

Audit committee and financial reporting quality in listed non-financial firms in Nigeria

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ABSTRACT

This paper evaluates the effect of the audit committee on financial reporting quality in Nigeria. The study utilized data from 41 non-financial firms listed in the Nigerian Stock Exchange (NSE) for the 2011 to 2019 period. The study employed the Generalized Method of Moments (GMM) technique which is robust to endogeneity and heteroskedasticity threat. The findings indicate that audit committee size, shareholders and financial experts' inclusion in audit committee convey a significantly negative relationship with earnings management, thereby reducing discretionary accruals and increase financial reporting quality. The finding of this study is also robust in scope concerning the issue of unobserved heterogeneity which prior studies have failed to address. Thus, future corporate governance reforms should recognize and sustain these efforts. The study recommends that the board of directors should ensure appointment of sufficient audit committee members with adequate financial expertise in which shareholder should be included. This will enable them to perform their functions effectively through proper oversight function and create good atmosphere for the statutory audit. This can also lead to suppressing reporting irregularities and increase public confidence regarding the quality of financial report.

Keywords:

Audit Committee, Earnings Management, Financial Reporting Quality.

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1. INTRODUCTION

The quality of financial reporting has remained an issue of significant concern among professional accountants, regulators, and other users of financial information. This is because financial reporting has been a principal means of communicating the results of transactions and events which transpired within the organization to the outsiders. It enables them to use such information in assessing the economic performance and condition of a business as well as a guide in making economic decisions. Hence, every user of financial information expects that such information will help him in gauging the health status of the reporting entity and in making informed financial decisions. However, events in previous times, especially the series of corporate scandals such as Enron, Worldcom, Parmalat and several Nigerian firms such as Cadbury Nigeria Plc in 2006, Afribank Nigeria Plc in 2009 and Intercontinental Bank Plc in 2009 have placed severe doubt on the quality of financial reports circulating in a corporate environment and their ability to meet the expectations and needs of the users (Enofe, Aronmwan & Abadua, 2013). The Companies and Allied Matters Act (CAMA), 2004 and the Revised CCG 2018, requires all listed firms to establish an AC through the provisions of Section 359 (3 & 4) and Part E Article 30 (1-4a-i) of the CAMA and the Securities and Exchange Commission (SEC), respectively. The AC size must comprise three independent directors and three shareholders' representatives, with at least one member with financial or accounting expertise (Salloum, Azzi & Gebrayel, 2014). Both the CAMA and the SEC regulations require the AC to adequately monitor and advise management on the preparation and timely release of the financial reporting to shareholders and other stakeholders (Sierra, Barbadillo & OrtaPe´rez, 2012). Furthermore, the AC's responsibility is to review essential matters and judgments made about the firm's financial statement (Temple, 2016). The committee is equally responsible for protecting investors' interests by securing high FRQ disclosure, accounting policy monitoring, maintaining the external auditors' independence, and regulating compliance. Additionally, Audit Committee (AC) as one of the most critical components of a firm's structure, has the potentiality to enhance the quality of financial reporting by reviewing the financial statements on behalf of the BoDs (Ragab 2014). It could link auditors and corporate managers via vital monitoring functions.

Nigeria's AC composition is unique and stands out, which is a reflection of significant efforts by regulators to restore investors' confidence that has been eroded due to the previous scandals and fraud, which in turn, has led to a yearly loss of varying colossal sums in both the financial and non-financial sectors (Jerry & Saidu, 2017). The AC in Nigeria differs in size and composition from both developed and emerging economies. Regulators have emphasized more on large AC, as argued by the proponents of the resource dependence theory (Garcia, Barbadillo & Perez, 2019). Consequently, the involvement of shareholders in the AC is a recent development that has opened up the debate on AC effectiveness. Shareholders are expected to suppress opportunistic management practice, improve financial reporting timeliness and protect the auditors' independence

by enhancing communication between auditors and management (Bajra & Čadež, 2018) In addition to the shareholders' effort; IOs are expected to play a critical role in enhancing the effectiveness of Nigerian AC. Hence, investigating financial reporting is a good way of assessing AC effectiveness based on its different features such as AC financial expertise, AC chairman, and involvement of shareholders in AC. Furthermore, financial expertise amongst AC members could mitigate agency costs (Oussii & Boullila-Taktak, 2018). Besides, financial expertise is likely to avert financial statement mistakes and spot incidences of financial fraud (Ghazali, Shafie & Sanusi, 2015). The AC chairman is responsible for overseeing the financial reporting process (Bilal, Chen & Komal, 2018) and, therefore, also responsible for the breakdown of the reporting process (Saleh, Mohd & Rahmat, 2007). Moreover, Institutional shareholders have higher experience in business with more exceptional monitoring abilities and the financial muscle to lessen agency problems compared to ordinary shareholders (Ayemere & Elijah, 2015). The current study holds the same opinion as regulators that an appropriate composition of AC, with highly committed shareholders and blockholders, would be inclined as owners and stakeholder representatives to influence credible and reliable financial report and consequently, providing enabling environment for external auditors to operate. The remaining part of the paper comprises the literature review, methodology, results interpretations, conclusion and recommendations.

