

# BOARD ATTRIBUTES, AUDIT COMMITTEE COMPOSITION, AND FINANCIAL REPORTING QUALITY OF COMMERCIAL BANKS IN NIGERIA

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## ABSTRACT

The aim of this study is to evaluate the relationship between the board of directors' attributes, audit committee composition and financial statement quality of commercial banks in Nigeria. The data were collected for the study from the annual reports of twenty (20) commercial banks using contents analyses technique and covered a period of ten (10) years from 2010 to 2019. The Modified Jones quality of accruals model and the ordinary least square (OLS) technique of regression were used in analyzing the data for the study. The research findings showed that audit committee that comprises more independent members has significant positive effect on financial statement quality. In addition, the size of the board of directors also revealed a positive relationship with the financial statement quality. Consequently, the findings showed that board composition has a significant positive relationship with the financial statement quality. Therefore, the study concludes that the audit committee composition affects the of financial statement quality. Moreover, the effect of the composition of the board of directors and their numerical size does not have much effect on the financial statement quality of commercial banks. Therefore, there is a need to appraise and fortify the composition and task of the audit committee especially in monitoring and oversight function on the financial statements in order to enhance the financial statement quality. The composition and size of the board of directors in commercial banks in Nigeria should be reviewed and the board empowered to exercise a more active role in the financial statement process.

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## 1. INTRODUCTION

The financial statements being issued annually by listed firms are obviously the major sources of information about corporate organizations. Through the financial statement, stakeholders can make judicial investment and fund commitment decisions by properly assessing the previous and present performance of an organization based on its previous performance in relation to other organizations in the same industry and across the whole economy. Although there are other sources from which financial information can be obtained about a corporate organization, the financial statements published by the concerned firms trumps them all as its content is generally more reliable due to its fidelity. In an event where information in the financial statement is identified to be materially misleading, the concerned firm as well as its auditors and regulators may be plunge into crises which may result to litigation and consequently liquidation. However, as a numerous scandals have shown, the contents of financial statements remain a source of worries for stakeholders. As noted by Ezelibe, Nwosu & Orazulike (2017) and Aifuwa, Embele, & Saidu (2018), high profile scandals like the ones involving Enron and Worldcom in the US and Cadbury, Afribank and Intercontinental Bank PLC in Nigeria involved major fraud and falsification of contents of financial statements. To avert financial statement fraud crisis, firms take a wide range of measures which comprises setting up committees whose tasks include monitoring the contents of the financial statement closely from compilation to publication. One of such committees is the audit committee which according to Holtz and Neto (2014) consists of a selection of board members of a company saddled with the responsibility of oversight of the companies accounting and financial statement as a good corporate governance tool which enhances the integrity of financial statement. Kantudu and Samaila (2015) further opined that corporate organization establish the audit committee so as to enhance the standard of financial practices and earnings besides reinforcing the integrity of financial reports. However, as observed by Muhammad, Ayoib and Noor (2016) audit committees in Nigeria have not shown the capability to perform expected supervision responsibilities as evidenced in

the crush of financial institutions and mismanagement by the executive directors. Therefore, questions continue to be raised about the efficiency and competence of the firms' audit committee.

Moreover, board attributes such as independence, composition, structure, and experience also affect the quality of financial statement. As affirmed by Ibrahim and Jehu (2018), board members independence assists in preventing compromise between the management and the board of directors. Ibrahim and Jehu (2018) affirm that larger corporate boards are less proficient monitors than small boards, because of membership coordination and free-rider related problems. Conversely, smaller boards may also lack the numerical power required to properly exercise their monitoring role. The subsequent sections of the study provide a problem statement, objectives, research questions as well as hypotheses of the study. It also go further to provide literature review, methodology, empirical results and finally, concludes the study.

