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BOARD CHARACTERISTICS AND FINANCIAL REPORTING QUALITY IN NIGERIA: THE MODERATING EFFECTS OF BIG 4 AND AUDIT TENURE

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CERTIFICATION OF THESIS WORK (Ph.D)

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ABSTRACT

Accounting and auditing practices in Nigeria suffer from institutional weaknesses in terms of regulations, compliance, and enforcement of standards that resulted to poor financial reporting quality on firms in Nigeria. Literature review reveals the missing link between board characteristics and financial reporting quality. Based on this gap this research attempts to examine the relationship between board characteristics, audit quality, and financial reporting quality. Moreover, the moderating effect of audit quality has been examined to further explain the financial reporting quality in Nigeria. Secondary data collected from the annual reports over the period 2011-2015. Multiple regression analysis employed to determine the effect of the focal variables indicating that audit committee size, and audit committee expertise have a positive and significant impact on financial reporting quality. However, board independence is significantly negative. Furthermore, the results reveal a statistically significant association of the interaction of auditor tenure and Big 4 with board characteristics and financial reporting quality. The audit tenure positively moderates audit committee expertise and negatively moderates board independence, audit committee diligence, and audit committee size and financial reporting quality. Furthermore, Big 4 positively moderates block shareholding and negatively moderates audit committee diligence and financial reporting quality. This indicates that the Big 4 and auditor tenure have a monitoring ability in mitigating and thus, enhancing financial reporting quality of Nigerian listed firms. In addition, the result reveals that director shareholding and audit committee independence are either vain or less active in controlling the management to ensure high-quality reports. Theoretically, this study indicates that board characteristics possess the monitoring ability that could enhance financial reporting quality. In addition, it highlights that the high audit quality and board characteristics exert influence on financial reporting quality. The results have valuable practical implications for stakeholders, the board of directors, company management and researchers.

Keywords: financial reporting quality, board characteristics, audit quality, block shareholding.

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ABSTRAK

Amalan perakaunan dan pengauditan di Nigeria agak lemah akibat daripada kekangan institusi yang terdapat dalam peraturan, pematuhan, dan penguatkuasaan standard yang membawa kemerosotan kualiti pelaporan kewangan firma-firma di Nigeria. Rumusan karya telah mengenalpasti bahawa terdapat jurang hubungan antara ciri-ciri lembaga pengarah dan kualiti pelaporan kewangan. Berdasarkan jurang yang telah dikenalpasti, kajian ini cuba mengkaji hubungan antara ciri-ciri lembaga pengarah, kualiti audit, dan kualiti pelaporan kewangan. Disamping itu, impak moderat berasaskan Kualiti audit juga telah dikaji bagi menjelaskan dengan lebih lanjut tentang hubungan kualiti pelaporan kewangan di Nigeria. Data sekunder dikumpul daripada laporan tahunan sepanjang tempoh 2011-2015. Analisis regresi berganda digunapakai untuk menentukan kesan pembolehubah saiz jawatankuasa audit, kepakaran jawantankuasa audit mempunyai kesan positif dan signifikan terhadap kualiti pelaporan kewangan Walau bagaimanapun, kebebasaan lembaga pengarah adalah signifikan secara negatif. Tambahan lagi, keputusan kajian menunjukkan interaksi yang signifikan statistiknya bagi tempoh khidmat juruaudit dan 'Big 4' dengan ciri-ciri lembaga pengarah dan kualiti pelaporan kewangan. Di samping itu,'Big 4' telah memoderat pemegangan blok secara positif dan secara negatif terhadap ketekunan jawatankuasa audit terhadap kualiti pelaporan kewangan. Ini menunjukkan bahawa kebolehan 'Big 4' dan tempoh khidmat juruaudit mempunyai keupayaan pemantauan dalam mitigasi dan ianya, boleh meningkatkan kualiti pelaporan kewangan firma yang tersenarai di Nigeria. Disamping itu, hasil kajian ini menunjukkan bahawa pemegangan pengarah dan kebebasan jawatankuasa audit adalah samaada sia-sia atau kurang aktif dalam mengawal pihak pengurusan bagi memastikan laporan kewangan yang tinggi kualitinya. Secara teorinya, kajian ini menggambarkan ciri-ciri lembaga pengarah yang mempunyai keupayaan memantau juga meningkatkan kualiti pelaporan kewangan. Selain itu ia menonjolkan bahawa kualiti audit mapan dan ciri-ciri lembaga pengarah mempengaruhi terhadap kualiti pelaporan kewangan. Hasil kajian ini mempunyai implikasi praktikal yang berguna bagi pemegang taruh, lembaga pengarah, pihak pengurusan syarikat dan penyelidik-penyelidik.

Kata kunci: kualiti pelaporan kewangan, ciri-ciri lembaga pengarah, pemegangan blok,

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LIST OF ABBREVIATIONS

AAA	American Accounting Association
AC	Audit Committee
ACC	Audit Committee Characteristics
ACE	Audit Committee Effectiveness
ACIND	Audit Committee Independence
ACM	Audit Committee Meeting
AEP	Awards for Environmental Protection
AICPA	American Institute of Certified Public Accountants
APB	Auditing Practicing Board
AR	Auditor Rotation
BIND	Board Independence
BMEET	Board Meetings
BSHOLDN	Board Shareholdings
BSIZE	Board Size
CAC	Corporate Affairs Commission
CAMA	Company and Allied Matters Act
CEO	Chief Executive Officer
CINCENT	CEO Incentive
CSR	Corporate Social Responsibility
CG	Corporate Governance
FASB	Financial Accounting Standards Board
FCCG	Finance Committee on Corporate Governance
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAO	General Accounting Office
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IASs	International Accounting Standards
ICAEW	Institute of Chartered Accountants in England and Wales
FGN	Federal Government of Nigeria

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FSIZE	Firm Size
IFRSs	International Financial Reporting Standards
NSE	Nigerian Stock Exchange
OLS	Ordinary Least Square
PROF	Profitability
SECN	Securities and Exchange Commission of Nigeria
UK	United Kingdom
US	United States

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Financial reporting is primarily concerned with users who are external to the reporting firm. Schugart, Benjamin, Francia, and Strawser (2003), and Mahboub (2017) identified the users of financial reports to include the owners of enterprises, lenders, suppliers, potential investors, and potential creditors. Others include employees, customers, stockholders, financial analysts, taxing authorities, regulatory authorities, trade associations, and teachers. The users use the financial information to carry out judgments and decide accordingly (American Accounting Association (AAA), 1966). Schugart *et al.* (2003) and Chen, Hope, Li, and Wang (2011) indicate that a primary focus of financial reporting is the information disclosed concerning the financial statement of a business. In their words, a vital objective of financial reporting is to provide information that is useful to business decision-makers.

According to Georgiou and Roberts (2004) on the Accounting Standard Board (ASB) Exposure Draft 1995, opines that the financial statements are to provide the necessary information about the state of affairs, and financial performance of the organization that will come in handy to a variety of stakeholders for passing judgment on the activities of management and for valid economic choices. The chief objective of financial reporting according to Deliotte (2011) is to portray the position and performance of the entity in question so that investors in equity and debt, among other stakeholders, can make decisions based on accurate information regarding potential risks and returns.

Financial reporting is an effective tool for improving investor's protection. In this regard, the Company and Allied Matters Act CAMA (2004) of Nigeria (as amended) mandates that every company keep its accounting records in accordance with the provision of the Act. This is because high financial reporting quality could be an advantage to the minority investors. Good financial reporting could enhance effective management of enterprises and better financial statements of the companies (Frederick, 2000; Zhou, Owusu-Ansah & Maggina, 2018). In the same vein, credible financial reporting improves the public's understanding of enterprises and their relationship with society. Reliance on credible financial reporting perceived as the aspect of financial markets regulation.

Beest, Braam and Boelens (2009) confirmed that the main purpose of financial reporting is to provide detailed quality financial information relating to organizations. FASB (1991) added that such information must come in handy for economic decision-making. Norwani, Mohammad and Chek (2011), and Alzoubi (2014) posit that providing high-quality financial reporting information has a positive association between the providers of capital and other stakeholders in making investment, credit, and other decisions relating to resource allocation. The information thus provided expected to go a long way in enhancing the overall market efficiency and improve organizational performance that could lead to a credible financial statement and enhance investors' confidence (Fama & Jensen, 1983). Previous studies have highlighted that high-quality financial reporting sends economic signals such as increased investment efficiency and investors' confidence (Al Azeez, Sukoharsono & Andayani, 2019; Bushman & Smith, 2001; Healy & Palepu, 2001; Leuz & Wysocki, 2016).

Bhattacharyya (2012) opined that firm governance mechanism is strongly associated with corporate financial reporting quality. It is difficult to isolate financial reporting quality from corporate governance because the product of financial reporting depends on the strength of corporate governance. According to him, shareholders have the responsibility to receive timely information and promptly act on financial matters of the company. This is consistent with the principle of financial reporting and corporate governance. Good corporate governance, therefore, initiates a system that would put in place processes that can facilitate financial reporting quality, foster healthy financial record keeping the culture, and bring about a vibrant financial reporting system (Alnabsha, Abdou, Ntim & Elamer, 2018). Poor corporate governance, however, could create an environment that may not promote good reporting and thus, causing investors and other parties to limit their trust in the financial data (Blackburne, 2014). Corporate governance also includes relationships among the stakeholders of the company and a definition of the goals for which is governed (Cadbury Committee, 1992). Corporate governance is not just about the process by which directors of companies make decisions. It is also about the way directors are to be transparent and held accountable particularly, through financial reporting (Uwuigbe, Eluyela, Uwuigbe, Obarakpo, and Falola, 2018).

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Consequently, the issues of weak corporate governance that leads to financial reporting failures could have an adverse effect on the economy both at international and national levels. Bhagat and Bolton (2009) asserted in the UK where high profile corporate failures such as Maxwell Communications, Polly Peck and Barrings were associated with corporate governance and financial reporting failures. The collapse of companies in Europe includes Parmalat in Italy. Parmalat hid its losses, overstated its assets,

recorded non-existent assets, understated its debt and diverted cash to the family members of the CEO and the president of the company. Pasminco, Harris Scarfe and Spedley Securities, and Tricontinental are cases of financial reporting failure occurred in Australia. In addition, France known for Credut Lyonnais corporate failures. Germany corporate failures were of Metagesellschaft and Schneider, while in the US, the collapse of Britol, Xerox, WorldCom, and Enron linked to corporate failures. At Enron, the board and management rewarded themselves with stock option and exercised undue pressure on rating agencies to ensure good investment rating in propping up their company's share price. Similarly, Roman Corporation and Canadian Commercial Bank in Canada also experienced governance failures (Nwonyuku, 2012; Norwani *et al*., 2011).

Japan has the case of Yamaichi and Indonesia has cases of Bank Ippo and Kimia Farma (Nwonyuku, 2012). Transmile, Port Klang Free Zone, Mega Media, and Technology Resources Industries faced with weak corporate governance and financial reporting failures in Malaysia (Norwani *et al*., 2011). Within the African continent, South Africa also witnessed the corporate failure of Olivencia, and Nigeria had cases of corporate failures involving Oceanic Bank, Intercontinental Bank, Cadbury Nigeria Plc and Afribank Plc (Salaudeen *et al*., 2015; Omoh & Komolafe, 2015).

In light of this puzzle, auditors, audit committee members, and managers have now made a serious attempt to will improve the prevailing poor financial reporting quality and different scholars have come up with a definition of financial reporting quality (Jonas & Blanchet, 2000). The Financial Accounting Standards Board [FASB] (2011) defined financial reporting as activities which are intended to serve the informational

needs of external users who lack the authority to prescribe the financial information they want from an enterprise and therefore must use the information that management communicates to them.

Lewis and Pendrill (1996) added that this definition is concerned with financial information that is given to users rather than information which is required by an individual or group of individuals who are in a position to enforce their request. Schugart *et al.* (2003) posit that financial reporting includes not only the financial statements but also other forms of information such as annual reports filed with the Securities and Exchange Commission (SEC), news releases, and management forecast. Financial reporting can also be defined as a life wire instrument for evaluating and monitoring managerial actions and measuring the performance of directors including the overall roles of the board in maintaining effective corporate supervision (Nwonyuku, 2012). Ekineh (2009) believes that financial information is a key barometer for measuring the status of a business entity and it should be timely, accurate and reliable. Therefore, financial reporting quality is defined as the accuracy of financial statements in disclosing the financial status in the annual report and providing useful information for financial forecasts. This would strengthen investors' confidence and ensure credible decisions about providing resources in an organization (Uwuigbe *et al.*, 2018).

In 2011, the Securities and Exchange Commission (SEC) of the Federal Republic of Nigeria revised the code of corporate governance for public companies (Watson, 2015). It stipulates that companies should address the interests of their stakeholders' such as investors, consumers, and the public (Sharma, Boo & Sharma, 2008). In

addition, the code provides that the board should report the nature and extent of its financial reporting quality and practices annually. The board of directors identified as the highest level of control for organizational decision-making (Fama & Jensen, 1983; Ofoegbu *et al.,* 2018). The board's major functions includes its monitoring role and strategic role. The former involves hiring, firing and compensating managers, while the latter encompasses advising managers on important key decisions.

Similarly, block holder ownership seems to have an influence on financial reporting quality. However, this claim remains inconclusive in extant literature (Wang, Wong & Xia, 2008; Dou, Hope, Thomas & Zou, 2018). While it was argued by some scholars that their presence protects the interests of the minority shareholders, others have argued from the expropriation point of view (Derrien, Kecskes & Thesmar, 2013; Firth, Fung & Rui, 2007). For example, La Porta, Lopez-de-Silanes and Shleifer (1999) reported block holders' ownership as a source of agency problem in companies because of the tendency in them to extract private profits of control to the disadvantage of the minority shareholder. On the other hand, Cronqvist and Fahlenbrach (2008) asserted that block holders' ownership does not show an effect on financial reporting quality.

In addition, the director ownership structure recognized by agency theory suggests that shareholding by CEOs can help align their interest with those of the shareholders, thus mitigating the agency conflicts (Srinivasan, 2005; Fama & Jensen, 1983). Jensen and Meckling (1976) posit under the convergence of interest hypothesis that higher equity holdings by the CEOs will align their interest with those of the shareholders. Thus,

ownership by directors could be an important mechanism to enhance financial reporting quality in firms (Gaynor, Kelton, Mercer & Yohn, 2016).

The responsibilities of the audit committee are increasingly becoming very vital in the governance mechanisms of many corporations (Sultana, Sigh, Zahn & Mictchell, 2015). Said, Zainuddin, and Haron (2009) and Zhang, Zhou and Zhou (2007) asserted that the audit committee plays a duty in studying the company's process of confirming high financial reporting quality. Haron, Jantan and Pheng (2005) defined the audit committee as a standing committee set up by the board with the objective of contributing to effective board characteristics and ensuring reliable financial reporting (Aifuwa & Embele, 2019).

In addition, past studies show results of the relationship between board characteristics and financial reporting quality to be inconclusive. For example, Chakroun and Matoussi (2012) and Haniffa and Cooke (2005) document non-executive directors to be negatively related to financial reporting quality, while Haji (2013) and Mohd Ghazali and Weetman (2006) state no relationship. In addition, Said *et al.* (2009) found no relationship between board size and financial reporting quality. However, the research conducted by Jo and Harjoto (2011) found a positive relationship which is similar to the findings by Haji (2013) and Sun, Salama, Hussainey and Habbash (2010).

DeAngelo (1981) and Vanstraelen (2000) asserted that audit quality detects frauds and accounting misstatement and then express them in a suitable audit opinion. The audit quality could also help reduce the information asymmetry between the management

and the stakeholders (Alaryan, 2017). In addition, audit quality could enhance the relationship between the independent and dependent variable that could lead to high financial reporting quality. These dimensions of the audit quality describe the auditor's ability to provide higher quality information that would show the true economic circumstances of the client financial statement. In prior studies, the dimensions of audit quality, such as auditor independence and auditor competence that could enhance financial reporting quality, has been considered by Fairchild (2008), Alrshah (2015) and one more. Brooks (2011) and Stoel, Havelka and Merhout (2012) used accrual quality and auditor specialization and client importance as dimensions for audit quality. However, Fairchild (2008) identified Big 4 as an important determinant of audit quality. Tepalagul and Lin (2015) also considered audit tenure as vital in the determination of audit quality. The quality of auditor and the duration of the auditor are very important in an organization (Spira, 2007; Solomon, 2010; Ziaee, 2014). This is because the quality of the auditor could ensure a more credible report while the longer the auditor serves the more such firm may have the ability to detect errors or manipulations in the accounts (Adeniyi & Mieseigha, 2013; Suryanto, Thalassinos & Thalassinos, 2017). In addition, past literature posits that the shorter the audit rotation can have an adverse effect on the independence of the auditor that later jeopardize the audit report (Carcello & Nagy, 2004). These could contribute to the quality of the financial report produced and enhance the financial reporting quality of the firm (Carcello & Nagy, 2004; Diang & Jia, 2012; Fairchild, 2008; Khurana & Raman, 2004).

The importance of financial reporting quality underscored from past studies and the variables that could influence it is mentioned above (Biddle, Hilary & Verdi, 2009).

The findings from previous studies also indicate the relationship of inconclusiveness with financial reporting quality. Baron and Kenny (1986) suggested that where there are mixed findings between an outcome and predictor variables a moderator should be used to explain the relationship.

1.2 Problem Statement

The problem of poor financial reporting quality has far-reaching consequences for the economy since poor financial reporting quality not only decrease foreign investment inflow due to loss of investor's confidence but also result in the collapse of companies (Norwani *et al.,* 2011). Financial reporting quality has been an important aspect of information involved in achieving access to global capital especially in emerging economies (Fathi, 2013; Popova, Gerorgakopoulos, Sotiropoulos & Vasileiou 2013; Peyravan, 2016; Mahboub, 2017). Companies in such economies, encounter obstacles attaining access to global capital due to the issues of poor financial reporting. However, quality financial reporting been claimed to help reduce such barriers (Gaynor *et al*., 2016; Kaklar, Kangarlouei & Motavassel, 2012; Labelle, Gargouri & Francoeur, 2010). Therefore, higher financial reporting quality is necessary to enhance investors' confidence and investment efficiency of an organization for developed and developing economies who are trying to attract capital flows.

The importance of high financial reporting quality became recognized after some high profile corporate scandals occurred globally, which suggested that financial reporting quality needed further scrutiny (Bhattacharyya, 2012; Beuselinck, Blanco & Garcia Lara, 2013). For instance, in the UK there were high profile corporate failures of large number of companies like Polly Peck and Maxwell Communication, while the collapse

of WorldCom, Enron and Britol occurred in the US. Furthermore, in Europe, the same happened at Schneider in Germany and Credit Lyonnais in France. Lastly, Pasminco and Centaur in Australia, Castor Holdings and Canadian Commercial Bank in Canada, Yamaichi in Japan, Kimia Farma in Indonesia, Transmile and Mega Media in Malaysia, all have suffered the same corporate failure (Norwani *et al*., 2011; Nwonyuku, 2012).

One of the factors that facilitate higher financial reporting quality is a good corporate governance mechanism (Al-Shear, Salama & Toms, 2017). Strong corporate governance mechanism and institutions in firms over the years have received policymaker's attention as an effective tool to promote sound reporting and disclosure quality. The case of Enron, WorldCom, Adelphia, Hollinger, Tyco, Xerox and Parmalat in the early millennium prompted the development of corporate governance code across the globe and establishments in Nigeria are not an exempted (Bebchuk, Cohen & Ferrell, 2008; Buslerier & Gabteni, 2010; Popova *et al*., 2013; Ofoegbu *et al*., 2018). Consistent with the agency theory, the code of corporate governance imposed on the board of directors a great deal of responsibility with respect to advisory and monitoring role (Jensen & Meckling, 1976; Ofoegbu *et al*., 2018). Hence, board characteristics could have positive impact in enhancing financial reporting quality.