2. LITERATURE REVIEW

2.1 The Concept of Financial Reporting

Several definitions have been given to the term FRQ. For instance, it is defined as the exact manner by which the report shows information as regards a business activity as it relates to its financial position, with the aim of informing shareholders about a company's operations (Saleh, et. al., 2007). Karajeh & Ibrahim (2017) defined FRQ as the degree to which financial statements provide information that is fair and authentic about the financial position and performance of an enterprise. However, a commonly accepted definition is provided by Ragab (2014), who asserted that quality of financial reporting is complete and unambiguous information that is designed to guide users. International Accounting Standard Board (IASB) noted that the objective of financial reporting is to provide financial information about the reporting entity that is useful to present to potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. Compliance with the objectives and qualitative attributes of financial reporting information, as stated by the IASB 2018, will no doubt enhance financial reporting quality.

2.2 Qualitative Features of Financial Reporting

The Conceptual Framework for Financial Reporting of the Financial Accounting Standard Board (FASB) and the IASB noted that, there are agreed-upon elements of high-quality financial reporting. The qualitative characteristics of FRQ include relevance, reliability, understandability, faithful representation, comparability, verifiability and timeliness. They are divided into fundamental qualitative aspects and enhancing qualitative characteristics. A theoretical explanation for each of these terms emphasizes their importance as qualitative characteristics, and also indicates what qualities are considered fundamental among different frameworks.

2.3 Measuring Financial Reporting Quality

In order to assess the quality of financial reporting, various measurement models have been used in prior researches. Some of these include: (i) accrual models (Jones, 1991; Dechow, Sloan & Sweeney, 1995); (ii) value relevance model (iii) specific elements in annual reports (iv) qualitative characteristics model (Abdulmalik & Che-Ahmad, 2016). However, the most widely used models among the scholars are the accrual models which are considered in this study.

2.4 Accrual Model

This model uses the level of earnings management as a proxy for the quality of financial reporting. It measures the extent of earnings management under existing rules and legislation. The model assumes that managers use discretionary accruals, i.e. accruals over which the manager can exert some control, to manage earnings (Aanu, Odianonsen & Taiwo, 2015). This model is based on the assumption that a company's earning is believed to be the most important item in the financial statements. Hence, most analysts tend to use this when analyzing a company's performance and prospective potential. EM is assumed to negatively influence the quality of financial reporting by reducing its decision usefulness (Abdulmalik & Che-Ahmad, 2016). There are many approaches in detecting earnings management but the accrual-based models, especially the discretionary accrual, is the most popular approach (Bajra & Čadež, 2018). Proponents of this model argued that the main advantages of using discretionary accruals to measure earnings management are that there is relative ease in data collection and measurement. In addition, when using regression models, it is possible to examine the effect of company characteristics on the extent of earnings management (Enofe, et. al., 2013). The main limitation of this model, however, is how to distinguish between discretionary and non-discretionary accruals (Abdulmalik & Che-Ahmad, 2016). Also, the model only provides an indirect measure for FRQ.

In measuring FRQ, EM is known to be widely used. It is frequently employed by the managers in altering figures in the financial statement (Fakhari, et. al., 2015). According to them, EM arises when managers use subjective judgement in financial reporting and structuring transactions to alter financial reports either to mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting practices. Elijah and Ayemere (2015) observed that earnings management occurs as a result of the loopholes and flexibility of accounting choices that are allowed by the Generally Accepted Accounting Principles (GAAP). These loopholes allow managers to choose reporting procedures that enable them to make estimations and assumptions that suite their business environment or maximise their wealth. In a situation where managers use subjective judgements in financial reporting to alter financial reports, thereby negatively affecting the quality of financial reporting, discretionary accruals model as a measurement tool for FRQ becomes desirable (Enofe, et. al. (2013). In corroboration with the above assertion, major strands in the extant literature on FRQ have been proxied by EM, which examines managers' use of discretionary accruals to shift reported income among fiscal periods. The discretionary accruals are determined by separating the non-discretionary accruals from the total accruals. To this end, this current study used the modified Jones model as advocated by many accounting experts (Fakhari & Pitenoei, 2017).