### **1.1 Problem Statement**

Financial statement is a valuable tool needed by users for useful economic decision. It is thus, essential that information reported are scrutinized by an independent audit and are meaningfully dependable, realistic and efficient. However, recent financial reporting times have witnessed constant issues of corporate reporting scandals that have put forward, a lot of questions concerning the quality of financial reports. The consequences of scandalous profit publications coupled with the crucial collapse of major firms across the world are seen as unavoidable indicators (Enofe, Edemenya & Osunbor, 2015). This has resulted to the critic of the efficiency of the board towards its financial reporting responsibilities and overall management of the firm. Similarly, Akeju and Babatunde (2017) are of the view that some firms' audit committees lack the required competence that will enable them to effectively check the work of executive directors and come out with concrete recommendations that will improve the reporting system of the firm. The revised Nigerian Code of Corporate Governance advocates a unitary board structure in which Non-Executive Directors (NEDs) are required to bring an independent verification to the board thereby separating management from decision control (Salaudeen, Ibikunle & Chima, 2015). However a main argument that tends to obstruct this fact is that directors and audit committee members are mostly appointed by the same management. This is a practice which tends to hinder the sanctified quality of the board independence. The request for independent directors was increased after the high-profile collapse of some firms both internationally and locally such as WorldCom, Anderson, Xerox, Enron, Parmalat, Intercontinental Bank Nigeria Plc, Savanna Bank Nigeria Plc, Oceanic Bank Nigeria Plc, and the financial malfeasance of some entities such as Unilever Nigeria Plc, Cadbury Nigeria Plc, Bank of Montreal, and the rest (Ofurum & Egbe, 2016). Finally, emanating from the problem of director's independence is the aspect of board diversity. Conventional boards are being criticised mostly for promoting homo-social domination and a small number of foreign board members (Onourah & Imene, 2016). The corporate boards are at present dominated by male directors with little chance for female representation and foreign directorship which result to forfeiture of their useful contribution, as they may bring diversity of ideas and experiences as well as decreasing information asymmetry and the related agency costs (Daghnsni, Zouhayer & Mbarek, 2016).

### **1.2 Objectives of the Study**

The main objective of this study is to evaluate the relationship between the board of directors' attributes, audit committee composition and financial statement quality of commercial banks in Nigeria. The specific objectives are:

- i. Assess the impact of board size on the quality of financial statement.
- ii. Assess the impact of board composition on the quality of financial statement.
- iii. Assess the impact of audit committee composition on the quality of financial statement.

### **1.3 Research questions**

This research attempts to provide answers to the following questions:

- i. What is the impact of board size on the quality of financial statement?
- ii. What is the impact of board composition on the quality of financial statement?
- iii. What is the impact of audit committee composition on the quality of financial statement?

### **1.4 Research Hypotheses**

In order to answer the above questions, the following hypotheses are tested.

- H<sub>o1</sub>** There is no significant relationship between board size and financial statement quality.  
**H<sub>o2</sub>** There is no significant relationship between board composition and financial statement quality.  
**H<sub>o3</sub>** There is no significant relationship between audit committee composition and financial statement quality.

## **2. LITERATURE REVIEW**

### **2.1 Review of the Concepts**

#### **2.1.1 Board Attributes**

The main idea behind the formation of board of directors is to constitute a strong team of business and financial experts capable of monitoring the operation of the company and performance of the executive directors. According to Makhoulouf, Al-Sufy and Almubaideen (2018), the board of directors is responsible for the internal control system of a company with a fundamental task for the overall operation of the firm. They define and set the policy and guidelines for the executive directors

concerning plans, targets, budgets and provision of strategic guidelines. Proper execution of their mandate can shape the actions of executive directors towards effective management, accurate record keeping and consequently coming up with reliable and consistent annual report. The board of directors' attributes can be labeled in terms of board independence, board composition, board size, gender diversity, board education and board activity, board age among others. This study will focus on board composition and board size. The board size comprises all individuals that constitute the board of directors regardless of their other attributes. Several researchers have expressed varied opinions on the impact the size of the board plays in their ability to deliver on their mandate. Al-Shaer, Salama and Toms (2017) opined that relatively smaller boards tend to perform better than larger boards because they are easier to be coordinated/observed and not prone to the free rider problem. Conversely, Eyenubo, S. A., Mudzimir, M. and Ali, M. (2017) averred that larger boards are better able to discover more opportunities and secure the required resources for the company.

