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RESEARCH ARTICLE

BOARD ATTRIBUTES AND QUALITY OF FINANCIAL REPORTING IN NIGERIAN COMPANIES: AN EMPIRICAL EVIDENCE

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ABSTRACT

The study x-rays the relationship that board expertise and board independence have on financial reporting quality in Nigeria. The study used data gathered from forty quoted companies for the period 2010- 2015. The study conducted descriptive statistics and correlation matrix and the analysis was done using ordinary least square. The study revealed that board expertise had a positive significant relationship on financial reporting quality. On the other hand, board independence had a positive insignificant relationship on financial reporting quality implying that increase or decrease of members that are independent of the board has no significant impact on financial reporting quality. The study concluded that board expertise is a major determinant of financial reporting quality. The study recommended that management should increase the number of members with expertise on the board since it will go a long way in enhancing financial reporting quality among others.

KEYWORDS

Board Expertise, Board Independence, Financial Reporting Timeliness

1. INTRODUCTION

The rate of business failure is sporadic as evidenced by Enron, Worldcom, Sunbeam, Cadbury Nigeria Plc. and other high-profile scandals. The causes of such failure, according to a researcher, are excessive short-term strategies which undermine market credibility and discourage long term value creation and investment [1]. The consequences of institutional failure on economic growth and sustainable development are unbearable to a developing country like Nigeria. This affects the level of confidence the public has in various corporate establishments. The consequences of ineffective corporate governance not only affect the shareholders but also, the employees, suppliers, consumers and the nation as a whole. Thus, a governance system that promotes ethical value, professionalism and sound management practice is desirable.

The Code of Corporate Governance in Nigeria 2011 (2011 SEC Code) was issued by the Securities and Exchange Commission and became effective on 1st April 2011. The stated intention of the SEC in making the 2011 SEC Code is to ensure that the Code is consistent with international best practices on corporate governance [2]. Evidently, as can be gleaned from its provisions, there was a deliberate attempt to align the provisions of the 2011 SEC Code with international best practices on corporate governance. However, the most elaborate provision of the subject in Nigeria can be found in the 2011 SEC Code. In section 5.1(b), it provides that the positions of the Chairman of the Board and Chief Executive Officer shall be separate and held by different individuals. Section 5.1(a) thereof pointedly declares that the chairman's primary responsibility is to ensure effective operation of the board such that it works towards achieving the company's strategic objectives; and not to be involved in the day-to-day operations of the company.

There have been several reasons of corporate failures in the past and some of the reasons stated for these corporate failures are the lack of vigilant oversight functions by the board of directors, the board relinquishing control to corporate managers who pursue their own self-interests and the board being remiss in its accountability to stakeholders. As a result, various corporate governance reforms have specifically emphasized on appropriate changes to be made to the board of directors in terms of its composition, structure and ownership configuration [3]. A researcher establishes negative relationship between the independence board and firm performance [4]. Similarly, a group of researchers document no relationship between independence board and firm performance [5,6].

In view of the above, it is important to note that Nigeria's neglect of core issues, which have been regarded as nation's building blocks, has had a negative impact on the country. Amongst these issues were improper rules and regulations from all governing bodies, especially the banking sector. This lack of respect for rule of law also impacted negatively on the way business was done, subsequently affecting corporate governance.

Therefore, this study contributes to knowledge by using Nigerian data to investigate the likely impact of board expertise and board independence on firms' financial reporting quality.

2. LITERATURE REVIEW

2.1 Conceptual Issues and Hypothesis Development

Corporate governance can generally be defined as the sum total of organizational mechanisms geared towards limiting the managers' powers and influence in decision making process; notably these related to funding and investment [7]. The ways a firm invests shareholders' funds determines its performance and goes a long way in determining its ability to achieve its objectives. Board composition denotes the percentage of board members who are employees of organizations who are referred to as internal board members and those who are outsiders. Outside directors are at times referred to as independent directors or non-executive directors who do not participate in the day to day running of the company [8]. Independent directors hold a special status as leading protagonists in companies' boards.

Accountability is presumed to be more properly and adequately rendered by a board comprising a majority or super majority of independent directors. A previous scholar notes that independent directors are more willing to provide oversight and disclosure due to their desire to maintain their reputations and improve firm performance. Based on a study, the outside directors of the company board tend to ensure their right in the company [9]. They concluded that the more outside members were on the board, the better the firm's performance. Installing a board of directors can be an effective instrument for monitoring top managers and coping with this problem and to reduce agency costs and enhance firm performance.