2.4.1 Audit Committee Size and Financial Reporting Quality

The size of the AC is an essential factor in improving FRQ as larger AC are likely to have the benefit of accessing an extensive knowledge base and diverse expertise and thereby conducting their responsibility more effectively (Abdullatif (2006). Regulatory bodies also deem AC size as an essential attribute in controlling the accounting procedure. The Blue Ribbon Committee of 1999 in the US, ASX Corporate Governance Council 2003 in Australia and Combined Code 2008 in the UK put immense emphasis on the size of AC, and all advocate at least three members in AC. The recommendations of minimum number of members on the AC, without an upper limit, suggest the bodies emphasize in ensuring the AC are adequately staffed (Albersmann & Hohenfels, 2017). However, the lack of apparent guidance on a desirable size gives rise to doubt as to what size AC better serve the interests of shareholders in advancing the general financial reporting procedure. Similarly, Elijah and Ayemere (2015) note that bigger ACs seem to advance earnings quality by decreasing the probability of restating financial statements and therefore give more oversight over the financial reporting procedures. The following hypothesis is formulated:

Ho₁: Audit committee size has no significant relationship with EM practice by listed firms in Nigeria.

2.4.2 Audit Committee Financial Expertise and Financial Reporting Quality

It is believed that the availability of an accounting and financial knowledge in the audit committee would enhance its efficiency and its ability in detecting and preventing EM. Kibiya, et. al. (2016) supported in their study that the presence of a member with financial literacy or knowledgeable in accounting, finance or financial management will enhance the quality of the financial report. However, Moses (2019) noted that the expertise criterion given is broad in terms of definition. They claim that persons with financial expertise can mean any of the following (1) certified public accountant, auditor, financial officers, or controllers (2) anyone that has worked in a supervisory role that involves financial statement preparation. Thus, expertise can be technical or supervisory in nature, but the contention is that which of this nature of expertise is fundamental to audit quality? Is it technical/accounting or supervisory/financial management? Alkilani, Hussin and Salim (2019) Jerry & Saidu (2017) provide evidence that supervisory expertise does not translate to effective understanding of accounting issues and may not ensure audit quality. This is supported by Kamolsakulchai (2015) who investigated various types of expertise against audit quality and found that only accounting expertise had a significant effect on audit quality. Bala & Kumai (2015) in their study on audit firm reputation and audit quality, controlled for audit quality using AC financial expertise as captured using the number of members with accounting expertise. They found an insignificant but positive relationship with audit quality. Similarly, Ghazali, et. al. (2015) also documented an insignificant positive relationship between AC expertise and audit quality. In their study, expertise was captured using the proportion of members with financial and accounting experience to the total board membership. Karajeh & Ibrahim (2017) argued that audit committees having members with requisite financial expertise are in a better position to have knowledge of capital market implications of decisions and disclosures in financial statement. Such disclosures are expected to improve reporting quality and reduce information asymmetry on firm's value. Thus, based on the expectation of the CCG in Nigeria specifying that at least one person must be able to read and interpret the financial statement, AC quality is one of the CG attributes that is very sensitive. It serves as a control mechanism employed by directors for enhancing the quality of the financial report (Ayemere & Elijah, 2015). Researchers debated and required members of the AC to have financial expertise and knowledge in auditing (Aanu, et. al., 2015). Furthermore, the ability of AC members with financial expertise to uphold audit judgement is supported by proponents of the resource dependence theory. They argued that the presence of financial experts in the AC will reduce the committee's reliance on external auditors that fundamental accounting figures are credible, relevant and reliable. The following hypothesis is formulated:

Ho₂: Audit committee financial expertise has no significant relationship with EM practice by listed firms in Nigeria.