Consequently, the monitoring role of board characteristics, audit committee, and external audit are widely recognized and agreed to improve and promote sound financial reporting and disclosure quality (Abdullatif & Al-Khadash, 2010; Albring, Robinson & Robinson, 2014; Adams, Benjamin, Hermalin &Weisbach, 2010; Haji, 2013). Unfortunately, in Nigeria, the board of director's ability in discharging their

statutory monitoring role seems to be in doubt (FRCN, 2015). Reports show that the boards are either complacent or less active in controlling the management due to lack of enforcement and adequate compliance with the code of corporate governance (Ofoegbu *et al*., 2018). Adegbite (2012) posits that the ineffectiveness and the high level of corruption of the boards and the audit committee in performing their responsibilities have led to poor financial reporting quality.

However, prior researches have also shown that the chief cause of poor financial reporting quality is due to the ineffective corporate governance, weak compliance, and enforcement of standards (Berndt, 2007 and Bashir, 2012). This emphasis on governance underscored by issues of financial reporting quality that arose in the wake of financial reporting frauds in Enron, WorldCom, Adelphia, Hollinger, Tyco, Xerox and Parmalat (Cohen *et al*., 2004; Larcker & Richardson, 2004; Wu, 2002). In addition, in 2018, according to the report of Corruption Perception Index (CPI) Nigeria ranked 32 out of the 52 African countries assessed in 2017. In the West African sub-region, Nigeria is the second-worst country out of the seventeen (17) West African countries assessed, which suggests how weak the country's corporate governance has been. Furthermore, the situation is worsening because of the influence of a number of the country's adversative attributes are highlighted such as accounting unprofessionalism, socio-cultural influences, political interference, opaque economic structure, poor leadership, lack of training of board of directors, and the archaic legal system. These attributes also weaken the country's corporate governance structures (Adegbite, 2012; Okike, 2007).

Many studies conducted in developed economies such as in the UK and the US on the issue of corporate governance and financial reporting quality are inconsistent due to the variables and sample size applied. Some studies found that the corporate governance characteristics such as board structure, ownership, and audit committee have significant positive influence on the financial reporting quality (Reddy, Abidin & Yu, 2015; Ozkan, 2007; Samaha, Khlif, and Hussainey, 2015; Zhou *et al* ., 2018). While other studies reported that, the corporate governance characteristics could have either positive or negative influence. Yet, others such as studies by Al-Shear and Salama (2017), Popova *et al*. (2013), Dou, Hope, Thomas & Zou (2018), Omer and Shelly & Tice (2019) reported no significant influence on the financial reporting quality.

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Furthermore, in the developing countries, there are many studies that investigated the issue of corporate governance and financial reporting quality and found a positive impact of corporate governance characteristics such as board structure, ownership and audit committee on the financial reporting quality (Othman, Ishak, Arif and Aris, 2014; Alaryan, 2017). In addition, some studies in the past literature found a negative or insignificant influence of corporate governance on the financial reporting quality (Al Azeez *et al*., 2019). This implies that the findings are inconsistent following the results presented by the authors.

While, there has been extensive research in these areas in the developed countries (Popova *et al*., 2013; Cho *et al*., 2012; Salama *et al*., 2012), it is noticeable that the results of the previous studies in developed and developing countries are inconsistent. Furthermore, in Nigeria, the studies are few, not consistent, piecemeal studies, utilizing

smaller sample sizes, most of which used the banking sector which is under the government regulatory agency (Nyor, 2013 and Hassan, 2013). In the developing countries there are little empirical research and lack of in-depth studies. Furthermore, the studies done in Nigeria are also inconsistent. While Nwonyuku (2012) in Nigeria asserted the negative role of the board of directors in failing to meet high financial reporting quality. Furthermore, another study, Onuorah and Friday (2016) in Nigeria reported that board independence and audit committee size is negatively related to financial reporting quality. Further study by Dabor and Dabor (2015) found that there is no significant relationship between board size, expertise, and financial reporting quality. For example, Aifuwa and Embele (2019) in Nigeria documented that board expertise was positive and significant with financial reporting quality while board independence and board diversity were found insignificant with financial reporting quality. In addition, while, Uwuigbe and Ajibolde (2013) use only forty (40) firms (both financial and non-financial firms), Owolabi (2010) even lesser twenty (20) firms, which could not be generalised. Uwuigbe *et al.* (2018) in Nigeria reported that foreign executive on the board has a positive significant relationship with timeliness of financial report. Additionally, piecemeal studies in Nigeria have examined the effect of some board characteristics (Ofoegbu *et al.*, 2018), audit committee (Bello, 2013), Big 4 (Okere, Ogundipe, Oyedeji, Eluyela & Ogundipe, 2018), and audit tenure (Salaudeen *et al.,* 2015), yet there remains dearth on the link between board characteristics and financial reporting quality and therefore, a further comprehensive research is highly needed. The utilization of larger sample size, in depth study, comprehensive study and using of non-financial firming needs would be of importance for further study.

In addition, Baron and Kenny (1986) recommend that if there is inconsistency in the relationship between predictor and outcome variables, a moderator should be introduced to enhance the relationships of the variables. Several variables were found to influence the relationship between board characteristics and financial reporting quality. For instances ownership structure (Beamish & Lupton, 2016) and audit quality (Balakrishnan, Core, & Verdi, 2014). Generally, audit quality plays an important role in maintaining an efficient market environment (DeAngelo, 1981). This is because an independent audit quality underpins confidence in the credibility and integrity of financial statements, which is essential for well-functioning markets and enhanced financial reporting quality. The influence of audit quality related to auditor's experience, expertise, independence and the quality of audit work could enhance financial reporting quality (Brooks, 2011).

Investors and financial analyst see the credibility of financial reporting quality as a function of the size of the audit firm (Guo, 2016). The Big 4 audit firm can produce better quality reports than non-Big 4 and smaller audit firms (Ding & Jia 2012). Studies have reported the difference between these qualities between Big 4 and non-Big 4 firms. The Big 4 firms have adequate and in-depth fieldwork and increase investment procedure that could assist in detecting errors, frauds, and misstatement in the accounting system (Yasar, 2013). In addition, the Big 4 auditors have the ability to provide higher audit quality because they have many numbers of clients, vast resources, technology and trained staff for the audit work. Furthermore, they could not care to lose any client due to unprofessionally work ethic and breach of the process (DeFond & Zhang, 2014; Okere *et al.*, 2018). For example, Jones, Temouri, and Cobham (2018) attest to a strong correlation and causal link between the size of MNEs

tax heaven network and the use of Big 4 as a moderator. In addition, Bala, Amran and Shaari (2018) asserted that the Big 4 could detect financial misstatement and fraudulent practices in the financial statement and thus could enable monitoring and evaluation of financial reports.

Similarly, the relevance of auditor tenure is evident in literature as seen in stating that the longer the length of auditor tenure, the more the dependence on customers (Daniels & Booker, 2011). An earlier study Watts and Zimmerman (1990) has revealed that audit tenure has an important role in audit quality. Recently, Jorjani, Safari and Gerayti (2018) used audit tenure as a moderating effect of auditor specialization on the relationship in the firms on the Tehran stock exchange to examine the effectiveness of audit tenure. Furthermore, DeFond and Zhang (2014) and Barbadilo and Aguilar (2008) and Knechel, Sofla and Svanstrom (2010) suggested that longer auditor tenure could enhance the auditor relationship with the clients by improving the accounting and internal control system and regulate the irregularities in the management financial reporting process. Also, Gonzalez-Diaz, Garcia-Fernandez and Lopez-Diaz (2015) and Boone, Khurana and Raman (2008) opined that information from investors and audit tenure will enhance audit quality. However, Firth, Rui & Wu (2012) and Daniels & Booker (2011) investigated the relationship between mandatory audit firm tenure and short tenure, and they reported a positive and significant relationship. This asserted that audit tenure with a short period enhances the independence of the auditor and has a significant positive association with financial reporting quality; thereby implying that shorter audit tenure could enhance financial reporting quality.

Furthermore, the enforcement of corporate governance code and standards could further assist in enhancing financial reporting quality. However, it has been observed that the effectiveness of the board in Nigeria is impaired by information asymmetry, which then leads to an agency problem between the management and the stakeholders, whereby managers exploit the residual claimants by making opportunistic decisions to their benefits (Uwuigbe *et al*., 2018). There has been relatively little empirical work on this relationship in developing countries, there remains dearth on the link between board characteristics and financial reporting quality. Previous studies show that there are inconsistent, of smaller sample sizes, not comprehensive and most of the studies used banking sector. Therefore, further comprehensive research is highly needed with non-financial sector, large sample sizes, and more variables that could enhance financial reporting quality. Furthermore, audit quality used as a moderator in previous researches focused on the relationship between board characteristics financial reporting quality. However, to the best knowledge of the researcher, there has been no work ever done, which has combined Big 4 and audit tenure as a moderator. Consequently, the Big 4 and audit tenure were introduced as a moderator between board characteristics and financial reporting quality in achieving comprehensive insights and deeper understanding of the relationship. Considering the above problem, the following research questions were raised.

1.3 Research Questions

The study uses non-listed companies in Nigeria in order to get a clear picture of financial reporting quality and board characteristics in each of the firms and to investigate quantitatively. It observed issues, as stated in the research problem, and this led to the following questions. The questions are designed primarily to hypothesize

and analyse the relationship that exists between the board characteristics practice of the firm and the financial reporting quality moderated by audit tenure and Big 4.

1. What is the effect of board characteristics on financial reporting quality in the Nigerian Stock Exchange?
2. What is the effect of Big 4 firms in moderating the relationship between board characteristic and financial reporting quality in the Nigerian Stock Exchange?
3. What is the effect of auditor tenure in moderating the relationship between board characteristics and financial reporting quality in the Nigerian Stock Exchange?

1.4 Research Objectives

The main aim of this research is to investigate the relationship between board characteristics with financial reporting quality in Nigeria. The specific objectives are:

1. To investigate the relationship between board characteristics and financial reporting quality in the Nigerian Stock Exchange.
2. To examine if Big 4 firms moderate the relationship between board characteristics and financial reporting quality in the Nigerian Stock Exchange.
3. To examine if auditor tenure moderates the relationship between board characteristics and financial reporting quality in the Nigerian Stock Exchange.

1.5 Motivation of the study

The general motivation for this study is the poor financial reporting quality and the weak enforcement and compliance of standards that is evident in the annual reports of companies quoted on the Nigerian Stock Exchange (NSE). This is against the

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expectation of stakeholders for the auditing process, which could effectively address financial reporting impropriety (Owolabi, 2010; Uwuigbe & Jimoh, 2012; Uwuigbe & Uadiale, 2011). Owolabi (2010) in a study of non-financial companies, found that thirty-five (35) percent of the sampled companies to provide some sort of financial statement. More recently, Uwuigbe and Ajibolade (2013) found the level of the financial statement, slightly lower at 24.29 percent. In this regard, companies whose operations are in Nigeria, most especially those quoted on the floor of the NSE market seem to have inadequate reports, which could affect their financial reporting quality.

The issue of unresolved conflicts of interest between the principal and agent motivates this study. For instance, there is likelihood that Nigerian listed companies adequately addressed in prior studies, are still faced with poor financial reporting in Nigeria. The lack of an effective and efficient agency instrument such as good governance and proper methods to overcome the loophole of agency problem also called for further investigations (Ahmed & Duellman, 2007). Previous studies highlighted that the weaknesses of corporate governance have led to poor financial reporting quality (Cohen *et al.,* 2004; Dechow, Sloan & Sweeny, 1996).

In addition, there is a lack of auditors' independence and non-compliance with standards and regulations of corporate governance code in the discharging of their responsibilities. This has contributed to a lack of truthfulness and accurate financial information that could enable stakeholders and other interested parties to make economic decisions (Adelaja, 2009; Bello, 2013). The study is also motivated by the corporate governance being managed by dishonest boards and the inadequacies of

transparency and accountability from management teams that are overseeing the organizations (Ewepu & Olasupo, 2014).

The Security and Exchange Commission (2011) contains a set of standards of corporate governance to address the issue of transparency, honesty, enforcement, and compliance with regulations for listed firms in Nigeria. Despite these provisions, the problem of lack of compliance and transparency still exists. The World Bank in 2004 observed that the financial reporting by the corporate organization in Nigeria is deficient. Previous researchers have explored the poor financial reporting quality in Nigeria (Ofoegbu & Okoye, 2006). This conclusion has been supported by many empirical studies including those of Adeyemi (2006); Ebirnga and Kule (2014) and Okike (2000); Wallace (1988); Uwuigbe & Ajibolade (2013). Oluwagbemiga (2014) also affirmed that the financial reporting quality of the country is poor and deficient.

Moreover, the reports of the observance and code highlighted that the accounting and auditing practices in Nigeria suffer from institutional weaknesses in regulations, compliance, and enforcement of standards and rules, which suggest the presence of corporate governance weaknesses. Subsequently, as a follow-up to the Nigeria Report of the Observance and Codes on Accounting and Auditing (ROSC, 2011), the Nigeria government requested the World Bank to carry out an investigation of how well the ROSC was implemented. The report presents the status of implementation of the country action plan and sets out current systemic issues pertaining to accounting professions that affect the governance mechanisms in firms thereby leading to poor financial reporting quality. The reports reviewed that in Nigeria, the companies' country action plans were poorly implemented and thus there was limited

improvement in financial reporting quality (ROSC, 2004, 2008 and 2011). These weaknesses gave room for manipulations and frauds (Adegbite, 2012; ROSC, 2008, 2011).

1.6 Scope of the Study

This study is not without its limitations in terms of the scope of the study. The sample consists of non-financial institutions listed on the Nigerian Stock Exchange while those excluded from the study consist of financial firms like banks and insurance companies, and they were excluded because they have an operational definition of financial reporting quality that is different from the one adopted in this study (Afrifa & Padachi, 2016). The selection of the sample in this study covers the period from 2011-2015. The criteria used to determine the sample size of this study is that the firms must have operated within the period of 2011-2015. Among those excluded are firms with missing substantial yearly figures in their annual reports and firms delisted within the period of the study. The company must not be an investment and financial broker (in order to exclude all financial institutions), and the financial information or corporate report must be accessible in the annual reports. Thus, the sample size comprised of 457 year-observations of unbalanced panel data. Year 2011 was chosen as the year of study as it was the year of implementation of the revised corporate governance code in Nigeria, i.e., the Nigerian Code of Corporate Governance 2011. The data used was secondary as extracted by hand from the annual report of the listed companies. The other boundary year of 2015 was chosen because of the availability of data in that year. For the purpose of this research, data collected were from only one country that is Nigeria. Therefore, the results of this study may not be generalizable to other countries with different institutional settings.

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1.7 Significance of the Study

The conclusion by the findings from previous studies indicates that high financial reporting quality practices can regulate the challenges of corporate firms arising from agency conflicts. It is significant to check the quality of financial reporting practices in Nigeria listed companies. Prior studies have suggested some devices to check the opportunistic behaviour of the controlling shareholders (Lobo & Zhou, 2006). One of these devices is the emplacement of boards (Ahmed & Duellman, 2007). The board characteristics thus form part of the mechanisms that determine the quality of financial reports (Chen *et al.,* 2010).

The past study highlighted that financial reporting quality relies on the philosophy of supervision, control and corporate governance (Magrus, 2012; Mautz & Sharaf, 1961; Dechow, Sloan & Sweeney, 1996). This study intends to examine the efficiency of the board characteristics considering they are accountable for the integrity and adequacy of the structure of financial reporting and are answerable to the shareholders for corporate performance (McIntyre, Murphy & Mitchell, 2007). This study gives information on how to improve audit committee effectiveness. In an effort to strengthen audit committee effectiveness, the board should re-examine the attributes of audit committee members, through their directorships in other listed companies and commitments in other board committees (Lynall, Golden & Hilman, 2003; Mautz & Neumann, 1970). This will enable them to give their commitment to improving financial reporting quality.

Specifically, from a theoretical perspective, although prior research has investigated the association and examined the relationship between board characteristics (block

shareholder, director shareholder board size, board independence, committee independence, committee size, committee diligence, committee expertise) and financial reporting quality, the results are largely inconclusive (Makaoto & Pascal, 2012 and Malik, 2014). This study provides more evidence on the issue.

The study is significant for a number of considerations, and in particular, the glaring absences of in-depth research examining the relationship between boards attributes, audit quality and financial reporting quality in a developing country like Nigeria. There are scanty studies that have examined the impact of board attributes on financial reporting quality in Nigeria. To fill the gap, this research portrays the importance of the audit quality as a governance instrument in the audit process. It also highlights important findings on the audit committee characteristics such as expertise, diligence, size, independence and audit quality as a moderating variable in capturing the effective oversight of management and auditors.

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The findings could contribute to helping users who have an overwhelming influence on the way companies are run to understand the status of board characteristics in their firms and the quality of financial reporting (Malone, Fries & Jones, 1993; Mc Nichols, 2002; Madani, Addin & Rad, 2013). In addition, the findings emanating from the study will serve as a starting point for the government and regulators to set up procedures and policies that would enhance high-quality reporting in the Nigerian business environment. Security and Exchange Commission, Central Bank of Nigeria, Nigeria Stock Exchange, and other statutory bodies will also gain from the outcome of this research. The research will provide an insight for the government to understand the extent of agency problems in corporate organizations in Nigeria, and thus identify

the means by which these could be reduced (Levitt 1998, 2000; Maraghni & Nekhili, 2014; SEC, 2011).

1.7.1 Theoretical Perspective

The importance of theories such as agency and stakeholder and their relevance to the implementation of high-quality financial reporting cannot be overemphasised. The study contributes to existing literature and debate on the importance of board mechanisms in agency theory. It also shows the importance of the agency theory, which underpins the principal-agent relationship. It shows that the agency theory provides a framework through which the principal and agency relationships could be enhanced and thereby promote the financial reporting quality process (Uwuigbe & Ajibolade, 2013; Barako & Tower, 2007). The study expected to add to the body of literature on the relevance of the agency and stakeholder theories in the investigation of firms' financial reporting quality (Fodio & Oba, 2012; Masulis, Wang & Xie, 2012).

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1.7.2 Practical Perspective

In the practical aspect, board attributes, audit quality, and financial reporting quality have become part of regulatory and policymakers' concern. This concern curtails from the need to identify what policies should be adopted and what regulations should be applied to enhance financial reporting quality. Undoubtedly, the board of directors and the quality of audit would feature prominently in any regulatory action. The outcome of this study should be expected to guide the policymakers in recognizing the roles of these attributes in promoting financial reporting quality. The loss of investors' confidence in financial reporting quality could weaken the capital markets and the economy. Given that investors make up a large chunk of the participants that support

and give credence to the economy, ensuring high-quality financial reporting could also have a positive impact on the economy (Levitt, 1998, 2000). Thus, this study would assist Nigerian regulators such as Securities and Exchange Commission, Financial Reporting Council of Nigeria and other policymakers to establish an appropriate framework for effective board oversight and high-quality audit to combat financial reporting quality failure in the country.

1.8 Outline of the Thesis

The remainder of the thesis has been organized as follows. Chapter Two presents the background of corporate governance and financial reporting quality in Nigeria. Chapter Three discusses the literature review and the theoretical framework of board characteristics, audit quality and financial reporting quality building on agency theory as the underpinning theory for the study. Considering the complexity, surrounding board characteristics and financial reporting quality discussion on supporting theories follows.