The board of directors consists of executive and non-executive (independent) directors. An independent board comprises more non-executive directors than their executive counterparts. The significance of board independence is that non-executive members are more inclined to act in the best interest of shareholders than executive members who tentatively are expected to act in their own best interest. According to Daghsni, Zouhayer, and Mbarek (2016), "the board independence is considered the most significant factor influencing the effectiveness of the board of directors in reducing the discretionary and opportunistic actions of the firm's management". Adebisi, (2017) asserted that non-executive directors help to restrain managerial chance of misappropriations that are capable of declining the quality of accounting information contained in the financial statements. Therefore as stated by Ilaboya and Lodikero (2017), compromise by the directors and management can be controlled by having a board where independent directors are sufficient. This is an indication that shareholders are properly represented.

### **2.1.2 Audit Committee Composition**

Audit committees assist in the decrease of errors and enhancing regulatory compliance monitoring of risk management and internal control systems and increase both mandatory and voluntary disclosures. According to Kipkoech and Rono (2016), the audit committee is an active committee constitutes to improve firm's accountability through working with internal auditors and management of firms to improve and enhance the accounting and financial statement practices and ensures proper conduct of corporate affairs in conformity with generally accepted legal and ethical standards. To ensure proper monitoring of annual reports in Nigeria, the CBN provides the code of corporate governance for commercial banks in Nigeria. It is also further supplemented by Securities and Exchange Commission which regulates the activities of all Nigerian listed firms. For non-banking businesses and unlisted companies, the Companies and Allied Matters Act (CAMA) provides an impression of a code of corporate governance for registered companies. CAMA stipulates that the audit committee comprise of six members drawn from three board members and three from the firm's shareholders. However for listed companies, the SEC further enhances the components of the audit committee by clarifying the addition of independent board members. The CBN further reinforces this code for banks by mandating that those representing shareholders should be selected from the ordinary shareholders and openly appointed during the banks' annual general meetings (AGM). The Audit committee in commercial banks composes of members appointed from the shareholders and board of directors. This structure is designed at ensuring that management and shareholders are sufficiently represented in audit committee considering the critical nature of their task, where the shareholders are expected to protect the interest of the owners by ensuring that published financial statements are true representation of the state of affairs in the company.

### **2.1.3 Financial Reporting Quality**

Firms that are known with providing questionable information in their financial statements may suffer financial crises and smear of their image and confidence with their stakeholders. According to Kusnadi, Leong, Suwardy and Wang (2016), financial statements provide an avenue for communicating information regarding the financial dealings of companies to stakeholders. It represents a device of identifiable stewardship (Nwanyanwu, 2013). According to Mouselli, Jaafar and Hussainey (2012), "qualitative financial statement is complete and transparent financial information that is designed to guide the users of the report. Moses (2016) further asserted that financial statements quality can be measured from the extent the annual report provided therein is authentic and fair information regarding the financial status and performance of a firm. Provision of qualitative financial statement by companies is important not only for the organization concerned but also for the industry and the economy at large.

## **2.2 Theoretical Framework**

The theories being considered by the previous researches to justify the need for effective corporate governance comprises agency theory, stakeholders' theory, institutional theory and stewardship theory among others. While each of the theories and their advocates have developed well through proposals, this particular research considers the stakeholders' theory as the most appropriate among them. The agency theory for instance which focuses on the conflict of interest between the managers (agents) and the owners of the firm (principals) is restricted to the relationship that exist between the agent and his principal with other stakeholders downgraded to the background in terms of significance. On the other hand, the stewardship theory proposes that the agent (steward) will act in the best interest of the principal, even without the significant influence of the board of directors and audit committee.

However, practical experience has proven that this view is not correct, as realistic evidence shows that managers usually act in their best interest to the detriment of the shareholders. The stakeholder theory holds a more holistic view of the firm including investors, employees, suppliers, customers, and other categories of the society who may be affected by the firm. The stakeholder theory is therefore an extension of the agency theory because it recognizes the stakeholders as important to the company's survival (Ofoegbu, Odoemelam, and Okafor, 2018). Therefore, the corporate governance system in the framework of the stakeholder theory is likely to provide for the interests of not only the shareholders but all stakeholders, (Sanders, Lewis & Thornhill, 2016). Additional to this view is the fact that the annual report produced by the company which is required to be inspected by the audit committee and board of directors is used by all categories of stakeholders. Therefore, the monitoring and supervision role of these corporate governance mechanisms are of significance to the entire stakeholders.