2.4.3 Shareholders Involvement in Audit Committee and Financial Reporting Quality

Shareholders in the AC may provide a greater level of determination in the firm's AC's functions to guard their investment. Bajra & Čadež (2018) suggested that an AC comprising shareholders can enhance decision-making. They further argued that such a committee with shareholding members is likely to dismiss external auditors who issue a going concern report, given that the effect of prediction is unclear from such report, and hence, likely to disagree with the auditor (Abdullatif, 2006). Further, large shareholders in the AC are more likely to provide effective AC performance due to the magnitude of shares held. They are also in a better position to suppress managerial myopia by advocating managers to invest in long-term and profitable portfolios (Abernathy, Beyer, Masli & Stefaniak, 2015). The shareholders are required to effectively play dual roles of being owners and exhibit the ability to monitor financial reporting process that can lead to quality financial report which can be evaluated within a reasonable time limit is contained in the regulation (Bala & Kumai, 2015). Moreover, shareholders as members of audit committee incline to restore timeliness of financial reporting and the committee's image as well as the whole corporate image (Ghazali, et. al., 2015). As investors and other stakeholders are more interested in firms timely financial report and the concern is noticed from companies with large shareholders equity (Saleh, et. al., 2007). With the coming on board of shareholders to sit in the audit committee coupled with the power of ownership, shareholders can effectively check Executive Directors (ED) powers regarding financial reporting functions and provide protection to the auditor in performing their duties (Temple, 2016). Furthermore, shareholders presence has increased public confidence regarding financial report (Stephen, et. al. (2019). In the same vein, shareholders equity holding gives them a definite power for absolute control of the company's activities and render effective monitoring (Kibiya et al., 2016). Prior research argues that the association exists between shareholders' investment and financial reporting quality (Ogundana, et. al., 2017). The following hypothesis is formulated:

Ho₃: Shareholders involvement in audit committee has no significant relationship with EM practice by listed firms in Nigeria.

2.4.4 Firm's Size

Firm size is also one of the CG attributes related to FRQ. It remains one of the variables of interest in most audit research associated with reporting delays. Bala and Kumai (2015) investigates the relationship between the size of the firm and audit report lag and reported that the bigger the firm, the higher the quality of audit demanded from such firms as the size is related

to high agency cost. Consequently, more prominent firms are likely to be more influential in terms of internal auditing and greater accountability due to effective internal control, leading to the timely release of the financial report (Abdullatif, et. al., 2015). Additionally, with available resources at their disposal, larger firms can pay high audit fees to more prominent audit firms, such as Big4, in order to achieve a timely report (Elijah & Ayemere, 2015). Firm size was found to be an influential variable in explaining differences in corporate financial disclosure practices among firms (Albersmann & Hohenfels, 2017). A common argument is that because larger firms act to protect their reputation and avoid government intervention, they are more likely to release more information than smaller firms do (Bilal, et. al., 2018). Fakhari & Pitenoei (2017) argued that agency costs are higher for more substantial firms given their more extensive number of shareholders. As a result, managers of large firms have an incentive to reduce potential agency costs. One method of doing so is to disclose more accounting information. Ghazali, et. al. (2015) argued that more substantial firms rely heavily on financial markets to raise funds.

2.4.5 Firm's Age

Generally, old firms are believed to disclose more information because they are more likely to have established, well-organized professional staff to deal with the technical aspects of their financial statements (Moses (2019). Also, managers of younger firms tend to be less experienced in running a listed corporation and complying with regulatory requirements. Consequently, Oussii and Boulila (2018) argued that younger firms' accounting systems tend to be inadequate, resulting in lower quality accounting and disclosures. In contrast, older firms tend to have well-established accounting systems and experienced managers and staff, resulting in higher quality accounting and disclosures. In a theoretical discussion on the age-performance relationship, the arguments can be found for both positive and negative relationships. The argument for a positive influence of age on performance lies in firm experience since older firms can benefit from accumulated knowledge in all crucial aspects of the business (better technology, well-developed supply channels, well-established customers' relations, and more reachable access to resources, better human capital and lower financing costs). As older firms have more experience, abilities, and skills, and since they have enjoyed the benefits of learning, they consequently can enjoy the superior performance (Saleh, et. al. (2007). Although previously described arguments are quite convincing, so are those that stream to explain the negative influence of firm age on its performance and quality of its financial reports. They argue that as firms become older, they often try to codify decision-making procedures which make them very bureaucratic, reduce organizational flexibility and ability for immediate changes.