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Chapter Four reviews the theoretical framework and research methodology adopted for the study. Here, the research framework and formulation of research hypotheses are presented. There is also discussion on research methods used for hypotheses testing, and the definitions of independent variables, dependent variable and control variables of financial reporting quality as used in the thesis. Sources of data explained, and the research design and determination of sample companies discussed. This chapter also contains the techniques for data analyses. The results and discussion are presented in Chapter Five. Descriptive statistics and interpretation of the results of the regression models of the statistical analyses are contained in this chapter. Finally,

Chapter Six contains the summary and conclusion of the thesis. The summary and key research findings of the thesis are discussed. Limitations of the thesis are provided and there are suggestions for further study in this area before drawing the conclusion.

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CHAPTER TWO

CORPORATE GOVERNANCE AND FINANCIAL REPORTING QUALITY IN NIGERIA

2.1 Introduction

This chapter discusses corporate governance and financial reporting quality. The primary objective is to provide an overview of corporate governance reform efforts by the Security Exchange Commission of Nigeria (SECN) and financial reporting quality as applicable in Nigeria. The chapter reviews the regulation of Nigeria capital market, describes the overview of Nigeria with the regulatory background, describes the overview of company and Allied Matter Act (CAMA), and the corporate governance in Nigeria. Finally, describes the overview of financial reporting quality in Nigeria and summarizes the chapter.

2.2 Overview of Regulation in Nigeria Capital Market

There are statutory bodies responsible for the regulation of Nigeria's corporate governance environment as an emerging market in Sub-Saharan Africa. This study notes that some of these bodies do not put sufficient emphasis on financial reporting matters. The Nigeria Stock Exchange (NSE) is one of the bodies responsible for the regulation of financial reporting quality and in the Listing Requirements in Nigeria. This is in conjuncture with developments in the UK where the financial reporting disclosure requirements incorporated into the Listing Requirements of the London Stock Exchange and the Companies Act. The US Securities and Exchange Commission has been providing the lead on financial reporting disclosure matter since 1938 (Odewale & Kamardin, 2015).

The CAMA 1990 provides the legal framework for the registration and operation of companies in Nigeria. The Corporate Affairs Commission (CAC) is an independent body established under the Act. The CAC is empowered to administer the Act under the administration of the Registrar-General. Companies recognized by the Act could be either private or public owned. It is the publicly owned companies that are listed on the NSE that have attracted much attention concerning corporate governance practice as the recommendations of Corporate Governance (CG) codes 2003 and 2011 are specifically for this category of companies (SECN, 2011).

The World Bank/International Finance Corporation (IFC) Report on the Observance of Standards and Codes (ROSC), (2008) documents that the CAC lacks the capacity effectively perform the function assigned to it under CAMA 1990. This inability of the CAC to adequately supervise registered companies in Nigeria has been acknowledged in past studies (Adegbite, 2012; Okike, 2007). Several reasons addressed for this inability. For example, Adegbite (2012) points out that according to a senior official of the CAC that the commission's capacity is constrained by myriad internal and environmental problems. Internal problems include corruption and the lack of human expertise. One of the environmental problems, which confront the CAC, is the lack of independence from the politicians (Mohamad & Muhamad Sori, 2011).

Another independent body responsible for ensuring good corporate governance practice of Nigeria's capital market is the Security Exchange Commission of Nigeria (SECN). The SECN is the principal regulator of the securities market that administers the Investment and Securities Act (ISA) 2007. The SECN was established in 1979 to

replace the Capital Issues Commission of 1962 that was established in 1973 as a replacement of the Capital Issues Committee of 1962 (Mohammed, Chapola & Bello 2013; Adegbite, 2012; Okike, 2007). This is the outcome of reform efforts to make the capital market more attractive to investors. As a reform, the ISA 2007 passed to replace the ISA 1999. The promulgation of ISA 2007 gave wider powers to SECN on activities of Nigeria's capital market. The duties of SECN as contained in Section 13 of ISA 2007 include the regulation of the activities of the capital market to protect the interest of investors.

In 2003, the SECN published the first CG Code 2003 to improve the corporate governance practice in the country. This was revised in 2011 to address the observed weaknesses of the CG Code 2003 to align it with global best practices (SECN, 2011). The CG Code 2011 contains significant recommendations over that of 2003 such as disclosure in the annual report of the level of compliance with the CG Code by companies, provision for independent directors, and remuneration of the CEO and executive directors to contain performance-related components that disclosed in the annual reports, among others.

The NSE was established in 1960 as the Lagos Stock Exchange but started operations in 1961 after the promulgation of the Nigerian Stock Exchange Act of 1961 (Adegbite, 2012; Okike, 2007). It is responsible for the mobilization of capital for listed companies, supervision of the operations of the securities market and regulation of the activities of the second-tier capital market. Okike (2007) and ROSC (2004) noted that the NSE had about 20 companies on its trading floor as at 1970 even though there were more than 2000 companies owned by foreigners that were operating in the country as

at that time. Before 1960, foreigners controlled several of the registered companies and this continued until the early 1970s. The plausible explanations for this could be the Colonialist's drive to deny the people of their colonies economic power, the inability of the locals to raise the needed capital, and the scarce managerial ability of the few educated Nigerians before independence to manage such companies. To halt this trend and empower Nigerians economically, the Federal Government of Nigeria promulgated the Nigeria Enterprise Promotion Decrees of 1972 and 1977. It was these decrees that put restrictions on the extent that foreigners could do business in Nigeria (Aina, 2013), and opened the way for the increase in the number of listed companies on the NSE. With these decrees in place, the foreign companies were required to sell part of their shares to the Nigerian public. Even though the indigenization policy was not well accepted by the foreigners, nevertheless, the shares oversubscribed by Nigerians (Okike, 2007).

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Another landmark made in 1988 with the promulgation of the Privatization and Commercialization Act No. 25 of 1988 that marked the beginning of government's effort at divesting from some of the public enterprises it had acquired under the indigenization policy of the 1970s. This again made the government divest its holdings in the government-owned companies to the Nigerian public. This further led to an increase in the number of companies listed on the NSE. As of September 30, 2008, there were 218 listed companies on the NSE, however, due to the delisting of some, the number decreased to 183 by December 31, 2015. ROSC (2008) categorized large companies in Nigeria into four domestic financial institutions, domestic controlled companies, subsidiaries of MNCs, and state-owned enterprises. The MNCs have the strongest impact on Nigeria's economy as it reported that ten of the twenty most

capitalized companies on the NSE are MNCs (SECN, 2013). However, it is sometimes difficult to identify the real owners of shares in Nigerian companies because of a lack of transparency in ownership disclosure (ROSC, 2008).

The NSE has its Listing Requirements for companies applying for listing on the exchange. Again, the Listing Requirements is weak in financial reporting quality disclosure matters. Adegbite (2012) argued that the problem confronting the NSE is that of weak structure, the consequence of which is its inability to enforce and monitor good corporate governance practice among NLCs. ROSC (2004) identified weak enforcement and administrative sanctions as part of the major challenges facing SECN. Furthermore, the only sanction that NSE can apply to any company that does not meet the Listing Requirements is delisting from the exchange. Similarly, ROSC (2011) reports that the monitoring and enforcement mechanism of the NSE is weak, thus, it is unable to conduct adequate monitoring of the disclosure by companies in the annual report to ensure compliance with regulations. According to PricewaterhouseCoopers (PWC) (2013), the legal system is inefficient, as the judicial system is susceptible to political interference and the rule of law is generally weak throughout the country. This aptly summarizes the reason for the inefficiencies in the regulations of Nigeria's capital market.

2.3 Overview of Nigeria

The Federal Republic of Nigeria is geographically located between latitude 4°16 and 13°53 north, and between longitude 2°40 and 14°41 east. It occupies a land area of 920,000 sq. km, which makes it one of the largest states within the African continent. The general climate is tropical with a temperature of about 32°C, high humidity, and

rainfall that averages about 3800mm in the south eastern part, while in the north the rainfall gets as low as 625mm. The vegetation portrays a country with rich green forest to grasslands surrounded by shrubs; this gradually fades into the dry desert areas.

Nigeria is bordered to the west by the Republic of Benin, to the north by Niger, to the northeast by Chad, to the east by Cameroon, and to the south by the Atlantic Ocean (Nwoko, 2013). Furthermore, she is located in West Africa, divided into 36 states and the Federal Capital Territory (FCT) Abuja. The states make up the second tier of government made up of 774 local government areas. She regained the democratic government in 1999 and since then has successfully conducted three general elections (Federal Government of Nigeria, 2013). Nigeria's population estimated by projection from the 2006 population census figure of 140 million people to rise up to 170 million as at 2013. This population has over 250 ethnic groups with more than 500 languages. English has been the official language though there is a local version of it called 'pidgin" spoken by most Nigerians (Federal Government of Nigeria, 2013).

Nigeria was chosen as the country of interest in this research because of its peculiarity as an underdeveloped economy when compared with the UK, USA, and Australia in terms of developed capital market structure. The thesis was conducted in Nigeria due to its peculiarity of poor financial reporting quality that has been reoccurring as reported in the annual reports from the NSE. The issue with low compliance and weak enforcement of regulations of the corporate governance that resulted in weak implementation of corporate governance code that lead to poor financial reporting quality. This could be attested from previous literature (Adelopo, 2011; Ebiringa & Kule, 2014; Okoye & Ofoegbu, 2011; Yakasai 2001).

2.3.1 Regulatory Background

The rise in industries such as banking, manufacturing, and an increase in financial reporting quality impacts has created serious sustainability issues in the financial statements. Therefore, the urgent regulation of these activities without extinguishing the prospects of these sectors is required. The Nigerian government has put in place a policy that addresses in totality, financial reporting quality, and management. The issue of whether this policy is adhered to is a subject for debate (Adeyemi & Olamide, 2011). There are indeed legislation and strategies in place to protect the existing facilities and ensure that the international standards and requirements are met, Furthermore, it ensures that the citizens have the best possible conditions for financial transactions for investors and shareholder protection rights and well-being, to enable them to invest and have good economic decisions. The policies for financial reporting quality and management range from enactments in the constitution, international treaties to regulations and resource protection laws.

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2.3.2 Companies and Allied Matters Act (CAMA)

Up until 1968, the Nigerian company law had no provision for the disclosure of mandatory information (Amao, 2014). The 1968 companies Act, which brought about mandatory disclosure of information originated from the British Companies Act of 1948. The current companies act operating in Nigeria now is the CAMA 2004 as amended. Section 331 of the Act mandates all companies to maintain records that reveal in clear terms the transactions of the company. Furthermore, also contained in the Act is the compulsory corporate governance for firms and banks in Nigeria as documented in the CAMA 2004 Part xi, section 342, and section 359(3) and (4) (Corporate Affairs Commission, 2004).

2.3.3 Corporate Governance in Nigeria

With explosive research efforts across the globe on corporate governance, little known about it in Nigeria except from some recent studies (Adegbite, 2012; Adekoya, 2011; Barde, 2009; Ehikioya, 2009; Okike, 2007; Wilson, 2007; Yakasai, 2001; Oluwagbemiga, 2014). An overview of corporate governance development in Nigeria has been presented in this section. Historically, it was the British colonists that introduced company formation that recognized the separation of ownership and control into Nigeria and the subsequent promulgation of different companies' legislation prior to Nigeria's independence in 1960 (Okike, 2007). It specified in legislation how a company should be run responsibly. During this period, the majority of the companies were foreign-owned. Before 1970, there was little concern about how corporate enterprises are run in Nigeria (Yakasai, 2001). This was because most of those companies were either foreign or government-owned.

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However, beginning from the 1980s, with extensive structural and economic reforms embarked upon by Nigeria during the implementation of the privatization and commercialization of some public enterprises, the new owners started demanding for transparency and accountability from company managers This was an effort at ensuring that these companies were governed properly run (Eteyibo, 2011; Mohammed, Chapola & Bello, 2013. Prior to the time, the public enterprises were seen as mere financial drainpipes that gulp billions of Naira in the annual budget without any tangible output (Olowokure *et al.* (2015). The public enterprise's performances were abysmally low and do not meet the expectations of the citizens (Emeh, 2012).

The most challenging issues were how to manage the firm profitability, maximise the shareholders' wealth and to increasing investors' confidence on financial reporting quality? Since the privatization of companies later failed, this prompted the stakeholders to request how companies would be managed in the future (Etieyibo, 2011). The Institute of Chartered Accountants of Nigeria in their annual conference in 1998 was able to deliberate the issue of corporate governance and the responsibilities of auditors alleged by the public for not performing their duties regarding the corporate scandals in Nigeria (Okike, 2007). The scandals involved AfriBank and the Lever Brothers Nigeria Ltd, and some commercial banks (Ahunwan, 2002; Aina, 2013). These events led to an extensive discussion of corporate governance in Nigeria by different authors (Yakasi, 2001; Akhidime, 2015). Adegbite (2012) also investigated corporate governance regulation in Nigeria respectively.

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In promoting financial reporting quality and corporate governance in Nigeria section 359 (4) CAMA 1990 incorporate the Audit Committee should comprise of equal numbers of shareholders and directors (not more than six members). According to section, one (1) of CAMA 1990 established the Corporate Affair Commission (CAC) that empowers the audit committees with the functions contained in section 7 to have the roles of monitoring and oversight functions over registered companies in Nigeria was established. The Nigeria CAMA 1990 has remained stagnant and non-progressive (Aina, 2013) and the need to respond to recent development globally. ROSC (2008) posits that a new CAMA should draft into laws and on the experience of the developed countries like the UK and Australian firm acts. It should be to enhance the shareholders' interest, to harmonize the legal framework of the developed economies, and to impose fines for non-compliance.

The recent global corporate crisis and failures coupled with the effect of good corporate governance practices by the developed and emerging countries has led to the need for Nigeria to embrace on standard corporate governance code for listed companies this became paramount and attractive to foreign and informed investors (Mmadus & Akomolafe, 2014). The financial scandals in financial and non-financial sectors in the 1990s added fervor to this development of standard corporate governance. SECN 2000 constituted of the seventeen-member committee that has Atedo Peterside as chairman with four key terms of reference to draft a standard corporate governance code for listed firms in Nigeria. The Peterside committee terms of reference as contained in SECN (2003) are as follows;

1. To examine the critical issue relating to corporate governance in Nigeria;
2. To identify weakness in the current corporate governance practices in Nigeria with respect to public firms;
3. To make recommendations on necessary challenges to current practices; and
4. To investigate practices in other jurisdictions with a view to the adoption of international best practices in corporate governance in Nigeria.

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The SECN code adopted after the UK code by adopting the single-tier board operational system based on corporate governance. The UK code fell short of international benchmark for corporate governance standard practices compared to those of Malaysia, India, South Africa, and other emerging countries. Rossouw (2005) opines the inadequacy of the code captured as the only code in Africa that does not embrace the all-inclusive model of corporate governance.

However, lack of compliance and weakness of the code were not inadequate in exposing the sub-standard financial practices, falsification of financial statements and cosmetics accounting of Afribank. The managing director of the bank who aligns with the board of director colluded with its auditor to cook and window dress the account of the company in 2006 (Okike, 1998; Salaudeen *et al*., 2015; Okoye & Ofoegbu, 2011). The cases of the Cadbury Nigeria Plc financial scandals and misappropriation of figures in 2006/2007 and the banking sector crisis brought a loss of about two trillion naira (ROSC, 2008, 2011). The incorporation of the code of corporate governance could enhance the investors' confidence, improve the shareholders' interest, encourage of foreign investors, strengthen protection of minority shareholders and enhanced investment efficiency in the economy (Stanwick, 2008).

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Adekoya (2011) examined the inadequacy of the corporate governance practices in Nigeria has resulted in a lot of corporate scandals in spite of the regulatory framework and legal code of governance put in place to improve the corporate governance mechanisms. In the period between 2008 and 2010, Nigeria suffered from the banking crisis in spite of the code for banks issued by the Central Bank of Nigeria in 2006. This issue was attributed to the weak corporate governance that resulted in poor financial reporting quality (ROSC, 2011). Adegbite (2012) opines that the regulatory framework and legal system of the corporate governance in the short-run gave birth to corporate failures and corruption that has affected the corporate governance structures. Nwonyuku (2012) asserted good corporate governance in Nigeria could enhance investor rights and result in credible and reliable financial reports. The board and the independence of the audit committee could also enhance the financial reporting quality

through monitoring, controlling and oversight functions exercise to improve the financial performance of the organization.

Previous studies in Nigeria focused on corporate governance and financial reporting quality (Nwonyuku, 2012; Onuorah & Friday, 2016) the evolution and corporate governance practices (Okike, 2000, 2007; Yakasai, 2001) the legal and regulatory framework of corporate governance (Adegbite, 2012) and the issues and prospect of the corporate governance (Adekoya, 2011). Other studies centred on the period before the corporate governance code of 2003 while some focused on the period after the period of 2003, and others also the view era of corporate governance of 2011 code of practices.

Financial reporting quality matters need adequate attention to enable investors to make good economic decisions. Good corporate governance will facilitate high, credible and reliable financial reporting that would increase the investors' confidence (Cohen *et al*. 2004). Audit committee could also enhance the financial reporting quality through their diligent and dutiful role of monitoring and oversight functions by being independent in their reports.

The state of corporate governance in Nigeria, as well as a number of African countries, is still at an elementary stage (Wilson, 2007). Corporate governance issues in Nigeria are usually discussed side-by-side corruption, which is adduced to be a strong deterrence to development (Adegbite, 2012; Omeruo, 2012). The Nigerian government on its part has made efforts to addressing governance issues in companies by establishing corruption-fighting bodies such as the Economic and Financial Crimes

Commission (EFCC) to intervene in cases of financial fraud in both public and private sector organizations (Ehikioya, 2009; Oteh, 2013).

In addition, a number of independent bodies such as the Securities and Exchange Commission (SEC) and Corporate Affairs Commission (CAC) are saddled with the task of ensuring good governance culture among companies in Nigeria (Oso & Semiu, 2012). The CAC, for example, is in the business of administering the Companies and Allied Matters Act, which has a provision for corporate governance of companies. Similarly, in striving towards good corporate governance and fighting corruption in the organization, the SEC in the course of interviewing managers of companies who apply to raise funds on the capital market ensures that the managers are quizzed on their business goals as well as their proposed use of raise funds (Adegbite, 2012; Adegbie & Temitope, 2015).

A further measure is a penalty for non-compliance with section 345 of 2004 Company and Allied Matter Act (CAMA) which requires that delay in delivering financial statements, would attract a fine of ₦500 ($250) daily per director. In section 348 of CAMA 2004, the fine for the presentation of defective financial statements is ₦100 ($0.50) per director. As indicated these penalties are too low and outdated as defaulting companies may not likely have much difficulty paying such fines once infraction is established. According to ROSC (2011), the CAMA is outmoded regarding penalties for noncompliance and suggest that the penalty reviewed to make it compliant with present reality. It surmised that the low penalty fees required under CAMA (1990) and the weak enforcement provisions have made the CAC remain ineffective in discharging of its statutory functions.

Md Salleh (2009) highlighted the importance of good corporate governance in the economy notes that the performance of the economy of any country affected by the corporate governance quality of that nation. He emphasizes the importance of efficiency in the allocation of investment as against the size of the investment in ensuring growth. In the Nigerian environment, the failure of several corporations has raised serious doubts about the information disclosed by companies. These widespread corporate failures have necessitated the need for improvement in financial information by ensuring good corporate governance mechanisms. The cases of failure include the collapse of several banks and other companies like African petroleum, Cadbury Nigeria Plc, and host of others have all been linked to poor and weak corporate governance.