### **2.3 Empirical Review**

In a study conducted by Adebisi (2017) who examined how board composition affects financial reporting quality of deposit money banks in Nigeria. The study which used a sample of fifteen commercial banks between 2008 and 2017 and analyzed data using ordinary least square (OLS) regression and panel data estimation method. The study showed that board composition has significant impacts on financial reporting quality in Nigerian commercial banks, as discretionary accrual which was a proxy for financial reporting quality was shown to be related positively to board independence and board size. Similarly, in a study conducted by Holtz and Neto (2014) on the "effects of board of directors' attributes on the quality of accounting information in Brazil" indicated that board independence and separation of the roles of chairman and that of executive director influenced the quality of accounting information positively. These findings entail that stronger governance systems have a significant positive impact on the quality of financial statements. Kipkoech and Rono (2016) also determine the effect of audit committee and experience on firm performance in Kenyan listed firms. The study covered the period 2006 to 2011 and uses the multiple regression analyses hypotheses testing. The findings showed that experienced audit members reduce financial misrepresentation and improve quality monitoring which consequently enhance the quality of financial reporting. The findings showed that audit committee size and their experience affect the performance of the firms significantly.

Furthermore, Moses, Ofurum, and Egbe (2016) in their study titled "audit committee attributes and quality of financial statement in listed Nigerian banks" used five years documentary records from the annual financial reports and accounts of 15 banks which were analyzed using correlation and modified Modified Jones model. Their findings indicated insignificant impact between audit committee size and the quality of financial statement in listed Nigerian banks. Their study recommends that audit committee size be significantly increased with experts with accounting and finance knowledge and experience. In addition, Eriabie and Izedonmi (2016) assessed the impact of Audit Committee on financial statement quality in Nigerian listed companies in Nigeria. Data were sourced from annual reports of one hundred and twenty (120) companies for the periods, 2009 to 2015 and analyzed using correlation and ordinary least squares (OLS) regression. Their findings revealed that audit committee attributes, such as independence, frequency of meetings, size and financial literacy, had significant positive effect on financial reporting quality. Similarly, in a study conducted by Umobong and Ibanichuka (2017) the relationship between audit committee attributes and financial reporting quality of food and beverage firms was examined using secondary data gathered from the Nigeria Stock Exchange. Audit committee independence and financial expertise were regressed against financial reporting quality measured by relevance and reliability. Their study findings revealed that an increase in audit committee independence, firm age, financial expertise of members and frequency of meetings increase financial reporting quality. However, increase in audit committee size and firm size decreases financial reporting quality.

Ibrahim and Jehu (2018) assessed the relationship between board composition and financial statement quality using data from 150 Nigerian firms between 2013 and 2016. The results from the multivariate regression analyses revealed that the rate of independent directors and that of the independent non-executive directors have a significant negative relation with abnormal accruals, which consequently, improves the quality of financial reporting. However, board size was not statistically significant. Finally, Onyabe, Okpanachi, Nyor, Onipe, and Mohammed (2018) observed the effect of the audit committee meeting and expertise on financial statement quality of commercial banks in Nigeria. The study obtained data from the Nigerian Stock Exchange fact-books and the financial statements of fifteen commercial banks for a period of ten years beginning from 2008 to 2017 adopted the modified Jones (1991) model to evaluate financial statement quality. The findings indicate that the audit committee meeting had a positive insignificant effect on financial reporting quality. On the other hand audit committee expertise had a negative effect on the financial reporting quality of the banks.