2.5 Review of Empirical Studies

The facts revealed by empirical studies are diverse on the relationship between AC size and FRQ. Stephen, et. al. (2019) observed no significant relationship between AC size and FRQ. However, none of the studies have suggested the optimal size of AC for monitoring the financial reporting process. The studies that advocate a suitable AC size in relation to other financial reporting outcomes find inconclusive and conflicting results. For instance, some studies have disclosed larger ACs are more likely to endure pressures of management collusion (Karajeh & Ibrahim, 2017) and being able to pay more attention to the general financial accounting process (Sierra, et. al., 2012), other studies consider larger AC as increasing the risk of material misstatement (Inaam & Khamoussi, 2016). Previous researches have indicated that AC with financial experts enhances the process of financial reporting and the quality of the report was justified (Karajeh & Ibrahim, 2017). Researchers and advocates of the agency theory have postulated that members in the AC with financial knowledge enhance the ability of the AC in monitoring external auditors' work well, understanding audit judgment and arbitrating misunderstanding with management, thereby lessening audit report lag. In the same manner, risk management and internal control are effectively improved by financial experts in the AC (Garcia, et. al., 2019). Additionally, Indirect evidence from past research indicate that members of the audit committee with investment in the firm can effectively provide vigilance and high monitoring ability that may lead to premium performance, quality financial report and without delay (Elijah & Ayemere, 2015). Hence, larger shareholders' in the audit committee will have the incentive to institute good corporate practice and monitor the managers. They equally, can enhance the process of financial reporting and timely release within the stipulated time (Kibiya et al., 2016).

2.6 Agency Theory

Agency theory is a theory that has been applied to many fields in the social and management sciences such as politics, economics, sociology, management, marketing, accounting and administration. The agency theory has caused research explosion on contract incentives for corporate staff, managers, and indeed all positions in the company (Ayemere & Elijah, 2015). The theory also explains the relationship between the principal and agent based on the premise that the agent will pursue the goals of the shareholders. The relationship is not without its costs, which include bonding costs and monitoring costs, as well as a residual loss if the contract eventually becomes costlier than the benefit (Inaam & Khamoussi, 2016). There are two principal problems, according to Ragab (2014), which relate to managers' behavior due to the separation of ownership and control, which include: first, the possible misplacement of priority between the principals and the agents. Managers are believed to be utility maximizers, who if given a chance, will act in their own best interest at the expense of wealth owners or the principals, and second, the principals may experience some obstacles in understanding the manager's actions or inactions. In situations like this, principals are left with insufficient information about the extent of risk or profitability about their business, and thus, are not particular about managers' contributions to the realization of the company's objectives. The above two scenarios are referred to as Type I agency problem. This means that the principals are left suffering from information asymmetry (Ogundana, et. al., 2017). Type II agency problem, on the other hand, is because of conflict among majority investors and minority owners. Consequently, the need for disclosure in financial reports came about due to the need to reduce agency conflict and information asymmetry between the principals and the agents (Oussii & Boulila-Taktak, 2018). The drive for disclosure to mitigate agency costs and reduce information asymmetry in the financial report came about consequent upon the demand by investors for full, transparent and reliable disclosure, especially in the case where the disclosed information is mandatory. The agency theory argues that effective CG mechanisms can mitigate agency costs by reducing information asymmetry by an increase in disclosure. These reasons motivate both principals and agents to invest in CG mechanisms aimed at reducing agency costs that are associated with information asymmetry (Bala & Kumai, 2015; Tambun, et. al., 2017).

3. METHODOLOGY

3.1 Research Design

This study adopts a multi-method quantitative model, which utilizes both descriptive and inferential statistics. The method is appropriate because it is inclined on the positivist research philosophy and deductive approach. The study examines the impact of some essential CG mechanisms on FRQ in Nigerian listed firms, which are measured numerically and analyzed using a range of statistical techniques. This study employed archival evidence, where quantitative data and CG information was obtained through secondary sources using 41 firms as sample size of the study. The study covered non-financial companies in Nigeria within the period of nine years from 2011 to 2019. This period is especially significant for this study because 2011 was the period when the World Bank re-evaluated the newly promulgated CG code, which took effect from April 2011 until 2018 where the SEC issued a revised CG code. The study used two sets of data from the financial statements for all observations: the first is the data to measure the corporate governance variables while the second is the data to measure FRQ taking EM as its proxy. In order to analyze the samples, CG variables were obtained from financial statements for the years under study. The impact of corporate governance and FRQ was analyzed to examine the degree of relationship between the two sets of variables for the same time frame. The study used both descriptive and inferential statistics using STATA 16 for the analysis of the result.