2.4 Financial Reporting Quality Disclosure Practice in Nigeria

Financial reporting quality disclosure is important because investors are interested in how business is being managed aid in the decision-making process (Australian Stock Exchange (ASX), 2014). Mandatory disclosure of financial reporting quality by companies suggests in reducing agency conflicts between shareholder and managers results from information asymmetry and prevents executives from extracting excessive compensation (Healy & Palepu, 1995; Onwuchekwa, Erah & Izedonmi, 2012).

It is appropriate to understand the financial reporting quality disclosure practice in Nigeria under the market-based corporate governance system practice in the country. The legal and regulatory framework on financial reporting quality in Nigeria is different compared to the UK. It remains if the factors that influence financial reporting

quality in the UK could also have equal effect in Nigeria considering country- specific factors. Nigeria is a part of the global economic community and as such is not immune to the happenings in other countries of the world in this era of globalization.

In Nigeria's quest to make its companies conform to corporate governance best practice that is in line with international standards, the CG code 2003 was published by the SECN with a revised version in 2011. The CG Codes require the disclosure of mandatory financial statement in the annual reports. The item for disclosure includes the emolument of directors, chairman, and highest-paid director. It further recommends the emoluments of the CEO and executive directors should include performance-related elements like bonuses, stock options, and long-term related components like the pension. There is however poor disclosure in the annual report on the individual basis.

In Nigeria, the CAMA 1990 remains the only legislative guide on financial reporting quality. However, the Act remains inactive and lacking in monitoring roles on companies' requirements to make disclosure of details of financial statement in the annual reports. Furthermore, the CG Codes 2011 Report indicated that company financial statement disclosed in the company's annual report was still poor. However, there was still poor disclosure on the financial statement of each individual director and key management personnel. The lack of enforcement and the adequate supervisory issue remains a challenge to NSE.

The report by the World Bank/IFC on corporate governance assessment on Nigeria, (ROSC, 2008; Ofoegbu & Okoye, 2006) documented that the weakness of corporate

governance highlighted that the accounting and auditing practices in Nigeria suffer from institutional weakness in regulations. The reports averred that the Nigeria action plan was poorly implemented and lacked transparency (Adegbite, 2012; ROSC, 2004, 2008, 2011). This provides support for the findings of ROSC (2011) Ogbonna and Appah (2011) that enforcement and compliance mechanism is weak in Nigeria.

This practice, however, contrasts those of developed economies that have been accepted as constituting good practice. For example, the US Securities and Exchange Commission (SEC) has been at the forefront of enacting rules that require companies listed in the US to make mandatory disclosure of financial statement in their proxy statements since 1938. The case of Nigeria is different from that of the US as the Listing Requirement of the NSE is weak, lack enforcement and compliance in financial reporting matters (Okike, 2007; Oyejide & Soyibo, 2001; Ogbonna & Ebimobowei, 2012).

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2.5 Chapter Summary

In this chapter, the background of Nigeria's corporate environment was discussed with emphasis on the regulators of the country's capital market, thereby highlighting the inherent weakness associated with the inability to perform their duties. The corporate governance landscape presented argued for a mandatory disclosure regime that backed up by relevant legislation. Furthermore, financial reporting disclosure was shown to be poor because of lack of transparency, weak corporate governance code, and lack of enforcement and monitoring devices of for regulations of a mandatory disclosure requirement for the public listed companies in Nigeria. The review of relevant literature as pertains to this study has been presented in the next chapter. This includes

different theories on board characteristics and financial reporting quality. The international perspective on board characteristics and past empirical research on the relationship between financial reporting quality and this study's explanatory variables presented.

CHAPTER THREE
LITERATURE REVIEW

3.1 Introduction

This chapter contains review of literatures on topics that are related to this study. The structure begins with the concepts of financial reporting quality discussion followed by measurements of financial reporting quality, overview of corporate governance, Big 4 firms and auditor tenure, underpinning theories and the literature gap and finally, presents the chapter summary.

3.1.1 Concepts of Financial Reporting Quality

Much attention is given to the quality of the financial reports and indeed the phrase "financial reporting quality'' has been widely used. The concept of the financial statement is elusive and has been interrupted in a variety of ways (Ball & Shivakumar, 2006). There has been no consensus on the definition of or the framework for financial reporting quality among researchers and accounting professionals (Jonas & Blanchet, 2000). As stated by McDaniel, Martins, and Maines (2002), the SEC auditing profession and national exchange (in the US) have not specified an explicit definition of or framework for financial reporting quality. As a result, there are various interpretations of or proxies for financial reporting quality.

Prior studies use either disclosure quality or earning quality (Wright, 1996; Atanasovski, Jovanovski & Jovevski, 2015; Lara Osman & Neophyto, 2009; Bushman, Piotroski & Smith, 2004; Bushman, Piotroski & Smith, 2005). Very few studies used multiple proxies for financial reporting quality (Barton & Waymire, 2004; Han, 2004; Rajgopal & Venkatachalam, 2008). This has motivated an understanding

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of the concept of financial reporting quality through multiple proxies. Aggarwal *et al*. (2011) formally test the idea of financial reporting quality and show that international organization investors lead to improved governance practice across the country through high financial reporting quality. Armstrong, Core, and Guay (2012), and Lamboglia and D'Onza (2015) agreed with other researchers that institutional investors may affect their investee's choice of board members through financial reporting quality.

Nevertheless, previous studies used different proxies in the measurement of financial reporting quality. Some researchers use either financial reporting quality (Wright, 1996) or measurement quality (Bushman *et al*., 2004). Very few studies use multiple proxies in the measurement of financial reporting quality (Barton & Waymire, 2004; Han, 2004; Rajgopal & Veenkatachalan, 2008). This has provided an understanding of the concept of financial reporting quality through multiple proxies. Other studies measure financial reporting quality in relation to certain characteristics or attributes. However, this study incorporates the use of financial reporting quality index as a basis for measurement of financial reporting quality because it is utilized in investment decision-making in the companies (Coy, 1993).

According to Deloitte (2011), financial reporting quality show the improvement and performance of the entity in question so that the investors can make strong decision based on accurate information regarding potential risks and returns. Another major objective of financial reporting quality is to explain that this decision includes buying, selling or holding their investment and an assessment that efficiently and effectively managing and governing boards have discharged their responsibility to users of the

entity resources (Popova *et al*., 2013). The financial reporting quality directed to providers of capital who cannot otherwise demand the information they need to make their decisions and assessments such as investors in an entity traded publicly traded equity or debt and thus, rely on financial reporting quality for much of the information they need.

The financial reporting quality also identifies the relevance and faithful representation of fundamental qualitative characteristics. Others are comparability, verifiability, timeliness, and understand ability (Beest *et al*., 2009; FASB, 2011; Kythreotis, 2014). Section 334 of the CAMA (2004) provides the content of financial reporting information for public liability companies. Financial reporting quality also includes the aggregate of individual financial statements such as total assets, total liability and net income. The financial reporting quality should also distinguish the entities operating, financing and investing activities, which raises the question of how to use different measurement bases (Beest *et al.,* 2009).

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Armstrong, Guay and Weber (2010) argue that financial reporting quality concept should be timely and relevant, credible information that would enhance the monitoring performance of the board of directors. Kim and Yang (2014) and Wang *et al.* (2008) portray the enhancement of transparency in the concept of financial reporting quality as the duty of the board of directors in monitoring the company and directing the financial reporting quality process. Brickley and Zimmerman (2010) posit that, regarding the class of agency problem that would separate ownership and control of the managers. Epstein and Jermakowicz (2010) provide a conceptual framework that

has the conceptual basis for selecting the information feature in such a quality index in enhancing financial reporting quality.

Financial reporting quality is important in order to improve the public understanding offense and their interaction with society. Beeset *et al*. (2009), FASB (2011) and Norwani *et al.* (2011) posit that high financial reporting quality information positively influence capital providers and other stakeholders in making investment credit and similar resource allocation decision enhancing overall market efficiency. Credible reporting quality reduces information asymmetry between company insider/the management and the outsider/investors (Laasonen, 2012).

In addition, financial reporting quality to certain characteristic suggested that the quality of a company financial reporting ultimately depends on financial information qualitative characteristics; relevance, reliability, verifiability, comprehensiveness, timeliness, and comparability (Jonas & Blanchet, 2000; Braam & Beest, 2013). The financial reporting is referred to as being of high quality if it possesses three attributes-transparency, full financial statement, and comparability. Transparency is referred to as the revealing of information about events, transactions, judgment and estimates, which allows users to see the results and implications of the decision, judgment, and estimates of preparers. The full financial statement was related to the provision of all information necessary for decision-making while comparability means that similar transaction is accounted for in the same manner both cross-sectional arising among companies as well as overtime (Barton & Waymire, 2004; Kamal Hassan, (2012).

A financial reporting index is a research instrument used to measure the level of the financial statement of information in annual reports (Wei *et al*., 2008). It also helps in detailed information on historical figures and the future prospects of the company's business activities (Chang, 2018; Hope 2003). It also checkmates in the behaviour of security prices and the comprehensiveness and completeness of information, the timeliness and relevance of financial reports (Bushee, 2004; Buzby, 1974; Coy *et al*., 1993; Firth, 1979) and ensures the information very transparent.

Furthermore, in determining the quality of financial statement prior studies have used their own self-developed financial reporting index (Devalle, & Rizzato, 2017; Li, Pike, & Haniffa 2008; Buzby, 1974; Cooke, 1993; Naser & Nuseibeh, 2003). The weighted index procedure involves an evaluation of the information item disclosed in a report (such as an annual report) based on a pre-defined list of the possible index items. The financial reporting index is either weighted or unweighted. The weighted index takes into account the importance of information items whereas an unweighted index assumes all items are of equal importance (Wei *et al*., 2008; SarDesai, 1997; Firth, 1979; Hooks, 2000). Some studies, which employed the weighted index are: Buzby (1975), Cerf (1961), Malone *et al.* (1993), Singhvi (1968), and Stanga (1976), while those studies that used the unweighted index includes Ahmed and Nicholls (1994), Hossein *et al.* (1994), Wallace (1988), and Wallace & Naser (1995). In addition, some studies employed both the weighted and unweighted index: these are Choi (1973, 1974); Chow and Wong-Boren (1987), more studies used the unweighted index than the weighted index therefore, this study would use the unweighted index.

Li (2016) investigated the relationship between the quality of financial statement and excess perquisites. The testing samples are adapted from the Shen Zhen Stock Exchange Market. The result found that top executives related to the higher quality of the financial statement of the firms to perquisites consumption. Moreover, it testified that the relationship is statistically significant in a lower environment index province in China. Finally, financial reporting index can be used as the instrument variable to solve for the possible endogeneity problem. The results further support that the financial reporting index will reduce the executives' extra perquisites and could assist in the survivability of the organization by regulating the activities of the board and evaluating their performances of the firm.

Chalaki, Didar and Riahinezad (2012) investigated the effect of corporate governance attributes on financial reporting quality in 136 firms listed in Tehran Stock Exchange in the period of 2003-2011. Chalaki *et al.* (2012) employed the study by Mc Nicholas (2002), Collins, and Kothari (2001) as the measurement for financial reporting quality. Institutional ownership, ownership concentration, board independence, and board size were variables employed. Descriptive correlation statistics using multiple regressions in SPSS and Eviews software were utilised. The findings showed that there was no relationship between corporate governance attributes including board size, board independence, ownership concentration, institutional ownership, and financial reporting quality. In addition, there was no evidence found to support the significant relationship between control variables (audit size, firm size, and firm age) and financial reporting quality.

Peyravan (2016) investigated whether financial reporting quality of firms is associated with investors' simultaneous participation in the firms' syndicated loan and equity (dual-holdings). The sample size using hand-collected data 2006-2014 consists of 98,842 firms' observations on institutional investors' loan and equity holding. Discretionary accrual quality was employed in analysing the data. The finding shows that investors are more likely to be dual holders in the firm with low financial reporting quality.

3.1.2 Measurements of Financial Reporting Quality

The previous literature documents different index utilized in measuring financial reporting quality of firms. It measured with some attributes of characteristics of qualitative (Beest & Braam, 2009) and another proxy to measure the quality of the financial statement of companies (Buzby, 1975; Cooke, 1993; Wallace, 1995).

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Boshnak (2017) investigated the extent and level of mandatory practice of financial reporting quality of companies in the Gulf Co-operation Council in UAE for the period of 2010-2013. The study covered companies with 325 mandatory financial reporting indexes. The level of mandatory items disclosed by the sample GCC country listed firms compared to what was required in the 24 applicable IFRSs/IASs (325 mandatory items) was found to vary across the GCC countries. The average level of mandatory reports requirements with the 24 IFRSs investigated across firms and years was 0.73, with a range from 61% to 87%. The level of mandatory statement increased from 0.72 in 2010 to 0.74 in 2013, indicating that the level of mandatory statement improved in the region over the study period. The age and status of the company (industry type)

appeared to be significant factors for mandatory reports size assets and sales and company profitability found to have no effect on mandatory financial reporting quality.

Li (2016) investigated the relationship between financial reporting quality information and excess prerequisite. The sample consisted of listed companies in Shen Zhen Stock Exchange in China for the period of 2009-2012. The quality index was used in analysing the data; the sample of 1,516 firm-year observations with 379 listed companies was used. The result showed perquisite consumption by director shareholder executives with higher financial reporting quality information of the firms. The result testified that the relationship is statistically significant in a lower environment index province in China. The internal control index was used as the instrument variable to solve the endogeneity problem. The financial reporting quality information disclosed will constrain the director-shareholder excesses to improve financial reporting quality.

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Hasan and Hosain (2015) investigated the extent and level of mandatory practice of financial reporting quality of companies in Bangladesh for the period of 2010-2013. The study covered companies listed on the Dhaka Stock Exchange (DSE) with a sample size of 246 companies. The financial reporting quality index employed in the analysis were both weighted and unweighted financial reporting index as noted by Cooke (1989). On the other hand, the weighted financial reporting index as applied by Adelopo (2011) in his studies concluded that financial statement compliance was poor among listed companies. They disclosed an average of 50.62% of the item selected during the study period 2010-2013. The minimum score found in the study was 20.81% and the maximum was 77.08%. The age and status of the company (industry

type) are significant factors for mandatory reports size of assets and sales and company profitability found to have no effect on mandatory financial reporting quality.

DeFond and Zhang (2014) attest through archival auditing research that audit quality enhances financial reporting quality by increasing the reliability and credibility of the financial statements. The audit quality depends on the firm's innate characteristics and financial reporting systems. Audit quality relied on the clients demand such as incentive agency cost and regulation, and the competencies of the audit committee and the efficacy of the internal control audit function. The auditor supply is another strand that could improve the audit quality through the reputation, litigation and the regulation and the competencies of the audit process and the function of the expertise. The intervention of audit market regulations such as Sarbanes Oxley Act (SOX) can be a check and balance to the equilibrium level of audit quality (DeFond & Lennox, 2011). Some of the major SOX provisions include financial expertise, audit committee, internal control audits, and restrictions on former auditor employees, with higher audit quality providing greater assurance of high financial reporting quality.

Ibrahim (2015) examines the adoption of International Financial Reporting Standard (IFRS) in Nigerian companies listed in the Nigerian Stock Exchange (NSE) for the years 2012-2014. The financial reporting index was used in the analysis and sample size of 97 listed companies. The study used unweighted financial reporting index to extract information about the quantity of segment item disclosed by sample companies' financial reporting quality. Cooke and Wallace (1989) employed the same approach. The dichotomous procedure was employed in the analysis if an item is disclosed one (1), or zero (0). The study documented that the financial reporting

quality was positively related to some aspects of firm characteristics such as industry type, auditor type, firm size, and these variables provide a significant impact on compliance with IFRS operating segments of financial reporting quality.

Siyanbola, Musa and Wula (2014) examine the extent of financial reporting quality compliance with IAS 16 by companies listed on the Nigerians Stock Exchange (NSE) for the year 2002-2011. The sample size consisted of five (5) listed companies as contained in the NSE fact book 2012/2013. The study employed qualitative grading using a compliance index and ANOVA statistics utilized in the data analysis. The eleven (11) requirements were developed from the statement of accounting standards while 21 requirements were developed from the international accounting standards based on a critical review of relevant literature. The total compliance index constructed by comparing requirements of the standard against the information disclosed in the financial reporting quality of listed firms similar to Barde, (2009) and Bashir (2012). The result showed that IAS 16 when compared to our local Statement of Accounting Standard (SAS) requires a higher number of financial statement requirements. This could be responsible for the failure of our companies to comply with IAS 16 financial statement requirements of financial reporting quality and this contributed to poor financial reporting quality in Nigeria.

Ali (2014) proposed the relationship between corporate governance and financial reporting quality in a context of principal-agent conflicts and poor investor protection. The sample consists of all French listed firms included in the French Stock Market Index (SBF120 index) in 2004. The sample size comprised of 81 companies and 20 observations analysed. The Herfindahl index was employed in the analysis and the

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result showed that there was a positive relationship between corporate governance and financial reporting quality and no relationship between financial reporting quality and cross listing.

Gorgan and Gorgan (2014) examine the financial reporting quality level of companies listed on the Bucharest Stock Exchange (BSE). The sample consists of companies listed on BSE (category I and II) that prepared their consolidated (the unweighted index employed in the analysis). The study utilized the IFRS financial statement index and checklist (Deloitte) and the text of standards consistent with Buzby (1975) and Cooke (1989, 1993). The result showed that there was a high level of non-compliance with IFRS 48 of the financial reporting quality information.

Agyei-Mensah (2013) investigated the financial reporting quality before and after adopting IFRS in Ghana. The sample size consists of all the 35 listed companies in Ghana Stock Exchange. The empirical analysis concentrated on the pre-official adoption period (2006) and the post-adoption period (2008). The quality of financial information reports (QFIR) index measures the financial reporting quality information using the qualitative characteristics of financial reporting information as advocated by IASB, IFRS theoretical framework. This showed the level of compliance after the adoption of IFRS in Ghana, how this affects the financial reporting process.

About twenty (20) key criteria first used by Beest, Braam and Boelen (2009) and the qualitative characteristics of the IASB framework include relevance, faithful representation, comparability, understand ability and timeliness. The study used sample of 231 annual reports from companies in UK, US and Dutch stock exchange

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from the period of 2005 to 2007. The findings reported that the measurement tool used in this study was a valid and reliable approach to assess the quality of financial reports. The measurement tool contributes to enhancing the quality assessment of financial reporting information, fulfilling a request from both the FASB and the IASB (2008) to make the qualitative characteristics operationally measurable. With the improvement of financial reporting quality after adopting IFRS, users assured of useful information on financial decision-making.

Nyor (2013) examined the quality of annual reports and accounts of Nigerian firms from the perspective of users of such accounting information. The study administered one hundred (100) questionnaires to seven (7) respondents' user group of relevance; understand ability, consistency, objectivity, comparability, reliability and completeness and using a five-point Likert scale and chi-square for the test of the hypotheses. The result indicated the quality of the annual report and accounts of Nigerian firms is only moderate.

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Popova *et al*. (2013) investigated the association between mandatory financial reporting quality companies' values using a sample of UK companies included in the FTSE 350 index for the period 2006-2010. The study adopted the unweighted financial reporting index, which, used in prior studies like (Cooke, 1987; Akhtaruddin, 2005; Bruslerie & Gabteni, 2010; Wallace & Naaser, 1995). The sample size consisted of 20 companies selected randomly in order to avoid bias and 100 observations were gathered. The findings showed that the average mandatory financial reporting index for the 5-year period was 91.51% (with minimum 69.31% and maximum 100%) which is consistent with financial reporting index by Wallace and Naaser (1995), and Owusu-

Anash (1998) in conformity with the financial reporting quality. This demonstrated the compliance ability of firm in the UK with mandatory financial reporting index.