## **3. METHODOLOGY**

In this study, data were collected from the secondary sources using the method of content analyses from the annual reports of a sample of 20 commercial banks in Nigeria i.e (First bank, Access Bank, Polaris bank, Diamond Bank, Guaranty Trust Bank, Fidelity Bank, Ecobank bank, Unity Bank, Sterling Bank, WEMA bank, Zenith bank, FCMB, Union Bank IBTC and UBA,) selected on the basis of availability of data. The period covered is ten (10) years from 2010-2019. The data collected consist of audit committee composition (AUCOM) measured as the proportion of the independent members of audit committee to the total audit committee size; board of directors attributes comprising - board size (BDSZE) measured as total number of board members and board composition (BDCOM) measured as the proportion of independent members to the

totality of board size; financial reporting quality (FRQL) was measured using the modified Jones model for accrual quality as advocated by Dechow, Sloan, and Sweeney (1995) and Mouselli, Jaafar, and Hussainey (2012) and generally accepted by accounting researchers as a good measure of financial statement quality. It is estimated by determining discretionary accruals (DAC) from the total accruals (TAC) and non-discretionary accruals (NDAC) in the model.

$$DAC = [(TAC_{i,t} / TAI_{i,t-1}) - NDAC_{i,t}] \dots \dots (1)$$

Where:

$$TAC = (\Delta CA_{i,t} - \Delta CASH_{i,t}) - (\Delta CL_{i,t} - \Delta STDEBT_{i,t}) \dots \dots (2)$$

$$NDAC = (1/TAI_{i,t-1}) + [(REVI_{i,t} - RECI_{i,t}) / TAI_{i,t-1}] \dots \dots (3)$$

$\Delta CA$  = change in current assets

$\Delta Cash$  = change in cash and cash equivalent

$\Delta CL$  = change in current liabilities

$\Delta STDEBT$  = change in short-term debt

$TAI_{i,t-1}$  = the lagged value of bank i's total assets

$\Delta REVI_{i,t}$  = change in annual revenue of bank i in year t from period t-1

$\Delta RECI_{i,t}$  = change in receivables of bank i in year t from period t-1.

Using the ordinary least square (OLS) regression technique of data analyses and using bank size (BNKSZE) and bank age (BNKAGE) as control variables, it therefore designed that:

$$\text{Financial reporting quality} = f(\text{audit committee composition, board attributes, bank size, bank age}) \dots (4)$$

Where financial reporting quality is indicated as (FRQL); audit committee composition is indicated as (AUCOM); board size is indicated as (BDSZE), and board composition is indicated as (BDCOM); bank size (BNKSZE) and bank age (BNKAGE), the above equation is rewritten in econometric form as:

$$FRQL = \beta_0 + \beta_1 AUCOM + \beta_2 BDSZE + \beta_3 BDCOM + \beta_4 BNKSZE + \beta_5 BNKAGE + \mu \dots (5)$$

Going by the results of previous empirical studies reviewed, it is expected that in this current study the results for  $\beta_1$ ,  $\beta_2$ , and  $\beta_3$  will be higher than zero.

#### 4. DATA ANALYSES AND RESULTS

**Table 1.** Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Probability
C	20.84121	26.75135	0.746243	0.5933
AUCOM	1.843100	0.6038929	0.934765	0.3226
BDSZE	0.039343	0.884126	0.031964	0.8955
BDCOM	4.032683	2.014762	1.919778	0.0745
BNKSZE	3.175430	1.577424	2.024160	0.0439
BNKAGE	-0.083660	0.132319	-0.485827	0.7283
R-squared	0.357214	Mean dependent var		27.12269
Adjusted R-squared	0.247234	S.D. dependent var		25.62205
S.E. of regression	26.14134	Akaike info criterion		9.405621
Sum squared resid	98061.02	Schwarz criterion		8.514676
Log likelihood	-689.0553	Hannan-Quinn criter.		9.467850
F-statistic	2.2189	Durbin-Watson stat		1.449702
Prob(F-statistic)	0.058433			

*Dependent Variable: Financial Reporting Quality*

*Method Adopted: Ordinary Least Squares*

*Sample Firms: 20*

*Total Observations: 200*

The regression result shown in table 1 indicates that the audit committee (AUCOM) consist more of independent members has a significant positive effect on the financial reporting quality (FRQL) of Nigerian commercial banks. Given a coefficient of regression of 1.8431 suggesting that one unit increase in the audit committee independence will forecast 1.8431 units increase in the financial reporting quality. Additionally, the size of the board of directors (BDSZE) also reveals a positive relationship with the financial reporting quality (FRQL) published by the commercial banks. Given a value of coefficient of regression 0.0393 which shows that a unit increase in the board of directors' size will give 0.0393 units increase in the financial reporting quality and vice versa. Going by the result obtained, it can be seen that the effect of board size on the quality of financial report is relatively low indicating that it has a very weak effect on the quality of financial reporting. The findings also show that board composition (BDCOM) has a positive relationship with the quality of financial reports of commercial banks. With a coefficient of regression value of 4.0326 indicating that greater numbers of independent members represented