3.2 Study Model

The existing models of DA have different explanatory power in different countries all over the world due to several factors such institutional factors, CG mechanism and legal system (Abernathy, et. al., 2014). However, according to Fakhari & Pitenoei (2017) the most reliable and consistent models to detect manipulative financial reports, using the manager's discretionary right of accounting methods choice and estimates are Jones model (1991), modified Jones models by Dechow (1995), and Kasznik model (1999). Further, the modified Jones model by Dechow et al. (1995) is considered as one the best and most powerful models for testing EM in Nigeria (Abernathy, et. al. (2015). The model recognizes accounting variations in income receivables in the event period. Therefore, managers revert to manipulating earnings on credit sales rather than cash sales. The modified Jones model allows credit sales variations during the period of the event as a result of EM (Garcia, et. al. (2019). Thus, this is a present study adopts and used the modified Jones Model (Dechow et al., 1995). The model is presented below:

$$TAC_{it} = EBIT_{it} - CFO_{it} \quad (1)$$

Where :

TAC is total accruals, EBIT is earnings before interest and tax minus CFO, which is the cash flow from operations for specific firms' year and industry represented by 'i' for industry and 't' for the year. The DA was calculated using the equation below:

$$\frac{TAC_{it}}{TA_{it-1}} = \alpha_0 + \alpha_1 \left(\frac{1}{TA_{it-1}} \right) + \alpha_2 \left[\frac{(\Delta REV_{it} - \Delta REC_{it})}{TA_{it-1}} \right] + \alpha_3 \left(\frac{PPE_{it}}{TA_{it-1}} \right) + \epsilon_{it} \quad (2)$$

Where :

TA is the previous year's total assets

ΔREV is the change in revenue

ΔREC is the change in trade receivables

PPE is property, plant and equipment

ϵ is the error term.

This study used Dechow et al. (1995) in terms of subtracting the change in accounts receivable from the change in revenue before the estimation. The aspects of the industry- and year-specific will then be used for the parameter estimation of the coefficients. (α_0 , α_1 , α_2 , and α_3), were calculated from equation (2), and after that, the non-discretionary accruals (NDAs) were found from the equation below:

$$NDA = \alpha_0 + \alpha_1 \left(\frac{1}{TA_{it-1}} \right) + \alpha_2 \left[\frac{(\Delta REV_{it} - \Delta REC_{it})}{TA_{it-1}} \right] + \alpha_3 \left(\frac{PPE_{it}}{TA_{it-1}} \right) + \epsilon_{it} \quad (3)$$

The total residuals of the DA is also found from the difference in the estimation of equation (3) and the actual accruals as depicted in the equation below:

$$DA_{it} = TAC_{it} - NDA_{it} \quad (4)$$

Where:

NDA is non-discretionary accruals and DA is discretionary accruals. Consequently, the residual from the above model is used as a measure for EM in the equation below:

$$DA_{it} = f(ACSZE; ACFE; ACSH) \dots \dots (5)$$

In econometric form:

$$DA_{it} = \beta_0 + \beta_1 ACSZE_{it} + \beta_2 ACFE_{it} + \beta_3 ACSH_{it} + \epsilon_{it} \dots (6)$$

Adding control variables to the study, the model is represented as:

$$DA_{it} = \beta_0 + \beta_1 ACSZE_{it} + \beta_2 ACFE_{it} + \beta_3 ACSH_{it} + \beta_4 FSZE_{it} + \beta_5 FAGE_{it} + \epsilon_{it} \dots \dots \dots (7)$$

Where :

FRQDA-it = Financial Reporting Quality as measured using Earnings Management (Discretionary Accruals);

β_0 = Constant;

ACSZE = Audit Committee Size

ACFE = Audit Committee Financial Expertise;

ACSH = Shareholders Involvement in Audit Committee;

FSZE = Firm's Size;

FAGE = Firm's Age;

ROA = Returns on Assets;

FGRW = Firm's Growth;

$\beta_1 \dots \beta_{13}$ = Coefficient of explanatory variables

ε = Standard error

i = Cross sectional (Companies)

t= Time Series (9 years)

A priori expectations in line with extant literature to be $\beta_1, \beta_2, \beta_3, \dots > 0$

4. ANALYSIS

4.1 Descriptive Statistics of Continuous Variables

Table 1 presents the result of the descriptive statistics of the continuous variables. It is described based on the minimum, maximum, standard deviation and mean values.

Table 1. Descriptive Statistics of Continuous Variables

Variable	Min	Max	Mean	Sd	Skewness	Kurtosis
DA 0.003		0.36	0.28	2.59	12.56	15.55
ACSZE 4		6	5.69	0.67	-1.91	4.95
ACSH 0		2	1.12	0.57	0.02	2.99
ACFE 1		2	1.27	0.44	1.06	2.13
FAGE 10		54	27.21	13.53	0.05	1.90
FSIZE 19.13		27.70	23.31	1.92	0.12	2.59

Source: Computed by the researcher using STATA 16

DA: Discretionary accruals, ACFE: Audit Committee Financial Expertise, ACSH: Shareholders in Audit Committee, FSZE: Firm Size, FAGE: Firm's Age.