Hassan (2012) examines the extent of corporate governance and financial reporting quality by United Arab Emirates (UAE) listed corporation. The sample size consists of 91 UAE listed corporation representing the various sectors (banking, insurance, industrial and services) in the country. The corporate governance index employed in the analysis and the financial reporting index based on the Organization for Economic Corporation and Development (OECD) 2004, UAE code of corporate governance, published in their annual report and prior research that addressed corporate governance index (Haniffa & Cooke 2002; Chen & Zhen, 2007). The study employed a weighted financial reporting index in the analysis. The result showed the extent of corporate governance index and financial reporting quality found to be similar across various sectors in the UAE. The highest financial reporting indices are is those dealing with management structure and transparency, which found to be significantly different across the sectors in the UAE.

Galani, Alexandrids, and Stavropoulous (2011) investigated the hypothesized impact of several firm characteristics on the extent of the mandatory index. They constructed a mandatory index of 100 items to measure the degree of compliance with the financial reporting quality. The study was conducted on a sample of companies on the Greek Stock Exchange for the year ended 2007. The finding showed that the listed companies in Greek disclosed the mandatory requirement of 86% of the mandatory index.

Hooks (2000) examines the extent of financial reporting quality in the annual report of Electricity retail and distribution companies from the accountability perspective. The study developed an empirically derived mandatory index design specifically for this purpose to limit the researcher's personal perspective. A questionnaire incorporating the potential item were sent to 15 purposively selected panel members who were asked to weight each item perceived importance in the annual report. The scale was carefully defined so individual respondents could make compatible distinctions between concepts such as "very important" and of "intermediate importance". However, the weightings for individual items and the scores for comprehensiveness of disclosure are necessarily subjective because they represent the attitudes, beliefs, knowledge and interests of each panel member and the researcher.

Table 3.1 presents a summary of relevant research in literature on financial reporting quality. These studies have individually considered investigations relating to audit committee, financial information, board independence, board size, board ownership, block holder, audit quality and other relevant variables. However, there are inconsistencies in the findings from these previous studies, in addition to lack of in-depth study, lack of enforcement regulations and auditor transparency, unresolved agency conflict and thus the issue of poor financial reporting quality. Therefore, this study aims to bridge the gap by investigating the relationship between board characteristics with financial reporting quality.

Table 3.1 Summary of Previous Research on Financial Reporting Quality Disclosures

Author and Year	Country	Dependent Variable	Hypothesis variable	Sample	Main findings
Li (2016)	China	Financial reporting quality disclosure	Top executive compensation state-owned enterprise	370 listed companies	Financial information reduces executive excess perks
Atanassovski, Jovanovski, and Jovevski (2015)	Macedonia	Disclosure quality	Size, listing status, leverage, ownership structure, profitability, and audit type	116 listed companies in Macedonia Stock Exchange	Disclosure with ownership concentration (positive)
Leong et al. (2015)	Singapore	Financial reporting quality	Independent audit committee, audit committee size, audit committee meeting.	423 non-financial companies from the annual report of Singapore Stock Exchange	Audit committee and audit committee independence (negative)
Hassan and Hosain (2015)	Bangladesh	Disclosure index	Firm size, age, profitability, and industry type	246 companies listed on Dhaka Stock Exchange	Disclosure quality compliance on the mandatory type (negative)
Kabir Ibrahim (2015)	Nigeria	Disclosure segment	Size, leverage, industry type, auditor type, and listing status.	97 companies from the Nigeria Stock Exchange	Disclosure segment with size, industry type, auditor type, and listing status (positive).
Zango, Kamardin, and Ishak (2015)	Nigeria	Mandatory compliance	Banks, IFRS	14banks in Nigeria Stock Exchange R15 listed	Mandatory compliance with Nigeria banks (moderate).
Kythreotis (2014)	UK	Financial reporting quality	Relevance, reliability, and consistency.	companies European Securities Exchange Commission	Relevance (positive) and reliability (unchanged)

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Devalle and Rizzate (2014)	Italy	Mandatory disclosure	Intangible asset, size, and performance	All Italian companies belonging to the ITSE	M\mandatory disclosure with size and intangible assets (positive)
Gorgan and Gorgan (2014)	Romania	Financial reporting quality disclosure.	Size, profitability, auditor reputation, leverage, and industry type	Typr1 and type 11 listed companies at BSE	Disclosure quality with IFRS (positive).
Ali (2014)	US	Corporate governance	Ownership concentration, shareholder voting rights, and family controls	81 companies in the US	Disclosure across the US cross-listing (positive)
Chakroum, Hussaney, and Hussainey (2014)	Tunisia	Financial reporting quality disclosure	Board independence, managerial ownership	54 firm-year observation	Board independence (negative) regulatory and shareholder (positive)
Samailia (2014)	Nigeria	Financial reporting quality	Separation of power, CEO, board meeting, ownership structure, and audit committee.	7 listed petroleum marketing companies in Nigeria	Separation of power, CEO, (positive) audit committee and audit committee meeting (negative).
Popova et al. (2013)	UK	Mandatory disclosure	Firm value, earnings, age, size, and leverage	Selected at random 20 companies in the UK	Company value, leverage, and age (positive).
Nyor (2013)	Nigeria	Financial reporting quality	Understandability, relevance, consistency, comparability, reliability, objectivity, completeness.	7 users' group of random selection from a higher national diploma degree	Understandability, relevance, comparability, reliability, objectivity, and completeness (moderate).
Dou, Hope, Thomas & Zou (2013)	Toronto	Financial reporting quality	Firm size, leverage, analyst and block holder	S &P 1500 firms Toronto Stock Exchange	Block holder (positive).
Alabadin (2013)	Nigeria	Financial reporting quality	Poor presentation, manipulation of figures and fraud		NAICOM (positive).

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Kamal Hassan (2012)	Egypt	Corporate governance	Financial reporting quality, governance regulations	91 UAE listed companies	Disclosure quality with management (positive).
Chalaki, Didar, and Riahieezhad (2012)	Iran	Financial reporting quality	Board size, board independence, institutional ownership concentration, firm size, and firm age	136 firms selected from TSE tested firms	Board size, board independence, ownership concentration, institutional ownership (negative)
Dangana Umaru (2011)	Nigeria	Financial reporting quality	Audit compensation, audit firm independent, Big 4 audit firm, and joint audit	8 building materials firm from Nigeria Stock Exchange factbook	Audit firm (positive)
Klai and Omiri (2011)	Tunisia	Financial reporting quality	Board director, corporate ownership, block holders and family ownership	22 not- listed companies from TSE	Block holders, family ownership (negative)
World Bank (2011)	Nigeria	Financial reporting quality	ROSC, annual report observance of codes		ROSC (negative)

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3.2 Overview of Corporate Governance

Corporate governance has focused on identifying the behavioural patterns; finally, this eventually becomes the guidelines influencing decisions regarding the internal governance of companies (Outa, 2011). These set of rules aid in shaping the relations among the board of directors, shareholders and managers alongside resolving the agency conflicts (Ashbaugh-Skaife *et al*., 2006, 2008; Gill, 2008). Mohamad and Muhamad Sori (2011) asserts that good corporate governance helps in ensuring transparent financial reporting, management accountability, and socially responsible corporation, which in turn, facilitates efficient use of scarce resources to increase shareholder value (Ebiringa & Kule, 2014). Jo and Harjoto (2011) define corporate governance as a system of checks and balances that trade-offs benefits and costs of firm decisions such as financial reporting quality engagement and is a system of controls, regulations, and incentives to minimize conflict of interest and prevent fraud. Similarly, the Cadbury Committee (1992) defined corporate governance as a system through which the operations of a company are directed, controlled by the appointed directors. The shareholders have a role in appointing the director and auditors, who should provide the shareholder with an external and objectives check on the director financial statement forming the basis of the reporting system.

Sarbanes Oxley Act (2002) defines corporate governance as a mechanism, processes, and a relation by which corporation is controlled and directed. Malaysia Institute of Corporate Governance (2011) defines corporate governance as a process and structure used to direct the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-

term shareholder value whilst taking into account the interest of other shareholders. This current study defines corporate governance as the way directors are seen to be transparent and are held accountable particularly, through financial reporting process of the organization (Nwonyuku, 2012).

3.2.1 The Corporate Governance Mechanism

Following the events of Enron, Cadbury and other corporate failures, corporate governance in Nigeria has developed towards issues of corporate ethics and financial reporting quality (Eng & Mak, 2003). In view of these new reforms, companies have developed mechanisms of corporate governance that seek to address shareholders concern, for example, board characteristics, audit committees, stakeholders' complaints and dialogue channels among others (Levi, Segal & Segal, 2014; Gillan 2006; Shil, 2008; Panfilii & Popa, 2011; Adewale, 2013).

The external corporate governance mechanism such as utilised by Big 4 audit firms is the mechanism developed to mitigate the impact of the agency problems and thus, reducing the financing cost of the firms to enhance financial reporting quality and to be more interested in the firms' resources and the growth of the firms (McNicholas, 2002; Vitols, 1995). For instance, the employment of Big 4 auditors could assist in reducing the fraudulent activities in the financial statement. The internal corporate governance comprises block shareholder, director shareholder, and board size and board independence, among others. The inclusion of these variables and audit committee are paramount to ensure more balanced governance's structure and guarantee credible financial reporting quality (Cohen *et al.,* 2004, Shuto & Takada, 2010; Liang, Xu & Jirapon, 2013) and to maximize shareholder wealth through

achieving the highest possible value for the firm (Brown & Caylor, 2006; Byard *et al*, 2006). This implies that the role of external auditor and audit committee are very vital in enhancing financial reporting process.

The external auditors are those individual experts that act as an external governing mechanism to the internal controls of a company by reviewing and evaluating its internal activities, and controls primarily to detect any material misstatement and promoting high financial reporting quality in a company (Ali *et al*., 2004; IAIS, 2009; Ojo; 2009; Beattie *et al*., 2004). Furthermore, the audit committee is a key element of corporate governance that makes management accountable to owners (principal) for its stewardship of a firm (Patel *et al.,* 2002). In this respect, attention has been drawn to the important role of audit committees vis-à-vis the external auditor's responsibilities (Ajeela & Hamdan, 2011).

Audit committees do not only serve as internal monitoring devices which augment good corporate governance practices, but they are also regarded as instruments that ensure that a proper relationship subsists between the auditor and the client's management (Al-Shaer *et al*., 2017; Li *et al.,* 2012). More importantly, the audit committee and the auditors need to maintain an ongoing dialogue independent of management and the rest of the board. In a way, the external audit serves as a signalling device to principals of a firm that financial information provided by the management could be reliable. It is, therefore a major concern, that mainstream accounting research reveals that enhancing the independence of audit committees and auditors would increase the credibility and financial reporting quality for the benefit of all key stakeholders (Cohen *et al*., 2004). This indicates that the external auditor and the audit

committee responsibility in monitoring, evaluating and detecting material misstatement could influence the quality of financial reporting process.

3.2.2 Block Shareholder Ownership

Block holders are shareholder with an exceptionally large amount or value of stock in the firms. They are real owners of the company and they have the power to appoint the director that should oversee the organization, they have the voting power. In addition, block holder is measured as the total shareholding by shareholders that own minimum shares of 5% in the company (Dwivedi & Jain, 2005; Farrer & Ramsay, 1998; Masulis *et al*., 2012). Past studies document that the role of the block holders' ownership in influencing firm management is inconsistent in the extant literature (Zureigat, 2011; Pucheta-Martínez & García-Meca, 2014). Some schools of thought argued from the expropriation point of view. While others argued that, the presence of block holders protects interest of the minority shareholders (Chhaochharia, Kumar & Niessen-Ruenzi, 2012; Derrien *et al*., 2013; Firth *et al*., 2007; Khan, Dharwadkar & Brandes, 2005; La Porta, Lopez de Silanes, Shleifer & Vishny, 1998; La Porta *et al*., 1999; Lemmon & Lins, 2003). For example, La Porta *et al*. (1999) argue that companies in countries with the weak market for corporate control and weak investors' protection rights will experience increased agency problems between controlling shareholders and the minority shareholders (Ozkan, 2007).

Similarly, La Porta *et al*. (1999) recognized block holders' ownership as a source of agency problem in companies because of the propensity in them to extract private benefits of control to the detriment of the minority shareholders. There are studies that have examined how it influences financial reporting quality but does not show how it

influences board characteristics variables (Boubakri, Cosset & Guedhami, 2005; Cronqvist & Fahlenbrach, 2008; Kouki & Attia, 2016; Latif, Kamardin, Mohd and Che Adam, 2013; Hassan, 2012). This necessitates the current study on the subject of board characteristics and financial reporting quality. In addition, another strand of literature that discusses the relationship between block holders' ownership and financial reporting quality (Dou, Hope, Thomas & Zou, 2013; Cheng & Firth, 2005; Firth *et al*., 2007; Khan *et al*., 2013).

Previous studies that examine the relationship between block holder ownership and financial reporting quality document that the proportion of shares held by block shareholders is associated with lower financial reporting quality (Cheng & Firth, 2005; Khan *et al*., 2005; Ozkan, 2007). Other schools of thought argue that block shareholders will use their influence to constrain the CEO from extracting the importance of financial reporting quality (Firth *et al*., 2007). Their result documents a statistically significant negative relationship between large outside shareholders and financial reporting quality (Latif *et al*., 2013). This shows the inconsistencies in the prior studies.

Block shareholder have a fixed effect in investing, financing and operating activities and compensation policies of firms and the financial reporting quality of manager can be sharpened by the block shareholder (Edmans, 2009 & 2014; Cronqvist & Fahlenbreach, 2008; Kim, 2005). Block shareholder being a homogenous group has to influence financial reporting quality and have a constant direction of influence to have heterogeneous preference beliefs and skills (Kouki & Attia, 2016). Block shareholder is to vote with their feet (McCahery, Sautrier & Starks, 2015). The

authority and power of the block holders enable them to appoint the director on the board of affairs of the entity (Derrien *et al*, 2013). Furthermore, prior studies show the result of the relationship between block holder and financial reporting quality and weakness of the board structure have mixed findings. For, example, Dou *et al*. (2013) indicate a positive relationship between block holder and financial reporting quality while Nodehi, Largani and Nokashti (2015) found a positive relationship.

Dou *et al*. (2013) investigated block holder heterogeneity and financial reporting quality with the size of the firm of 1500 S&P (Stock market index in the US) using the hand-collected sample and covers annual reports 2002-2009 and regression analysis was used based on Dechow and Dichev (2002). The results indicate that the block holder significantly positively affect financial reporting quality. It also shows that a large shareholder influencing the selection of firms and the action of block holders enhances financial reporting quality. Cheng and Firth (2005) examine how to block holders' structure and governance mechanism affects top executives pay in Hong Kong during the period 1994 to 1999 using a sample of 2,016 firm-year observations. Using the highest-paid director as a proxy for CEO duality, they find a significant positive relationship between financial reporting quality and institutional share ownership. This finding supports their argument that institutional investors could constrain the CEO from extracting higher compensation for their monitoring and oversight activities.

Klai and Omri (2011) examine corporate governance and financial reporting quality in Tunis stock exchange with the sample size of 22 non-financial firms. Descriptive statistics employed to analyse the data between the independent and dependent

variables. The finding shows that the governance mechanisms affect the financial information quality of the Tunisian companies. In addition, the power of the foreigners, the families and the block holders reduces the reporting quality, while the state control and the financial institutions is associated with good quality of financial reporting.

3.2.3 Director Shareholder Ownership

The primary duty of the directors is the monitoring of managerial actions to protect the interest of the shareholders (Smit, 2015; Chen *et al,* 2012; Lemmon & Lins, 2003). It is however been noted that directors may not be fully committed to serving the shareholder interest without any personal stake. It is on this premise that the agency theory proposes that directors should have equity holdings in companies where they sit as directors make them align their interest with those of the shareholder. Share ownership by directors as a way of mitigating the principal-agent conflicts as this will help align the interest of the directors with those of the shareholders, thereby making them to take delight in doing adequate monitoring of managerial activities (Armstrong *et al*., 2014; Cheng & Firth, 2005; Firoozi *et al*., 2016; Jensen & Meckling, 1976; Fama & Jensen, 1993).

Bhagat and Bolton (2009) and Bukair and Abdul Rahman (2015) recognized the possibility of directors with appropriate stock ownership to be motivated to do effective monitoring of the executives. In their study of 847 companies covering the period between 1998 and 2002, they examined the relationship between management turnover and director stock ownership. The finding revealed a positive relationship between management turnover and director stock ownership when a company reports

poor financial reporting quality. In another study, Ozkan (2007) report a negative relationship between directors' ownership and financial reporting quality in the UK, thereby indicating that managerial ownership aligns managers' interest with those of the shareholders. Furthermore, Fama and Jensen (1983) note that the directors shareholding is the highest level of control for organizational decision making and they possess the powers to engage, fire and provide incentives for top-level management, as well as and approve and monitor key decisions.

The director's responsibilities are categorized into two. One is the monitoring role involving hiring, firing and compensating managers, while the second is the strategic role, which encompasses advising managers on important key decisions (Masulis *et al*., 2012; Alzoubi, 2014). The handling of these two roles is required in ensuring the board's effectiveness in adding value for shareholders (Brickley & Zimmerman, 2010; Hermalin & Weisbach, 2003).

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One of the most important functions of the director shareholding is to ensure the financial reporting quality as the main source of information for investor/shareholder decision-making (Cohen *et al*., 2004; Van Peteghem, Bruynseels & Gaeremynck, 2017). Financial reporting quality is the extent to which the accounting measurement processes capture the firm's underlying economic transactions (Isele & Ugoji, 2009; Dechow, Ge & Schrand, 2010; Schipper & Vincent, 2003). Therefore, it is argued that the director shareholding has a fiduciary duty to oversight activities undertaken by the managers to ensure the integrity of financial reporting (Cohen *et al*., 2004). In addition, Rodriguez-Fernandez, Fernandez-Alonso, and Rodriguez-Rodriguez (2014) found

director shareholder to have a positive relationship while Omer, Shelly &Tice (2019) found a negative relationship.

Many empirical studies have shown the relationship between directors' shareholders and financial reporting quality. For example, Ritchie and Khorwatt (2007) and Rose, Mazza, Norman, and Rose, (2013) examined the influence of directors' shareholders on corporate governance in the US, Australia, and Europe. The study found that directors' shareholders help enhance corporate governance. The study supported the idea that outside directors are beneficial for the firm and support the hypothesis that there is a direct relationship among directors' shareholders and financial reporting quality because they are truly independent as have been stipulated by the code of corporate governance. Abdullah (2006), and Ismail and Abdullah (2009) examined the relationship between director shareholders and financial reporting quality in Malaysia listed companies. The study found that directors' shareholders have an influence on the financial reporting of firms. This evidence is consistent in suggesting that one contribution to the Asian financial crisis was the effect of corporate governance-related with effective directors.

Rofriguez-Fernandez *et al.* (2014) examine the roles of directors' shareholders in financial reporting quality and review of previous research conducted the study with the sample from Risk Metrics (Responsibility Research Centre) from 2007-2010. Descriptive statistics employed in the analysis to test the relationship between the variables and the finding shows a positive relationship between the tasks performed by such director and financial reporting quality.