in the board of directors will lead to higher levels of quality of financial reports. The R-Squared gave a value of 0.3572 indicating that composition of audit committee (AUCOM), Board size (BDSIZE) and board composition (BDCOM), as well as the controlling variables; bank size (BNKSZE) and bank age (BNKAGE) as a unit, can represent about 35.72% of the changes in the quality of financial reports published by commercial banks in Nigeria. Lastly, it is observed that all the variables had no statistical significant relationship with financial reporting quality of commercial banks in Nigeria. This is due to the fact that the probability of t-statistics gave values for audit committee composition (AUCOM), the board of directors size (BODSIZE) and board of directors' composition (BDCOM) as 0.3226, 0.8955, and 0.0745 respectively which were higher than the probability default value of 0.05. Therefore, all the three null hypotheses are not rejected indicating that audit committee composition, the board of directors' size and board of directors' composition have no statistical significant relationship with the quality of financial reports.

## **5. DISCUSSION OF FINDINGS**

The findings of this study revealed that the audit committee that composed of more non executive members has a positive effect on the quality of financial statement of commercial banks in Nigeria, considering the coefficient of the regression value of 1.8431. This finding is in line with Umobong and Ibanichuka (2017) who affirmed in their research that financial statement quality increases with the increase in financial expertise of audit committee, independence of audit committee, frequency of meetings and firm's age. However, increase in the audit committee size and firm size declines the reporting quality. Similarly, Eriabie and Izedonmi (2016) revealed that audit committee attributes, such as financial literacy, size, independence, frequency of meetings, and meeting attendance had a significant positive effect on the quality of financial statement in Nigerian firms. Moreover, the size of the board of directors also indicates a positive relationship with the quality of financial statement being published by the commercial banks in Nigeria, with a value of coefficient of regression 0.00341 which indicates that a unit increase in the size of board of directors will result in 0.00341 units increase in the quality of financial statement and vice versa. This shows a very weak effect of the board size on the quality of financial statement. This finding opposes the findings of Ayinde, (2002) which argue that having a small size of board will result to significant performance in the financial statement quality because smaller board of directors is easier to manage and controlled. In a similar study, Adebisi (2017) revealed that discretionary accrual as a measure of financial statement quality had a positive relationship with board size and board independence. Finally, the findings showed that board composition had a positive relationship with the financial statement quality of commercial banks, with a coefficient of regression value of 4.03268 which shows that greater number of independent board members will result to higher levels of financial statement quality. This concurs with findings of Ibrahim and Jehu (2018) that assessed the relationship between board composition and financial statement quality and found that the proportions of the non-executive directors, as well as that of the independent non-executive directors, have a negative and significant relation with abnormal accruals, which will consequently improves the quality of financial statement.

## **6. CONCLUSION AND RECOMMENDATIONS**

Audit committee which is mostly being derived from board of director and shareholders, serve as a back bone for promoting accountability and success of an enterprise. The effect of audit committee composition on the financial statement quality of commercial banks in Nigeria is very crucial. A review of the composition of the audit committee to include more independent members who are suitably qualified for the task in terms of both expertise and integrity, will improve their impact on the quality of financial statement. The fact that the board of directors in Nigeria seems to be excessively large and focus towards supporting more executive members than non-executive members, is a reason the size and composition of the board of directors fail to have much effect on the financial statement quality published by commercial banks. Finally, the monitoring role of the board of directors on the quality of financial statement of commercial banks in Nigeria is generally vested in the audit committee - making the board of directors a more or less an observer role regarding financial statement quality. The board of directors should be allowed to play a more active role in the financial statement process of commercial banks in Nigeria. There is also need for firms to appraise and fortify the composition and task of the audit committee especially in monitoring and oversight function on the financial statements in order to enhance the financial statement quality

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