Table 1 shows the estimation of absolute value for Discretionary Accruals (DA) using the MJM (Dechow et al., 1995) and reported based on absolute values. The minimum value of DA is approximately 0.003 and the maximum is 0.36, while the mean value is 0.28 and the standard deviation is 2.59. This means that the extent to which managers engage in opportunistic EM among listed firms on the NSE has reached up to 28% which is disturbing, and therefore, a cause for a great concern. The mean value for audit committee size (ACSZE), shareholders in audit committee (ACSH) and financial experts in audit committee (ACFE) which are expressed in discrete data are 5.69, 1.12 and 1.27 respectively. Similarly their minimum values are 4, 0 and 1 while their maximum values are 6, 2 and 2 for each of the AC size, shareholders in AC and financial experts in AC respectively. The three variables also have the standard deviations of 0.67, 0.57 and 0.44 which show a divergence from the mean as sensible and normal. This shows that most of the companies complied with the CCG guidelines concerning the size of audit committee of a maximum of six and a minimum of three members and the inclusion of at least one financial expert among the AC members as prescribed in section 11.4 (11.4.2). However, with regards to inclusion of shareholders in AC, some firms did not comply with this guideline as revealed by a minimum value of 0 for ACSH in the table. Looking at the mean of control variables measured as discrete data, the mean value of firm's age is 27.21 while the minimum and maximum values are 10 and 54 respectively. Firm size indicates that on average, a Nigerian listed firm has assets worth N23.31 billion. The standard deviation shows N1.92 billion which is a normal disparity as it is not far from the mean. Looking at the skewness and kurtosis value, it can be observed that the data is moderately normal. The data set did not violate the normality assumption of parametric data test. Similarly, Inaam & Khamoussi (2016) noted that even if the population is not normally distributed, but the sample size is large enough i.e >30 , then the means will have an approximately normal distribution.

4.2 Correlation Analysis

This study regards correlation analysis as an essential procedure to examine whether or not a correlation subsists among variables. It is believed that zero relationship indicates the non-existence of connection between variables, and therefore, there is no need for conducting research with such unrelated variables (Tambun, Sitorus, Panjaitan & Hardiah, 2017). Therefore, there must be either a positive or negative connection between the dependent variable and all the explanatory variables for a research to be conducted. In view of this, correlation was performed to determine the link between DA and FRQ and explanatory variables.

Table 2. Correlation Matrix

	ABDA	ACSZE	ACSH	ACFE	FSZE	AGE
ABDA	1.00					
ACSZE	0.05	1.00				
ACSH	-0.03	-0.10**	1.00			
ACFE	-0.06	0.13**	-0.08	1.00		
FSZE	0.07	0.05	0.01	-0.02	1.00	
AGE	0.04	0.00	0.12**	-0.11**	0.12**	1.00

Source: Computed by the Researcher using STATA 16

Note: ***, ** and * represent significant level at 1%, 5% and 10% respectively.

The results of the correlation analysis are mixed with some variables showing positive coefficients while others show negative coefficients. The coefficients with significant positive values are ACFE and ACSZE (0.13); AGE and ACSH (0.12); FSZE and AGE (0.12). On the other hand, the coefficients with significant negative values are ACSH and ACSZE (-0.10); AGE and ACFE (-0.11). Having observed a non-zero correlation link between FRQ and all the explanatory variables as asserted by Garcia (2011); and Uwuigbe, et al. (2017), analysis was carried out on FRQ and all the explanatory variables. Even though the

correlation between FRQ and each of the independent variables seems to be weak as the value of the coefficients fall within the limit of $(r) < 0.3$, the weakness does not affect the outcome of the regression results (Herbert, et al., 2016). The correlation is therefore free from Multicollinearity threat.

4.3 Results and Discussions

The results for Dynamic Panel Results for Discretionary Accruals Model is shown in table 3

Table 3. Discretionary Accruals Results using Dechow et al.: Two-Step System GMM

Variables	Coefficient	Std. Err.	z-statistics	p-Value
ABDA L1	0.3247***	0.0049	66.67	0.000
ACSZE	-0.1325**	0.0654	2.03	0.043
ACFE	-0.6022***	0.1560	-3.86	0.000
ACSH	-0.4205***	0.0505	-8.33	0.000
FSZE	-0.1608***	0.0113	-14.21	0.000
AGE	0.0016	0.0052	0.31	0.760
_cons	8.7086***	0.8083	10.77	0.000
Statistics	Coefficient			p-Value
Wald chi2(12)	331727.37			
Prob > chi2				0.000
AR2				0.458
Hansen J.				0.386
No. of Group	41			
No. of Instrument	35			
Year Effect	Yes			