Al Daoud, Ismail, and Lode (2015) explored the influence of board of directors, the board size, CEO duality, board diligence, board financial expertise, and financial reporting quality as well as the type of sector on the timeliness of financial reports. The sample size consists of 112 companies listed on the Amman stock exchange from 2011-2012. Multiple regressions applied between the dependent and independent variable. The result also show that companies that separated the CEO and chairman roles are quicker in publishing financial reports than companies combining the roles of CEO and chairman. Board of directors with more meeting makes the audit report lag shorter. Financial reporting quality could resolve the information asymmetry between management and the external auditor. Management report lag related positively to large board size and board diligence and negatively to the existence of an audit committee (Nelson & Jamil, 2012).

3.2.4 Board Size

The issue of the board of directors' size and its relation to financial reporting quality discussed in corporate governance-related studies (Abidin, Kamal & Jusoff, 2009; Akhtaruddin, Hossain, Hossain & Yao, 2009; Uwuigbe & Ajibolade, 2013; Haji, 2013). The board defined by a number of studies as the number of directors in the board (Abidin *et al.*, 2009; Akhtaruddin *et al.*, 2009; Clendenin, 1972; Zahra, Neubaum & Huse, 2000). The size of the board is one of the key corporate governance attributes utilized in ensuring the business activities properly conducted by management (Said *et al.*, 2009). The board size is to have an influence on the ability of the board to carry out its function of monitoring and evaluating management (Fama & Jensen, 1983).

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A small board could enhance speedy information processing, dissemination, and cohesion among the directors and lead to better monitoring curbing the managerial opportunistic behaviour (Zango *et al.,* 2015). On the other hand, a small board might lack the technicality and expertise; required knowledge actually put the CEO in check and supervised properly. Thus, the results of board size have mixed findings from the academic literature (Husnin *et al*., 2016; Ibrahim, 2015; Htay, Mohd Said & Salman, 2013).

On the other side of the divide, the study that has examined large board size argues that as the board increases in size, there is the tendency for the breakdown in coordination and coherency among the directors (Clendenin, 1972; Kamal Hassan, 2012). This reduces the director's effective control of management. In addition, large directors on the board might find it difficult to come up with new strategies (Goodstein, Gautam & Boeker, 1994), as difficult factors within the board may oppose each other. Furthermore, as asserted by Judge and Zeithaml (1989) large boards may take too much time in making decisions. On the contrary, Dalton, Daily, Johnson and Ellstrand (1999) opine that larger boards have the tendency of having more experienced and knowledgeable hands that could have insights on specific issues like financial reporting accounting.

Furthermore, across the literature board size has mainly be measured using the total number of directors in the board (Uwuigbe & Ajibolade, 2013; Barako & Tower, 2007; Chakroun & Matoussi, 2012; Fodio & Oba, 2012; Haji, 2013; Said *et al*., 2009) and most of the studies find the average number of directors to lie between six and ten directors. Furthermore, The SECN (2011) code of corporate governance for Nigerian

listed companies assert that the size of the board should be such that it is commensurate with the magnitude of the company's operations. It recommended a minimum of five members.

Empirically, prior studies on the relationship between board size and corporate performance measures, financial reporting quality inclusive have mixed findings, hence, providing a need for further research (Duffy, 2004). Said *et al.* (2009) investigating the role of corporate governance variables on financial reporting found no relationship between the size of the board and financial reporting. Haji, (2013) in a similar study on financial reporting and corporate governance found a positive relationship. Chakroun and Matoussi (2012), and Uwuigbe and Ajibolade (2013) examining determinants of the mandatory index and financial reporting quality respectively found a positive relationship. They argue that when boards are large, it is more likely that they include members who tend to favour the increase of the extent of mandatory reports in the annual reports. Haji (2013) found a positive relationship between board size and financial reporting quality but Firoozi, Magnam and Farrina (2016) found no relationship.

Lipton and Lorsch (1992) examine the relationship between board size and financial reporting quality for UK firms. Corporate boards of directors play a central role in the corporate governance of modern companies, and hence understanding this relationship is very important to our understanding of corporate governance (Rodriguez-Fernandez *et al.*, 2014). Much of the public debate on board structure has centred on pressure for smaller board size.

It argued that although larger board size initially facilitates keyboard functions, there comes point when larger boards suffer from coordination and communication problems and hence board effectiveness declines (Lipton & Lorsch, 1992; Jensen, 2010). The empirical evidence appears to support this view, with the majority of studies documenting a significantly negative relation between board size and corporate financial reporting. If larger board size indeed causes worse performance, then larger boards would represent inefficient governance that possibly is improved by a one-size-fits-all approach to board size, For example, influential scholars have argued that board size should be no greater than 8 or 9 (Jensen, 1993; Lipton & Lorsch, 1992) for all firms.

Oba (2014) investigated the ability of certain board dynamic to influence management attitude in relation to financial reporting quality in Nigeria listed firms. The sample of the study of 219 companies quoted firms on the floor of the Nigerian Stock Exchange from 2008-2012. The study employed Dechow and Dichev (2002) accrual model to analyse the data between dependent and independent variables. The finding showed that board size to have an inverse relationship on financial reporting quality.

3.2.5 Board Independence

Directors are group into two classes: inside directors and outside directors (Adams *et al*., 2010; Kesner, 1988; Kinney, Palmrose & Scholz, 2004; Amran & Manaf, 2014). Inside directors comprise of the former or current staff of the company and as such, they are holding or have held top executive positions making them the privilege to providing the board with an insight into the happenings of the organization (Brochet & Welch, 2011; Kesner, 1988). Outside directors (or independent directors as they are

sometimes referred to), on the other hand, are directors whose main employment is outside the firm (Brochet *et al*., 2013; Adams *et al*., 2010; Beattie & Fearnley, 2002; Beattie & Jones, 2002).

Although, the independence of some directors that meet the criteria of outside directors is doubtful, because of the affiliation, for example, lawyers and bankers doing business with the company and meeting the requirement of outside directors to be effective (Li *et al.*, 2013). They are extremely important to the organization as they bring to the board their wealth of experience and knowledge gathered from their contacts outside the firm with different companies and different boards (Beatty, 1989; Duc & Thuy, 2013). From the agency theory point of view, non-executive directors could assist organizations to acquire scarce resources through their external affiliations (Pfeffer, 1972; Ghosh & Sirmans, 2003). Some the executives' director lack independence, and jeopardise their function and some of them have secret affairs with the organization, thereby making them lack independent as per their role through their affiliations (Robinson & Owen, 2009; Zhou *et al*., 2018). In addition, some cases their appointment are influenced by the CEO of the firm.

Furthermore, the outside directors are independence are able to ensure proper monitoring done than insiders who be easily dominated by the CEO by the very fact that they work for the CEO on a daily basis (Cornett, Marcus & Tehranian, 2008). As Fama and Jensen (1983) and Fama (1980) posit, the role of the board of directors is to monitor management decisions. They argue that having a higher ratio of non-executive directors on the board leads to better monitoring and reduced managerial opportunism (Levi *et al* ., 2012).

Contrarily, shreds of evidence of independent directors not performing up to expectation could also exist in organizations leading to an adverse effect on the board monitoring capacity, with the main issue relating to non-executive director not who are not truly independent of management (Vicknair, Hickman & Carnes, 1993). Similarly, Percy (1995) posit that independent non-executive directors may be caught in a conflict of interest because they play a dual role of decision-making and monitoring of management which could lead to an adverse impact on the board. In the Nigerian environment, The Securities and Exchange Commission (2011) stipulates code of corporate governance advises that the board should be composed in such a way as to ensure diversity of experience without compromising the independence compatibility, integrity and availability of members to attend meetings. Additionally, it recommends the board should consist of a mix of inside and outside directors, the majority of which should be non-executive directors and at least one independent director. This could enable the non-executive director to be effective and efficient in their responsibilities to influence high financial reporting.

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A number of studies have measured board independence using the ratio of non-executive directors to total directors, combining both the independent and non-independent non-executive directors to the total board size (Abdullah, Ismail & Jamaluddin, 2009; Ali *et al.*, 2004; Akbas, 2016; Eng & Mak, 2003). This is compared to other studies, which have used just the ratio of independent directors to total directors as the metric (Haji, 2013; Mohd Ali *et al.*, 2008). Furthermore, in Nigeria the board independence is measured as the percentage of non-executive directors to total director, which is not applicable to the developed countries.

Abdullah, Ismail and Jamaluddin (2008) investigated the role of board independence in explaining a firm's distress status. The study found no relationship attributing the result to the passive role of independent directors as a fall out of the nature of their appointment and the conflict of roles. Other studies highlighting mixed results include; positive results (Herda, Taylor & Winterbotham, 2013), no relationship (Haji, 2013), negative relationship (Hamadan, 2012; Mohd Ghazali & Weetman, 2006). Whereas Holtz and Neto (2014) found the positive relationship between board independence and Alves (2014) shows a positive relationship. In summary, there is still conflicting evidence in the relationship between the independence of the board and financial reporting, thus providing a need for further research.

The independence of the board member is responsible for monitoring the quality, credibility and the integrity of the firm's financial reports and compelling top managers to be diligent, credible, and transparent with the financial reports (Fama & Jensen 1983; Nkundabanyanga, Ahiauzu, Sejjaaka & Ntayi, 2013). Another, important role by the independent board member is the ability to monitor firms' manager composition and mechanism to reduce the agency problems, internal control with a sufficient level of external scrutiny that will play an important oversight role in the financial reports (Fama & Jensen 1983; Lynall *et al.*, 2003). Previous studies on data of US and UK firms conclude that independent board tend to have less grossing organization (Dechow & Dichev, 2002; Garcia-Meca & Sanchez-Ballesta, 2009) and independent board member constrains manipulation (Davidson, 2005) and incomes quality is improved by the independent board (Ahmed & Duellman, 2007; Chhaochharia *et al.*, 2012).

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Alves (2014) examines the effect of board independence on the financial reporting quality and the sample of 30 firms whose stock listed in the main market Euronext Lisbon. Using the ordinary least square and two-stage least square (2SLS) techniques to control potential simultaneity problem between board independence and earnings quality. The findings from the study showed that an independent member of the board improved financial reporting quality.

On the other hand, Chaliki *et al*. (2012) investigated the effects of board independence as a corporate governance attribute on financial reporting quality in firm listed in Tehran Stock Exchange (TSE) for the period 2003-2011. The sample of 136 observations were selected for the data for the fiscal year. The study employed descriptive statistics correlation in analysing the data and using multiple regressions in SPSS and Eviews software for the dependent and independent variables. The findings showed that there was no relationship between corporate governance attributes including board independence, board size, ownership concentration, institutional ownership, and financial reporting quality.

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The role of the audit committee is increasingly becoming important in the governance mechanisms of many corporations. (Li *et al*., 2012). Said *et al*. (2009) and Bebchuk *et al.* (2008) assert that the audit committee plays a role of reviewing the company's process in ensuring high financial reporting quality. Haron, Jantan, and Pheng (2005) and Nimer *et al*. (2012) argued that the audit committee as a standing committee set up by the board with the objective of contributing to effective corporate governance and ensuring reliable financial reporting.

Among the core, duties of the audit committee were including overseeing the entire financial reporting process and ensuring an objective external audit by providing the communication relationship between the external auditors and the board of directors (Vicknair, Hickman, & Carnes, 1993). Sori, Mohammed, Abdul-Hamid and Md Nassir (2006) further added that an effective audit committee should possess sophisticated accounting knowledge, review of financial statements and play traditional role in accounting and auditing, in order to ensure auditor independence, good management, and internal control. The board of directors in some cases tends to transfer the responsibility of monitoring the process of financial reporting quality to the audit committee, although, this does not absolve the entire board of their legal financial reporting quality duty.

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Section 359 (3) (4) of the CAMA (2004) mandates all companies to establish an audit committee (Corporate Affairs Commission, 1990) in Nigeria. The Securities and Exchange Commission (2011) stipulates that: Audit committees should assist in the oversight of the integrity of the company's financial statements with legal and other regulatory requirements, assessments of qualifications and independence of the external auditor, and performance of the company's internal audit function as well as that of the external auditor. The code further asserts that at least one member of the audit committee should be financially literate to provide the necessary expertise. This implies the efficiency and effectiveness of audit committee in monitoring and ensuring auditor independence in enhancing financial reporting quality.

A review of the literature reveals a number of measures that have been used in the literature as a measurement of audit committee effectiveness such as size, financial

expertise, independence activity, diligence and tenure (Abernathy, Beyer, Masli, & Stefaniak, 2014; Abernathy, Herrmann, Kang & Krishnan, 2013; Albring, Robinson, & Robinson, 2014; Othman, Ishak, Arif, & Aris, 2014). Furthermore, prior studies have studied various attributes of the audit committee and financial reporting and come up with a number of findings. For instance, Abernathy *et al*. (2014) found that committee members with financial accounting expertise gained from public accounting experience were associated with financial reporting quality. Othman, Ishak, Arif and Aris (2014) examine the relationship between audit committee characteristics and mandatory financial reporting of the largest 100 companies in Bursa Malaysia. The result suggests that only two audit committee characteristics (tenure and multiple directorships) are associated with the voluntary ethics disclosure, whilst independence, expertise, meeting frequency and size were inconsistent. This study serves to assist the stakeholders in putting greater emphasis on audit committee in determining ethics disclosure of companies.

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The existence of an audit committee is likely to indicate a commitment to sound corporate governance and a high financial reporting quality. The effectiveness of an audit committee related to the extent to which the committee is independent, whether members have accounting and financial expertise, the frequency of its meetings and its size. Another important characteristic is the number of meetings held with the external auditor (Blue Ribbon Committee (BRC) (1999) but this information is not publicly available and hence difficult to observed.

Generally, it assumed that audit committee members are likely to be less biased and able to exercise oversight function over the client's management if there are not

economically dependent on the company or did not have strong personal ties with management. Hence, we anticipate more independent audit committees to be a strong deterrent to auditor manoeuvrings than less independent audit committees (Carcello & Neal, 2003). In a related study, DeZoort and Salterio (2001) established that independent audit committee members also have greater audit knowledge and tend to protect external auditors in accounting disputes. In view of the foregoing discussion, it is evident that to fulfil its oversight mandate and protect the interest of shareholders, the audit committee must be independent of the company's management. Thus, the effectiveness and monitoring effectiveness of the audit committee depends on the degree of independence of the auditors that could enhance financial reporting quality.

3.2.6 Independence of Audit Committee

Of the various audit committee attributes, independence has the most persuasive theoretical and empirical support because it regarded as one of the key variables associated with the audit committee (Goddard & Masters, 2000). Audit committee effectiveness (ACE) creates integrity, efficiency and effectiveness of independence of the auditor. For that reason, the independence of the audit committee has attracted a lot of scholarly interest (Spira, 2007; Tanyi & Smith, 2014). An independent audit committee is one who is not a current employee of the firm, former officer or employee of the firm or related entity. The audit committee should not also be a relative of management (Dimitropoulos & Asteriou, 2010), professional advisor to the firm, officer of significant suppliers or customers of the firm, interlocking director, and/or one who has no significant transactions with the firm. This is necessary in order not to impair their independence (Robinson & Owens-Jackson, 2009).

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DeZoort and Neal (2001) posit that audit committee members are likely to be less biased and able to exercise oversight function over the client's management if there are not economically dependent on the company or did not have strong personal ties with management. Hence, this study anticipates more independent audit committees to be a strong deterrent to auditor manoeuvrings than less independent audit committees (Carcello & Neal, 2003), while Leong, Wang, Suwardy and Kusnadi (2016) examine three characteristics (independence, expertise, and overlapping membership) of audit committees and their impact on the financial reporting quality for Singapore-listed companies. The findings found a positive relationship on committee independence but Madawaki and Amran (2013) found a negative relationship. These inconsistencies give room for further studies. In a related study, DeZoort and Salterio (2001), and Moses, Ofurum & Egbe (2014) established that independent audit committee members also have greater audit knowledge and tend to protect external auditors in accounting disputes. In view of the foregoing discussion, it is evident that to fulfil its oversight mandate and protect the interest of shareholders, the audit committee must be independent of the company's management. In other words, independent audit committee members are effective monitoring tools because they are free from the demands of the management and enhance financial reporting quality.

Leong, Wang, Suwardy and Kusnadi (2015) examine three characteristics (independence, expertise, and overlapping membership) of the audit committee and their impact on the financial reporting quality. The accrual quality model was employed based on the Dechow and Dichev (2002) and the findings reveal that financial reporting quality will be higher if the audit committee has mixed expertise

and supervisory in accounting. It further shows no evidence in the incremental independence of audit committee already consist of a majority of independence. The result shows no impact of overlapping membership of the audit and remuneration committee of financial reporting quality.

Enofe, Mgbame, Aderin and Oshio (2013) analyze the determinant of the audit committee in the Nigerian business environment. The sample size consists of 100 companies selected from the south-south geopolitical zone of Nigeria. The ordinary least square applied to analyse the data between the dependent and independent variable. The result shows that audit firm size, board independence, and ownership structure positively related to audit quality. Audit committee independence has a significant positive relationship with audit quality and financial reporting quality.

3.2.7 Diligence of Audit Committee

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According to the Tredway Commission (1987) who suggested that, the criteria of expertise and independence not necessarily lead to effectiveness unless the audit committee is diligent. Lin, Li and Yang (2006) added that diligence audit committee enhances the committee's role to execute its duties and responsibilities. As noted by Robinson and Owens-Jackson (2009), diligence audit committees that meet often demonstrate greater commitment and interest and are more likely to be effective monitors.

In other words, the frequency of audit committee meetings indicates whether the entity is diligent. In essence, audit committee diligence generally refers to the eagerness of audit committee members to pursue their terms of reference and goals. Since actual

audit committee, activity is difficult to measure directly, extant literature dominated by the use of the number of audit committee meetings per annum as a substitute for such diligence (DeZoort, Hermanson, Archambeault & Reed, 2002). Nonetheless, a number of other studies have used alternative proxies for the diligence of the audit committee such as its mandatory disclosures, the duties it has to perform and its size. However, the most common substitute used in many studies has been the number of audit committee meetings for each year.

Rochmah and Mohd Ghazali (2012) examine the association between audit committee diligence and timeliness of financial reporting quality. Using a sample of 211 listed companies of non-financial firms in Indonesian the finding shows that timeliness of financial reporting is associated with audit committee diligence. The result suggested that audit committee effectiveness reduce financial reporting lead-time. Yusof (2009) examines the role and responsibility of the audit committee towards credible financial reporting quality is still much the same but the issue of selecting appropriate people with the right mind is the challenge. The development of three variables such as independence, diligence, and knowledge of the audit committee as a sample for the study and ordinary least employed in the analysis to analyse the data. The finding shows that the audit committee with a higher proportion of financial expertise (former senior auditor former CEO) and more diligent audit committee are significant for the purpose. Audit committee with the former senior auditor and audit alumni are associated more diligent with higher financial reporting quality. Previous studies documents that the relationship of audit committee diligence is inconclusive, some are positives and significant, negative and significant while other have no relationship at all. For example, Elijah and Ayemere (2015) found a negative relationship between

audit committee diligence and financial reporting quality. While Rochmah and Nazli (2012) and Zaiee (2014) reported a positive relationship with financial reporting quality. In addition, Said *et al*. (2009) and Leong *et al*. (2016) found no relationship between the audit committee diligence and financial reporting quality. This implies that the more frequent meetings of the board the more the diligence of the board and this could assist in enhancing financial reporting quality.

3.2.8 Size of the Audit Committee

Most of the empirical studies support the notion that audit committee size influences corporate disclosure in the like of (Barako & Tower, 2007; Watson, Shrives & Marston, 2002; Belkaoui, 2001). Among the relationships that exist between financial reporting quality, board characteristics and segmental of the financial statement, the presence of audit committee size emerged as a variable that presents a substantial relationship with such disclosure (Chen & Zhou, 2007). This is mainly because there are more opportunities for firms that grow in size to operate in bigger segmental financial reporting quality, in both business and geographical regards. Therefore, audit committee size is said to be one of the most examined determinants which depends on the size of the enterprise and other relevant factors associated with the firm financial statement and many researchers recognized this element as positively connected to higher financial reporting quality (Al-Shaer *et al* ., 2017).