2.1.1 Board Expertise and Financial Reporting Quality

The functional experience and professional background of board members has now been recognized as very significant and germane to the firm financial reporting quality. A researcher found board expertise to be associated with a lower incidence of restated earnings [10]. A group of researchers investigated board of directors' composition and corporate performance and found a positive relationship between board expertise and firm financial reporting quality [11]. This means the intricacies of daily business activities, transcends professional expertise and earnings growth requires greater entrepreneurial skills which finance knowledge, may not necessarily confer. A scholar focused on 1574 directors of firms among 224 Switzerland quoted companies and reported a positive relationship between board expertise and financial reporting quality [12]. This necessitates the postulation of the hypothesis as follows:

H_0 1: There is no significant relationship between board expertise and financial reporting quality.

2.1.2 Board Independence and Financial Reporting Quality

Mura (2007) notes that independent directors are more willing to provide oversight and disclosure due to their desire to maintain their reputations and improve firm performance. A scholar claim that the outside directors of the company board tend to ensure their right in the company. They concluded that the more outside members were on the board, the better the firm's performance. Installing a board of directors can be an effective instrument for monitoring top managers and coping with this problem and to reduce agency costs and enhance firm's performance.

The focus on board independence is grounded in the agency theory [13]. From the banking sector's perspective, board composition is expected to play an important role in synchronizing the interest of managers and those of the shareholders. It is widely argued that the presence of directors who are not employees of the bank may enhance the effectiveness of the board in monitoring managers, and hence improve bank value and performance. This is because independent directors are more likely to defend the interests of external shareholders better compared to internal directors. In the study of the efficiency of Chief Executive Officer monitoring mechanism between inside and outside directors finds that outside directors play an important role in monitoring the Chief Executive Officer and are more likely than inside-dominated board of directors to replace a non-performing Chief Executive Officer [14]. The banks corporate governance system is based on three principles: to receive non-confidential information on how the bank is functioning, to effectively control the bank and its managers through deliberations in general meetings and to foster banks' long-term interests in tandem with those of the shareholders; more specifically shareholders wealth maximization. This necessitates the postulation of the hypothesis as follows:

H_0 2: There is no significant relationship between board independence and financial reporting quality.

2.2 Theoretical Framework

The theoretical framework on which this study is based is the resource dependency theory

2.2.1 Resource Dependency Theory (RDT)

Resource dependency theory explains that organizations depend on resources from external sources which affect it corporate governance structures in terms of the strategic management of external relations alongside enforcing control over such organizations. A group of researchers asserts that Resource Dependency Theory has its origins in open system theory as such organizations have varying degrees of dependence on the external environment, particularly for the resources they require to operate. They express the same view as proponents of the theory who suggest that company should seek proactively to control resources in order to improve organizational performance.

The hallmark of resource dependence theory that distinguishes it from transaction cost economics is the emphasis on power and a careful articulation of the explicit repertoires of tactics available to organizations. This follows that directors or non-executive are greatly appreciated than their inside directors' counterparts because of their ability to provide the organization with resources that would enhance firm's performance as put by proponents in terms of board capital and board motivation.

3. METHODOLOGY

The research design adopted is the ex-post facto research design which enables the researcher to ascertain the impact of the independent variable on the dependent variable. The data for the quoted companies were sourced from the Nigeria Stock Exchange fact books and the company's annual financial reports. The data were hand collected by the researchers. The population of this study consists of all 189 companies trading on the Nigerian Stock Exchange as at 2015 [15]. The sample size of this study is made up of 40 selected firms from the 189 companies trading on the Nigerian Stock Exchange. The sample of the firms was selected using convenience sampling technique. This technique is a non-probability sampling technique that allows the researcher subjectively select a sample size. The ordinary least square method of regression analysis was used to examine the relationship between the dependent and independent variables.

3.1 Model Specification and Operationalization of Variables

Two (2) variables representing board composition which are Board expertise and Board independence were selected in order to ascertain its relationship on financial reporting quality in Nigeria. The study employed the Jones model. The model attempts to control the effects of changes in a firm's economic circumstances on non-discretionary accruals.

$FRQ = \beta_0 + \beta_1$ BDEXP $+ \beta_2$BDIND $+ U_t$…………… eq. (1).

Where:

FRQ = Financial Reporting Quality

BDEXP = Board Expertise

BDIND = Board Independence

βo, β_1, β_2 are parameters

Ut = Stochastic error term

3.1.1 Measurement of Variables

Financial Reporting Quality: This is measured by the discretionary accruals of firms.

Board Expertise: This is taken as education, skills and professional status of directors.

Board Independence: This is taken as the number of non-executive or independent directors on the board.

Table 1: Measurement of Variables

1.	Financial Reporting Quality	FRQ	Measured by the discretionary accruals of firms	VanBeest, Braam and Boelens (2009)
2.	Board Expertise	BDEXP	Measure as education, skills and professional status of directors.	Agrawal and Chadha (2005)
3.	Board Independence	BDIND	The number of non executive or independent directors sitting on the board of directors.	Ilaboya and Iyafekhe (2014)

4. RESULTS AND DISCUSSION

The statistical method of descriptive statistics, correlation and regression analyses was used to analyze the data collected for this study.

