effects models. The result of the hausman test with chi-square value (χ^2= 24.72, p-value=0.09) suggests that there is a significant difference between the coefficients of the random effects and fixed effects model. The fixed effect is preferred to the random effects model. The fixed effects model is then tested

for the presence of heteroskedasticity and auto correlation using the modified wald test for group wise heteroskedasticity and the Wooldridge test for autocorrelation. The probability values of ($P<0.00$), shows that the model is both heteroskedasticity and auto correlated. The random effect model is then corrected to resolve these problems using the robust standard estimates (Hoechle, 2007). The main hypothesis of the study predicts that there is a significant relationship between audit committee size and financial reporting quality. The result of the robust fixed effects regression model shows that there is a positive and significant relationship between FRQ and ACSIZE ($\beta= 0.006$, $p<0.05$). The results for the control variables show that firm size as measured by the natural logarithm of total assets was significant and positively related to financial reporting quality ($\beta= 0.112$, $p< .05$), while the other control variable profitability as captured by return on equity(ROE) was also significant ($\beta= 0.014$, $p<0.10$).

6.0 Conclusion

The paper examined mandatory disclosure of accounting information in the annual reports and specifically the effect of audit committee size on the financial and non-financial firms listed companies in Nigeria. The study found an interesting result between audit committee size and financial reporting quality disclosure. Also, the audit committee size enables the members to distribute the workload and dedicated more time and resources in monitoring the financial reporting quality disclosure. The result is in line with the theoretical expectation of mandatory disclosure among listed companies in Nigeria. The study found significant positive relationship between audit committee size and financial reporting quality disclosure in the annual report. In section 359 (amended), CAMA 2004 mandated the audit committee in discharging their responsibility in the oversight and control of financial reporting quality. The study will be of importance to management, regulator, accounting profession and investors in Nigeria

6.1 Recommendations

Against the backdrop of the findings, we advanced the following recommendations

1. Firms in Nigerian should ensure that the size of audit committee is effective and efficient in discharging their duties as to enhance financial reporting quality.
2. The Nigerian Stock Exchange should relax its stringent listing requirements so that firms can be listed on the first tier since larger firms engage the services of professionals which by extension will positively affect the financial reporting quality
3. Since audit firm size increases financial reporting quality, bigger audit firm should be encouraged to disclose more information to strengthen the investor confidence.
4. The propensity of high profitability in Nigerian firm would enhance the financial reporting quality.
5. The audit committee size is to ensure that there is consistency with the international best practices on corporate governance. It directs all directors to focus on their responsibilities and play a constructive role in the affairs of the company.

6.2 Suggestions for Further Studies

The present study spanned a five-year period covering 2011 to 2015 and the selected samples included only listed financial and non- financial companies in Nigeria stock exchange. It is therefore suggested that the study be extended to a longer period and more samples.

The findings of the study should be interpreted with a number of proxies. In collecting the data there are of difficulties in getting company information for a developing country like Nigeria However, future studies to increase the sample size and to improve the level of data collection. It is also possible for future study to increase the numbers of variable of the study.

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Instead of using the annual report as the main unit of analysis researchers may choose other sources of information to capture the disclosure level by firms such as interim report, corporate press release and newspapers.

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