Bajra and Cadez (2018) examined the impact of audit committee monitoring effectiveness and audit committee competencies on financial reporting quality in public companies in the EU. Using a sample of 2300 firms from listed on the main EU stock exchange over the period of 2004-2013. The finding shows that audit committee

size in monitoring effectiveness and competencies are positively associated with financial reporting quality while the existence of an audit committee is negatively associated with financial reporting quality.

Firoozi *et al*. (2016) and Leong *et al*. (2016) and Onuorah & Friday (2016) suggested the positive relationship between audit committee size and financial reporting quality disclosure. Farouk and Hassan (2014) examine the impact of audit committee size on financial reporting quality of quoted firms in Nigeria. The sample size consists of data collected from the annual report and account of Nigeria cement company data from 2007-2011. Multiple regressions using SPSS version 15.0 employed to analyse the variable and the findings showed that audit committee size and audit independence have a significant impact on financial reporting statement of quoted cement firms Nigeria.

3.2.9 Expertise of Audit Committee

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The objective of this current study is to examine the impact of the audit committee (AC) expertise on the AC's effectiveness in monitoring the financial reporting process (Bedard, Chlouou & Courteau, 2004; Ge *et al.,* 2008; Rochmah Ika & Mohd Ghazali, 2012; Tanyi & Smith, 2014). Despite the increased responsibilities, authority, independence, and financial expertise requirements placed on ACs by the Sarbanes-Oxley Act (SOX), ACs nonetheless, lack sufficient expertise to understand and thus properly monitor complex specific accounting issues. For instance, expertise in the retail industry may assist ACs to ensure that companies take an adequate write-down of inventory when their products face potential obsolescence. Similarly, revenue recognition, a prominent area of accounting manipulation that the expertise take

expertise and knowledge that entails evaluation and understanding of the earnings process, which is tied to a company's business processes that are often industry specific (Beasley *et al*., 2001, 2010).

These researchers (Carcello *et al*., 2002; Dhaliwal *et al*., 2010; Hoitash, Hoitash & Bedard, 2009; Krishnan & Krishnan, 1997; Bedard & Gendron, 2010) contribute to three streams of literature: studies that examine the association between AC, financial expertise and the quality of the financial reports. The findings show that financial expertise has positive significant association with financial reporting quality. Furthermore, some previous studies (Abbott, Parker, Peters, & Raghunandan, 2003; Carcello *et al.,* 2002) examine the association between AC financial expertise and oversight of the external auditor the results indicates positive relationship between financial expertise and financial reporting quality. In addition, studies by (Carcello & Neal 2003; Krishan *et al*., 2011) look beyond AC and financial expertise in examining the effectiveness of ACs, found that financial expertise enhances financial reporting.

Abernathy, Beyer, Masli and Stefaniak (2014) argue the studies targeting external auditors and internal auditors discovered that both groups had notably lower perceptions of audit committee members' proficiency than those of audit committee members. Despite the difficulty in accessing audit committee member expertise, a number of experimental studies regarding audit committee expertise were conducted (DeZoort, 1998; DeZoort & Salterio, 2001; McDaniel, Martin & Maines, 2002). In this respect, Robinson & Owen-Jackson (2009) note that relatively few studies explore the proposition that financial expertise enables members to better assess and monitor

management actions relating to financial reporting. Hence, financial expertise could assist in monitoring and evaluating the financial process thereby enhancing financial reporting quality.

Elijah and Ayemeres (2015) examine audit committee attributes and financial reporting quality and 50 companies were used with the annual report covering from 2006-2013 as the sample size for the study. Descriptive analysis employed as a measurement to analyse the data with the dependent and independent variable and the finding shows that audit committee characteristics have the constraining effect on financial reporting quality. Audit committee financial expertise, audit committee size, audit committee independence, and diligence show an inverse and significant relationship with financial reporting quality. This resulted to the issue of inconsistencies in prior studies.

3.3. Importance of independence of auditors

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Similarly, the extant literature revealed the concept of auditor independence as the auditors' state of mind, their ability to make objective and balanced audit decisions has a major drawback because it relies on an auditor's personal attributes or characteristics that are unobservable and immeasurable (Fathi, 2013; Lopes, & Rodrigues, 2007; Watkins *et al.*, 2004; Wines, 2006). It is therefore not surprising that scholars, practitioners as well as regulatory and professional bodies have attempted to define auditor independence in a more precise way. Consequently, another concept of auditor independence has been established, that is, "independence in appearance".

Generally, the auditing profession acknowledges two forms of auditor independence, namely, “independence in fact” and “independence in appearance” (Mautz & Sharaf, 1961). Independence, in fact, the auditing profession refers to an auditor’s honesty, objectivity, and mental attitude. Notably, the International Ethics Standards Board (IESBA) of the International Federation of Accountants (IFAC, 2005) describes this notion of independence as the state of mind that permits the expression of a conclusion without being by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional scepticism. It is necessary to mention auditor independence because it will enhance the independence of the audit quality.

The notion of ‘independence in appearance’ requires auditors to avoid any relationships with their clients that might lead financial statement users to doubt their independence or autonomy. In other words, it refers to an auditor’s freedom from possible diverging interests, which might affect public confidence in the auditor’s independence. For instance, the Auditing Practicing Board (2009) defines ‘independence in appearance’ as freedom from situations and relationships, which make it probable that a reasonable and informed third party would conclude that objectivity rather is impaired or be impaired. Independence related and underpins objectivity. However, whereas objectivity is a personal behaviour characteristic concerning the auditor's state of mind, independence relates to the circumstances surrounding the audit, including the financial, employment, business and personal relationships between the auditors and their client.

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Auditor capability inextricably linked with auditor independence because if the attribute of capability does not exist, the extent to which the audit opinion can be trusted as an independent or unbiased statement is reduced (Mansouri, Pirayesh & Salehi, 2009). Thus, if the auditor is not capable, independence not guaranteed. In such a scenario, auditors lacking expertise and experience are compelled to depend on the client's management in terms of exercising their functions. According to Mansouri *et al*. (2009), capable auditors are expected to have academic training in accounting, taxation, auditing, and other areas related to their profession. Meanwhile, Daud (2007) indicated that auditors must have a strong educational background with adequate knowledge and expertise in order for them to be regarded as capable. These attributes bother on acquiring the relevant qualification, proper training, and experience.

A number of scholars have highlighted the importance for auditors to enhance their knowledge and experience in dealing with advanced electronic systems in order to assure the integrity and reliability of the accounting processes (Abu-Musa, 2004; Brazel, 2008; Brazel & Agoglia, 2007; Kinney, 2001). In the context of auditing, auditor capability described by Brazel (2008) and Vafeas (2005). As a form of audit knowledge and skill, which is the product of education training and practical experiences (Ojeka *et al.*, 2015). The auditor independence would enhance audit quality thereby improve hign financial reporting.

3.4 Audit Quality Moderating Variable

Furthermore, including measures of moderating and mediating variables is inexpensive, given their potential for providing information about how interventions work and for whom interventions work. Mediating and moderating variables are

important for nonintervention outcome research as well as intervention research. A mediating variable is relevant whenever a researcher wants to understand the process by which two variables are related, such that one variable causes a mediating variable which then causes a dependent variable. Moderating variables are important whenever a researcher wants to assess whether two variables have the same relation across groups. Describing mediation and moderation theory clarifies the purpose of the intervention and forces consideration of alternative interpretations of the results of the study leading to better research design and more information gleaned from the study.

Mediating variables are central to many fields because they are used to understand the process by which two variables are related. The use of mediating variables for design is central to interventions designed to affect behavior. Intervention studies are based on theory for how the intervention is expected to change mediating variables and the change in the mediating variables is hypothesized to be what causes changes in an outcome variable.

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Moderating variable is the case which intervention has a different effect at different values of the moderating variables. Moderating variables are relevant whenever the researcher wants to assess whether two variables have the same relation across groups (Fairchild & MacKinnon, 2014). A moderating variable strengthens, and also can weaken the relationship between an independent and dependent variable (Kraemer, Wilson, Fairburn & Agras, 2002). A moderator variable can be continuous or categorical variables and specified before a study as a test of the theory or they be investigated after the study in an explanatory search for different relation across subgroups (Al-Shetwa *et al*., 2011; DeAngelo, 1981; Gaynor *et al*., 2016).

The Big 4 audit firms are multinational organizations and, in most cases dominate the auditing market in most countries (Bavishi, 1989; Ball & Shivakumar, 2005, 2006; Moizer & Turley, 1989; Okike, 1998), the implication being that they have the resources to hire the best hands, provide quality training and retain highly skilled staff. While studies such as Camfferman and Cooke (1992), Mahmood (1999), Naser and Nuseibeh (2002), and Raffournier (1995) found a positive relationship between financial reporting quality statement and auditor. This implies that audit quality could enhance financial reporting quality. Al Saeed (2006), Barako and Tower (2007), Owusu-Ansah and Yeoh (2005) and Balsam, Krishnan, and Yang (2003) did not find any significant relationship between audit quality and financial reporting quality. Mgbame, Eragbhe and Osazuwa (2012) asserted that the proxy of audit tenure could measure audit quality and the result showed a non-significant relationship. Their current study conceives of a positive relationship between the corporate financial statement and auditor quality for a sample of Nigerian companies (Alrshah, 2015; Farouk & Hassan, 2014; Salehi & Kangarlouei, 2010). Thus, audit quality could assist in improving the relationship between board characteristics and financial reporting quality in Nigeria.

At the inception, it should be pointed out that the terms 'audit quality' and auditor quality' are assumed to be synonymous, and this is in line with (Clarkson and Simunic's 1994; Jang & Lin, 2008; Lin & Hwang, 2010) suggestion. Although a precise definition of auditor quality is difficult to identify, the most common definition for audit quality is, however, derived from Ball, Kothari and Robin (2000) and DeAngelo (1981), who presents it as the co-existing probabilities that an auditor will detect and also report any infringement in a client's accounting system. This definition

captures auditor quality as the ability of an auditor to discover accounting misstatements and then to express them in a suitable audit opinion (Vanstraelen, 2000; Carey & Simnett, 2006). What is vital about this definition is that it captures attributes crucial to understanding the influence of the audit on financial reporting quality information. DeAngelo (1981) further argues that auditor's major task in providing different levels of quality and as such, if a company wishes to change audit quality it must change auditors (Habib, Jiang, Bhuiyan & Islam, 2014; Habib & Hossain, 2012).

From the regulator's angle, the ICAEW (2005) defines auditor quality as the ability to deliver an appropriate professional opinion supported by the necessary evidence and objective judgments (Kilgore, Radish & Harrison, 2011). Duffy (2004) reported that auditor quality is of both technical quality (consisting capability, reputation capital, experience, expertise, and independence) and service quality (empathy, responsiveness, and the block shareholder and client services). In short, service financial reporting quality represents the levels of clients' satisfaction and expectations. Conclusively, the study defines auditor quality as the ability to enhance the degree of confidence of intended users in the financial statement. It is (measured with the proxy of Big 4 and audit tenure). This is achieved by auditors gathering sufficient and appropriate audit evidence in order to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Kamolsakulchai (2015) investigate the relationship between the audit committee effectiveness and audit quality on financial reporting quality. The sample size of panel data collected from listed companies of Thailand from 2008-2012 using panel fixed

effect model in analysing the data. The findings show that audit quality had a significantly positive relationship with financial reporting quality. Ziaee (2014) examines the relationship between audit quality and financial reporting quality of all the listed companies of Tehran stock exchange from 2008-2012. The statistical excel package of SPSS version 19.0 applied in the data analysis. The findings show a positive relationship between audit quality, the audit board size, and financial reporting quality.

Nelson and Jamil (2012) investigated the effectiveness of audit quality on Government Link Company's (GLCs) transformation program through their audit committee and financial reporting quality. The variables were analysed using binary logit to examine the association between the variables. The findings show that GLCs for post-transformation are likely to have higher numbers of audit committee independence ensuring audit committee effectiveness as recommended by the Green book to improve the financial reporting quality.

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Enofe, Ediae, and Ejiemen (2013) and Okere, Ogundipe, Oyedeji, Eluyela, and Ogundipe (2018) evaluate the relationship between audit quality and financial reporting quality and 20 companies chosen as the sample size from selected companies in the Nigeria stock exchange to the ending from the period of 2011. The findings reveal that as audit quality improves the independence of the board and the ownership structure increase financial reporting quality. Furthermore, Adeyemi, Okpala, and Dabor (2012) investigate the factors affecting audit quality in relation to financial reporting quality in Nigeria. The sample size of 430 respondents with users of the financial statement selected. Descriptive statistics employed to analyse the data

between the independent and dependent variables. The results show that audit quality has a significant effect on financial reporting quality. Dandago and Rufai (2013), and Okolie and Izedonmi (2014) aim in assessing the role of audit quality on the financial reporting quality statements of money deposit banks in Nigeria. In assessing the independence of an auditor and the level of compliance to audit guidelines and in what way these guidelines affect the quality financial reporting of money deposit bank in Nigeria. The study employed ANOVA variance regression and judgmental technique. The results reveal that audit quality enhances the consistency and reliability of external auditor and the financial statement of the money deposit bank.

From the previous studies, there are inconsistencies among the variables according to Baron and Kenny (1986) and Mackinnon (2011) the introduction of Big 4 and Audit tenure to moderate and strengthen the relationship between the dependent and independent. It is consistent with the agency theory, which states that board mechanisms are important monitoring devices that govern audit quality which help to enhance the quality of financial reporting quality (GarcíaMeca & Sánchez-Ballesta, 2009). The Big 4 and audit tenure will foster financial reporting quality and ensure relevance, reliability, and confidence to all stakeholders in the financial reporting quality (Abbott, Daugherty, Parker, & Peters, 2016; Alrshah, 2015).

3.5 Big 4 and Auditor Tenure

Previous studies documented that big 4 audited firms and audit tenure could enhance financial reporting quality (Bala et al., 2018; Joriani et al., 2018). The big 4 audit firm are duty banned to disclosed to the diversified stakeholders the information needed by the stakeholders who have invested in the company on equity capital so that the timely

disclosure would enable monitoring, evaluating and measuring the performance of management. While the audit tenure could be able to check the irregularities in the financial statement.

3.5.1 Big 4 Audit Firms

The Big 4 is the nickname used to refer collectively the four largest professional services network in the world. They offer such services as audit, assurance, corporate finance, consulting, tax and legal services and among others. The firms include the PricewaterhouseCoopers, Deloitte Touche Tohmatsu, Ernst & Young, and KPMG. These firm are not single firms but made up of a network of other firms who managed and owned independently from each other. The Big 4 audit firm produces high and standard quality of financial statement (Francis & Wilson, 1988).

The credibility of the financial statement depends upon the quality of the auditor and researchers report finding from the US indicates that Big 4 firms are perceived as providing higher quality audits and enhance assurance of financial statement (Bala *et al*., 2018). Agency theory posits that credible and reliable financial reporting reduces the problem of conflict between corporate managers and shareholder (Jensen & Meckling, 1976). Big 4 firm as providing higher quality audits and more credible financial statements than non-Big 4 firms do.

Big 4 firms have sought to differentiate themselves from other audit firms by investing more in reputation capital (Beatty, 1989). The Big 4 audit firm are known by competence by their competence by virtue of their heavy spending on audit training facilities and independence. Big 4 firm are transparent about their audit approach and

the quality of their delivered reports. They are also associated with a lower ex-ante cost of equity capital for the auditee. For Big 4 firms to produce higher quality audit, litigation risk to provide the Big 4 firms an incentive to provide higher quality audit consistent with their brand name reputation (Sumunic & Stein, 1996). The Big 4 firms in this study measured by the dichotomous variable of Big 4 being the auditor of the firm (Francis, 2004).

According to prior studies, big 4 audit firms have been used as a moderator. For instance, Bala, Amran and Shaari (2018) used big 4 audit firms as a moderator and the finding reveals that financial reporting quality was improved and the high level of financial statement was achieved and reduce the issue of falsification in the accounting system. In addition, DeFond and Zhang (2014) also use the big 4 audit firms as a moderator in their study and their findings show that the effectiveness of the big 4 firms and were able to reduce the earnings management, that is, enhance financial reporting quality. Similarly, Okere *et al.* (2018) also used big 4 audit firms as a moderator in their study and they asserted how the big 4 audit firms to detect accounting misstatement and control the internal system thereby improving financial statements. While Salaudeen *et al*. (2015) used big 4 as moderator and their result reported the effectiveness and efficient of big 4 audit firms reducing the manipulation of auditors and enhanced financial statements. Accordingly, the used of big 4 audit firms as a moderator is suitable in this study.

3.5.2 Audit Tenure

The impact of auditor tenure on audit quality cannot be overemphasized in the accounting literature (Kim & Cheong, 2009). There have been divergent opinions

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concerning audit tenure. Some schools of thought have the favour of long tenure relationship between the auditor and auditee. Long tenure relationship allows the auditor to gain experiences, the expertise of the operation clients and makes the auditor more efficient. It also enhances the ability of the auditor to detect irregularities in the book of account of the clients (Fairchild, 2008). However, this can also lead to increased fraud incentive. The increase in tenure could increase the independence of the auditor and auditor empathy towards the manager implying financial scandal. This implies the longer the tenure; the auditor could understand the accounting system of the firm thereby enhancing the independence (Asthana, Balsani & Krishnan, 2010). Carcello and Nagy (2004) and Chi and Huang. (2005) posit that audit failures are more likely to occur with short audit tenure of between 2-3 years.

Auditor tenure has two dimensions; the tenure of the audit firm and the tenure of the individual partner engaged in the audit. Empirical evidence of the effect of audit tenure on audit quality is mixed and conflicting. Auditing Practices Board (2009) suggested auditor tenure adds credibility and reliability to the financial statement by providing independent verification of management provided on financial reports and help to reduce investor information risk (Watts & Zimmerman, 1986). Audit tenure could reduce corporate scandals and collapses that cast doubts and eroded audit quality (Imhoff, 2003). Audit tenure measured as the numbers of consecutive years the audit firm has audited the client financial statement (Johnson, Khurana & Reynolds, 2002). The audit tenure has the ability to check the irregularities in the accounting financial system. In addition, the audit tenure could assist in checking the internal control system of the firms and evaluate the external auditor in order to enhance the financial reporting quality.

Furthermore, previous study have used audit tenure as amoderator such as Jorjani, Safari and Gerayti (2018) used audit tenure as moderator and their findings indicate a significant positive association of board characteristics variable and financial reporting quality. In addition, Gonzalez-Diaz, Garcia-Fernandez and Lopez-Diaz (2015) in their study also used audit tenure as a moderator aver that the presence of auditor tenure improved the financial process and reduce the opportunistic asymmetry behavior of the board of director and improved high financial reporting. Similarly, Barbadilo and Aguilar (2008) used audit tenure as a moderator their result indicates the effectiveness and efficient of longer audit tenure in detecting accounting frauds in the financial statements. In addition, Daniel and Brooks (2011) utilized audit tenure as a moderator the result reveals the efficacy of audit tenure in checking the irregularities in the accounting system and enhance high financial statements. Firth, Rui and Wu (2012) used audit tenure as a moderator and their findings show that audit tenure could be active in checking the accounting misstatement, manipulation, overstatement of accounting figure and increased financial reporting quality. Similarly, the used audit tenure as a moderator is appropriate in this study.