4.1 Descriptive Statistics

Table 2: Descriptive Statistics

	FRQ	BDEXP	BDIND
Mean	1.329896	0.061053	6.260753
Median	-0.052250	0.001253	6.000000
Maximum	23.56230	1.008854	13.00000
Minimum	-21.98420	0.000163	2.000000
Std. Dev.	7.097926	0.213312	2.092025
Skewness	1.038693	3.408013	0.609105
Kurtosis	8.513725	12.99414	3.297479
Jarque-Bera	117.1688	493.9011	24.37421
Probability	0.000000	0.000000	0.000005
Sum	107.7216	4.945322	2329.000
Sum Sq. Dev.	4030.444	3.640163	1623.707
Observations	40	40	40

Source: E-view output (2017)

The descriptive statistics of the variables used in the analysis are presented in Table 4.1. Financial Reporting Quality is the dependent variable and constitutes the main variable of interest from the table 4.1. Financial reporting quality has a mean value of 1.329896 and a median value of -0.052250. It had a maximum value of 23.56230 and a minimum value of value of -21.98420. Financial reporting quality was positively skewed with value of 1.038693. While board expertise had a mean value of 0.061053 and a median value of 0.001253. Board expertise was positively skewed with value of 3.408013. The standard deviation of board independence was 2.092025 which was far from the mean value of 1.329896. This suggests a high degree of variability of the data between time series. The result further revealed that board expertise had the lowest mean with a value of 0.061053, and also median value of 0.001253. All the independent variables exhibited positive skewness. The Jacque-Bera probabilities with $p<0.05$ is an indication that all the variables are normally distributed.

4.2 Correlation Analysis

Correlation: t-Statistics

Probability	FRQ	BDEXP	BDIND
FRQ	1.000000		

BDEXP	-0.055994	1.000000	
	-0.498467	-----	
	0.6195	-----	
BDIND	0.282511		1.000000
	2.617649		-----
	0.0106		-----

Source: E-view (2017)

In an attempt to explore the relationship amongst variables used in this study, correlation analysis was carried out. Table 2 shows the relationship amongst variable. The table shows that the co-efficient of correlation of a variable within respect to itself is 1.00. The analysis showed that board expertise had a negative relationship with financial reporting quality while board independence had a positive relationship.

4.3 Regression Analysis

Table 3: Regression Analysis

Dependent Variable: FRQ

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-7.668477	6.689887	-1.146279	0.2553
BDEXP	16.48703	4.814555	3.424414	0.0010
BDIND	1.135638	0.948268	1.197592	0.2348

R-squared	0.635101	Mean dependent var	1.329896
Adjusted R-squared	0.594843	S.D. dependent var	7.097926
S.E. of regression	6.369008	Akaike info criterion	6.600505
Sum squared resid	3082.884	Schwarz criterion	6.748311
Log likelihood	-262.3205	Hannan-Quinn criter.	6.659807
F-statistic	5.839873	Durbin-Watson stat	1.793950
Prob(F-statistic)	0.000375		

Source: E-view (2017)

The result of the regression analysis is presented in table 4.3. From the analysis, it can be seen that BDIND had a positive relationship with financial reporting quality while BDEXP had a negative relationship with financial reporting quality [16]. The R-squared value of 0.635101 was very high and indicates that 63 percent of the systematic variation was explained by the explanatory variables. This figure when further adjusted reduces to 0.594843. This indicates that the estimated model had a good predictive power since only 41 percent of the variations in the dependent variable was left unaccounted for. In terms of individual significance, board independence had a positive insignificant relationship with financial reporting. The study therefore accepts the null hypothesis and rejects the alternative hypothesis. However, board expertise had a positive significant relationship with financial reporting quality. The study therefore rejects the null hypothesis and accept the alternative hypothesis. The Durbin-Watson statistic of 1.793950 indicates the absence of autocorrelation in the model.

5. CONCLUSION

The focus of this study was to empirically examine the impact of board expertise and board independence on financial reporting quality in Nigeria. The study concludes that board expertise had a positive significant relationship on financial reporting quality which was consistent with the findings of a previous researcher. Board independence on the other hand had a positive insignificant relationship on financial reporting quality which was consistent with the findings of other scholars. The study therefore concluded that board expertise is a major determinant of financial reporting quality in Nigeria.

The quality of governance in organizations would in the long run determine the survival and stability of such organizations. Therefore, strong governance framework that enhances compliance and sanction non-compliance of corporate governance codes should be taken seriously and should not be treated with levity.

5.1 Recommendations

From the results, the following recommendations were made:

Management should increase the number of members with expertise on the board with a view to enhancing financial reporting quality. This is because the presence of more members with expertise on the board has the likelihood of increasing financial reporting quality.
The regulatory agency for companies should develop a checklist with which firms can scores themselves on the aspect of compliance with corporate governance codes.

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