Source: Computed by the researcher using STATA 16

Notes: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$, indicate significance levels

The results show that the lagged dependent variable is significant at 1% level of significance with lag one of three (1 2) and the coefficient value is 0.3247, using the second lag. The use of second lags became necessary as it is not correlated with the current error term. However, the first lag is correlated (Samuel, et al., 2017). It is also used to find suitable instruments for model efficiency. Thus, the results indicate that the lag argument is correctly specified and the instruments used are valid. The result indicates that ACSZE has a significant association with p-value = 0.001, while the coefficient is -0.1325. It implies that numerical size of AC can reduce DA by -0.2184, on the econometric assumption that other factors remain constant. Hence, the result provides enough evidence to reject the hypothesis which argues that audit committee size has no significant impact on EM practice by listed firms in Nigeria. Therefore, hypothesis 1 is not supported. This result is consistent with the findings of Saleh, et. al. (2007), that larger audit committee plays a vital role in restraining the occurrence of EM. Jerry & Saidu (2017) also observed a negative significant impact between the size of an AC and EM practice. Hence, this supported a positive impact of large audit committees on FRQ. The result also indicates that ACFE has a significant negative association with p-value = 0.000, while the coefficient is -0.6022. It shows that the presence of financial expertise in the AC can reduce EM by -0.6022, on the econometric assumption that other factors remain constant. Hence, the result provides enough evidence not to reject the hypothesis which argues that audit committee financial expertise has no significant impact on EM practice by listed firms in Nigeria. Therefore, hypothesis 2 is not supported. The result is consistent with the argument that AC financial experts, as activists and representatives of shareholders, can check opportunistic managerial behaviour and enhance CG (Ogundana, et. al., 2017). This study is in accordance with some prior studies that have examined the AC financial expertise role on improving the FRQ. They documented that ACFE can curb the extent of EM in Nigeria (Tambun, Sitorus, Panjaitan & Hardiah, 2017). This result is also in line with both the resource dependency and agency theories in terms of conflict resolutions and effective resources utilisation (Jerry & Saidu, 2017). Therefore, financial experts in AC in Nigeria put more pressure on managers to provide more quality financial reports. The result also discloses that involvement of shareholder in AC has a significant negative association with coefficient of -0.4205 and p-value of 0.000. This implies that the inclusion of shareholders in the AC decreases the extent of EM by parameter value of -0.4205 on the econometric assumption that all other factors remain constant. Consequently, there is enough evidence to support the existence of a significant impact of ACSH on EM. The negative association supports the established theoretical assumption of both the agency and resource dependence theories. Thus, hypothesis 3 is rejected. Looking at the control variables, the result for FSZE indicates a significant negative relationship with p-value = 0.000 while the coefficient value is -0.1608. The negative relationship between FSZE and EM is consistent with Ragab (2014). It is widely believed that large firms can disclose more qualitative financial information at low cost as they have sufficient resources to gather and analyse the data (Arowolo & Che-Ahmad, 2017). The result of FAGE indicates a positive and insignificant relationship with p-value = 0.760 and coefficient of 0.0016. This means that the FAGE has negative impact on the FRQ because the results show that FAGE increases the extent of EM by parameter value of 0.760 on the econometric assumption that all other factors remain constant. This finding is in accordance with the findings of Kamolsakulchai (2015).

They found that firms' performance decline with their age, and that older firms have a lower level of productivity and profitability which consequently effect their compliance with the mandate of presenting a qualitative financial report.

5. CONCLUSION AND RECOMMENDATIONS

The zeal of the shareholders involved in AC to protect their investment against misappropriation enables them to closely monitor the managers' activities and scrutinize the financial reports vigorously. This is because shareholders are not likely to connive with managers in earnings smoothing to display a script-like performance in the AGM in favour of the manager's financial report. Therefore, involvement of shareholders in AC is essential as it gives confidence to them that the financial reports are true and fair. This can also enhance the system of internal control in an organisation. Consequently, involvement of shareholders in AC could provide the needed monitoring and restrain EM practice in firms listed on the NSE. The result is consistent with the agency and resource dependence theories as involvement of shareholders in AC brings stakeholders' confidence, reduces conflicts and leads to inflow of resources in the firms. The board of directors should therefore, ensure appointment of sufficient audit committee members with adequate financial expertise in which shareholder should be included. This will enable them to perform their functions effectively through proper oversight function and create good atmosphere for the statutory audit. This can also lead to suppressing reporting irregularities and increase public confidence regarding the quality of financial report.

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