3.6 Firm Size

Firm size is one of the variable used by various studies to explain financial reporting quality. Evidence from literature reveals that the size of a company measured in several of ways, such as company’s average market value, turnover, a number of employees, and total assets (Craven & Marston, 1999; Kansal, Joshi & Batra, 2014; Setyorini & Ishak, 2012).This indicates that firm size could enhance financial reporting quality.

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Theoretically, from the agency theory viewpoint there exist a positive relationship between the size of the firm and financial statement as large firms have a desire for external capital, and this in turn, increases the potential agency cost that arises as a result of the conflict of interests between managers, debt holders and shareholders (Eng & Mak, 2003). A number of studies have also supported this view (Alarussi, Hanefah, *et al*., 2009; Barbu, Dumontier, Feleaga & Feleaga, 2014; Cho *et al*., 2012; Shaverdi *et al*., 2016). Barbu, Dumontier, Feleaga and Feleaga (2014) provide evidence showing that large firms are likely to comply more with financial statements IAS/IFRS than are smaller firms, by asserting that financial reporting quality disclosure enables firms to reduce societal and board characteristics related with financial reporting quality issues (Liu & Lu. 2007). Similarly, Buniamin (2010) provide insights that firms that are highly visible to the public of their size tend to report more in an attempt to improve their image. In addition, Setyorini & Ishak (2012) assert that larger companies across products and geographical markets and thus have a greater need for disclosure to satisfy their diverse stakeholders.

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3.7 Profitability

Profitability is another important factor influencing financial statement, and this is reflected in most of the previous studies on financial statement (for example refer to Ahmad *et al.,* 2003; Alarussi, Selamat & Hanefah, 2009; Barako & Tower, 2007; Hackston & Milne, 1996; Haji, 2013; Haniffa & Cooke, 2005; Janggu, Joseph & Madi, 2007; Uwuigbe & Egbide, 2012). It has been measured using a number of ratios such as earnings per share (Alarussi *et al*., 2009), return on assets (Setyorini & Ishak, 2012; Uwuigbe & Egbide, 2012), profit after tax and return on capital employed (Kansal *et al*., 2014).

Most of the studies find a positive relationship between profitability and financial statement. For example, Haniffa and Cooke (2005) base their arguments from a legitimacy theory perspective. They argue that profitable companies will disclose more in an attempt to justify their presence to shareholders. Similarly, Haji (2013) studying Shari'ah compliant companies attribute increased disclosure to the Islamic beliefs of sharing profit to less privilege.

3.8 Underpinning Theories

The board characteristics and financial reporting quality accounting literature developed since the past few decades and there have been a number of theories that used by different studies to explain the factors that may likely influence the level of financial reporting quality. However, there is no well-known theory that explains board characteristics and financial reporting determinants. Consequently, there is no single theory that explains how board characteristics relate to financial reporting quality. Riahi Belkaoui (2000) asserted the roles of theory in aligning the corporate phenomena and practical issues with the related theoretical relationship being overemphasized. Alles, Kogan, and Vasarheyi (2008) posit that the agency and stakeholder theories assist in shaping, analysing and interpreting any concepts in relation to the inherent practical implications. This study will adopt the agency theory as its main theory and supported by stakeholder theory. The agency theory could solve the problem of the agency conflicts between the managers and the shareholders. In addition, the stakeholder theory could assist the firms in the relationships between the shareholders, management, audit regulation, regulations of the firms, creditors and lenders, auditors, employees and the public.

3.8.1 Agency Theory

Agency theory provides a framework for the study of the relationship between board characteristics and financial reporting quality Riahi-Belkaoui (2000). The agency theory posits that the separation of ownership from the control of the organization encourages managers to maximize their wants and pursue interests contrary to the desires of the owners (Jensen & Meckling, 1976; Bahmani, 2014). In order to prevent this, board mechanisms initiated to keep the managers under control. The parting of the ownership from the control function prevents the principal (shareholders) from being in the position to take managerial actions (Fama & Jensen, 1983; Fama, 1980; Kao & Wei, 2014). Thus, the principal lacks access to all relevant information necessary to access what the managers are doing. This is what referred to as the agency problem (Evans & Weir, 1995). It said to arise a result of contracts not enforced to the detailed (Fama & Jensen, 1983).

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The control is extremely important most especially when the management who are responsible for initiating and implementing the decisions are not the main beneficiaries and therefore do not enjoy a huge chunk of the proceeds of their decisions (Fama & Jensen, 1983, Riahi-Belkaoui, 2001). The problem if not properly managed could lead to two key conflicting issues between the agents and owners. Firstly, in terms of differing objectives, as the main concern of the shareholders is to maximize their wealth, while on the other hand managers have various psychological and economic needs ranging from higher salaries and emoluments to power enrichment.

Another form of agency problem that is gaining grounds rather rapidly especially among large corporations is that of domination of minority shareholders by controlling

shareholders (La Porta *et al*., 1999). This problem can also be described using the term tunnelling, which is the transfer of resources out of the firm for the benefit of controlling shareholders (Johnson, La Porta, Lopez-de- Silanes & Shleifer, 2000). The tunnelling of firm value by controlling shareholders includes activities such as loan guarantee, outright theft, and disposal of the company's assets or products below the prevailing market price. These issues are particularly prevalent in emerging markets characterized by weak governance mechanisms (Liu & Lu, 2007).

Therefore, opportunistic behaviours cannot be ruled out, as it is one of the assumptions of agency theory, that there lies information asymmetry between the shareholders and managers, or between minority and controlling shareholders and that, this is linked to the corporate financial statement (Diamond & Verrecchia, 1991; Ball & Shivakumar, 2006). Information asymmetry is cases where managers have access to more privy information within the organization (Abidin *et al*., 2009). In a more specific term financial statements brings investors closer to the affairs of the company and hence reduce the perceived gap between the investors and management (Akhtaruddin *et al*., 2009).

Agency theory suggests that companies may undertake different approaches such as compensation initiatives or mandatory financial statement to reduce the conflict of interest between shareholders and managers. An organization deviating from board attributes action by mandatory financial reporting quality information may direct shareholder's attention from monitoring activities of the management (Stanton & Suttipun, 2012). The managers (agents) hired by shareholders (principals) to make decisions that are to benefit the shareholders (Abidin *et al*., 2009).

Furthermore, Fama and Jensen (1983) assert that an efficient order of procedures for decision control will ensure that the control (ratification and implementation) of the decisions separated from the management (initiation and implementation) of the decisions. In other words, what should constitute control is a situation where an individual does not perform the management and control over the same decision. To this end, agency theory looks at the tendency of directors to act in their own best interests contrary to the best interests of the shareholders. Managers may arrange transactions and report such transactions in an opportunistic way. Hence, agency theory focuses on the protection of ownership rights of shareholders; while the corporate governance focuses on the effective and efficient accomplishment of transaction and reports. Insomuch as the trust placed by shareholders on directors to operate in their best interest misplaced in the relationships, which will lead to high financial reporting quality (Ican Study Pack, 2009; Tricker & Tricker, 2015).

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Drawing on the work of Jensen & Meckling (1976), Fama and Jensen (1983) seek to explain the survival of organizations characterized by the separation of ownership and control and to identify the factors that facilitate this survival. Their paper is concerned with the survival of organizations in which important decision agents do not bear a substantial share of the wealth effects of their decisions. The structures suggested by the agency theory for the enhancement of corporate transparency and improved financial reporting quality in the agency theory (Ujunwa *et al*, 2013). These include the board of directors and the audit committee, which designed to constrain managerial decisions and reduce agency costs associated with the separation of ownership and controls. In spite of the criticisms against agency theory, economics and finance

literature still use it to anchor their studies; as such, this study also adopts it as the underpinning theory. The next sub-section discusses the stakeholder theory.

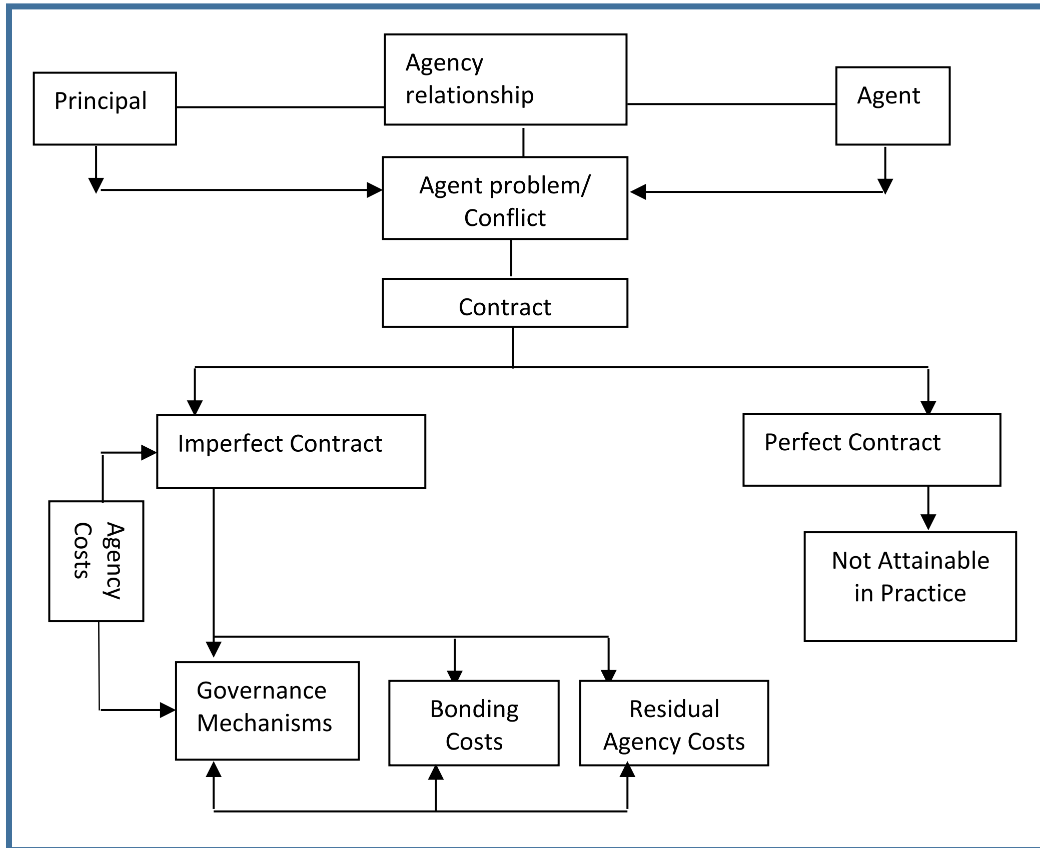

Figure 3.1 Agency Theory perspective

Source: *Cullen, Kirwan, and Brenan (2006)*

3.8.2 Stakeholder Theory

The idea that corporations have stakeholders has become commonplace in the management literature both in academia and other professional establishments since the publication of (Freeman, 1984; Ayuso *et al.,* 2014; Jones & Wicks, 1999). Theoretically, the stakeholder theory empirically posits that the existence of any corporate entity and its sets of activities at the benefit of the company's shareholders,

rather such existence should be enshrined to benefit all the interested stakeholders (Freeman, 2010; Freeman *et al*., 2004; Mallin, 2010; Tricker &Tricker, 2015).

Included among the interested parties in any business activities are its shareholders, customers, suppliers, employees, suppliers, government agencies, credit providers, local communities, the public and so forth (Dillard & Yuthas, 2001; Jones, 1991; Mallin, 2010). In the increasingly more environmentally and socially concerned world of the 21st century, the notions of board characteristics and sustainability reporting have commanded a lot of attention (Labelle *et al,* 2010). It is therefore not surprising that the stakeholder approach to board characteristics that call for boards of directors to take into consideration the interests of a diverse range of stakeholders has also attracted a lot of scholarly and corporate interest (Friedman, 1970).

Undoubtedly, a major argument by those that theorized the stakeholder theory is that corporate entities are practically managed in a dynamic way that will serve the diverging interests of key stakeholders. Hence, the ability to effectively coordinate these diverse interests would positively influence the organization's ability to formulating good corporate strategies that would seemingly generate the desired outcomes. Phillips (2003) attested that the extent of theoretical arguments for stakeholder's theory on issues of moral justifications and ethical considerations in business activities are very important. However, critics view stakeholder ideas as problematic because meeting the conflicting needs of stakeholders and shareholders is not feasible due to numbers of shareholders that the stakeholders would attend to even to the public and entity, in which the organization is in operation (Tricker & Tricker, 2015).

The so-called stakeholder versus shareholder dilemma demonstrates that management or agents cannot serve two masters at the same time. Although this stakeholder's theory is much related in this study, still available evidence has shown that it has empirical evidence of measurability establish its applicability on issues of board characteristics (Hendry, 2001). Unlike the agency theory of controlling business interest, the stakeholders' theory has not suggested any measurable variables that researchers can use to proxy for measuring the different stakeholders' interest in a company. Notably, for the purpose of this study, the researcher has used stakeholder theory to provide alternative explanations (Brenner & Cochran, 1991) for the nature of interactions between the business and its stakeholders.

A recent variant of stakeholder theory, the enlightened shareholder theory attempts to go beyond the stakeholder versus shareholder dilemma (Jensen, 2010). This implies that the stakeholder theory could go beyond the auditor, management, and employees and to the lender, creditors, government and public in this study. This new approach recognizes the primacy of meeting shareholders' interests, but it also acknowledges the importance of satisfying stakeholders' interests as well (Jensen, 2010; Mallin, 2010; Tricker & Tricker, 2015). This theory advocates for a win-win scenario. Conclusively, this study strongly believes the stakeholders' theory has a major impact on establishing the theoretical linkages that exist between the shareholders, board characteristics, audit committee members, audit quality, financial reporting quality, and the public. It thus means that this current study is theoretically linking in its ability to establish the practical linkage between the aforementioned variables of interest with the stakeholders' theory.

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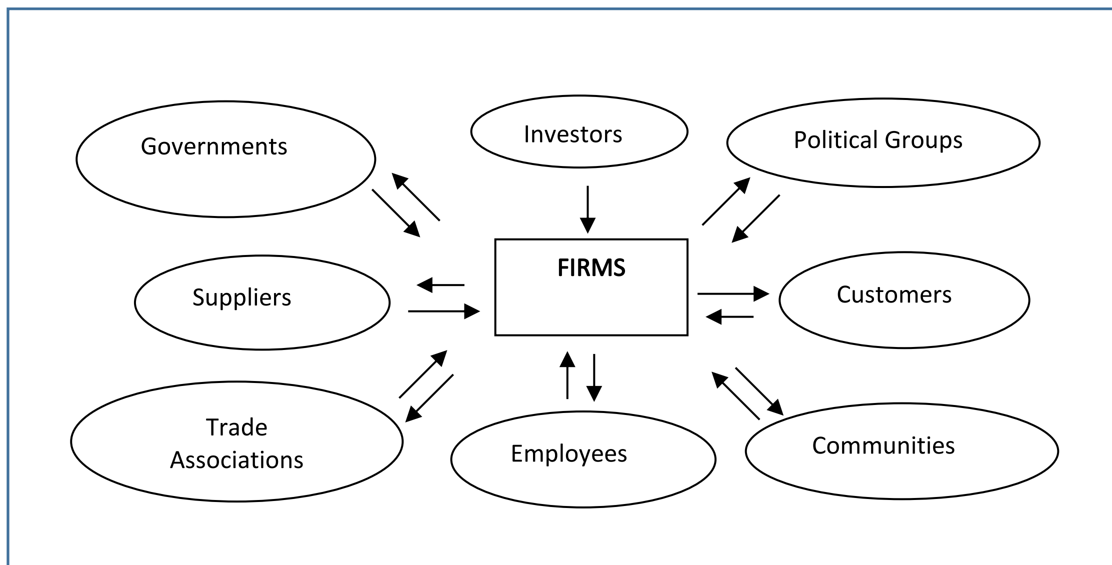

Figure 3.2 The Stakeholder Model.

Source: Donaldson and Preston (1995)

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Stakeholder theory offers a framework for determining the structure of governance and operation of the firm and cognizant of the myriad participants who seek multiple and sometimes diverging goals (Donaldson & Preston, 1995). Sundaram and Inkpen (2004) argue that empirical evidence supports a link between stakeholder theory and financial reporting quality. From the empirical evidence, the stakeholder theory is adopted in this study. These stakeholders encompass all the sectors that comprise the organization. The theory posits that there are interested parties apart from the shareholders and high-quality financial reporting is important to these stakeholders. This theory assist the shareholders in decision-making and it encompasses all interested parties that are involved in the business activities. Thus, creditors, for instance, show interest in the financial information of a firm and rely on the quality of reporting to obtain vital knowledge about a firm (Elijido-Ten, 2009; Jensen, 2010). In

summary, board independence, audit committee diligence, financial expertise and audit tenure interaction were based on stakeholder theory.

3.9 Prior Studies on Financial Reporting Quality

Prior studies that have examined the audited financial statements find that the companies' specific attributes are significantly associated with board characteristics (Popova *et al.,* 2013; Kent & Stewart, 2008). For example, the size of companies (proxied by total assets or market capitalization), whereby large companies are expected to announce their financial reports on a timely basis than small companies as they are being more closely monitored by the shareholders and regulators (Barbu *et al*., 2014). In addition, board characteristics are expected to influence the profitability of a company, whereby companies with strong financial standing, are more likely to disclose their financial results early (Abbott *et al.,* 2016). Furthermore, industries which have variations in their type of assets, technology requirements, commitments on capital expenditures and growth rate, have a significant association between the type of industry and the company's board mechanism (Popova *et al*., 2013).

Prior studies that have examined board characteristics and financial reporting quality, reported those effective boards can reduce earning management and in turn increase financial reporting quality (Hossain *et al*., 1994; Alzoubi, 2014; Holtz, 2014). Htay *et al*. (2013) report that board independence and executive director positively influence the quality of reported accounting information. On the other hand, Ruiz-Barbadillo and Gomez-Aguilar (2002) documents that financial reporting is not an important determinant of the market for directorship. Also, Amran and Manaf (2014) reports that board independence does not actually have the power of 'independence'

monitoring and advising the board of directors that lead to adverse effect on financial reporting quality. From the above studies and others that have investigated the relationship between board characteristics and financial reporting quality but their findings are inconsistent evidence such as (Peyravan, 2016; Holtz, 2014; Hassan, 2015).

Prior literature also used audit committee variables with financial reporting quality (Abernathy *et al*., 2014; Othman *et al*., 2014; Sultana *et al*., 2015) to determine the effect on financial reporting quality, therefore, studies thus far have looked at the audit committees in isolation to examine governance implications. This current study combined the board and audit committee characteristics to examine the effect on financial reporting quality and to have effective and comprehensive results. In developing countries as Nigeria studies linking board characteristics and financial reporting quality of listed companies are still limited (Bello, 2013; Nwonyuku, 2012; Nyor, 2013). Therefore, in addressing the research gap this current study attempts to explore the influence of board characteristics and financial reporting quality and audit tenure and Big 4 as a moderator.

In relation to the board characteristics, it highlighted that there are limited studies on the interaction among board characteristics (Carcello *et al.,* 2011). Further, the authors claim that the lack of interaction between these board mechanisms may result in undetected material financial reporting risks by the audit committee. Similarly, Habib, Bhuiyan, and Uddin (2015) reiterate that there is far too little attention given to the effect of board characteristics on financial reporting quality. In addition, the relationship between board and audit committee characteristics and financial reporting

quality in Nigeria is minimal to the best knowledge of the researcher. To sum up, the results from the literature on the association between board characteristics and financial reporting quality are still inconsistent and contradictory. Accordingly, the present study attempts to develop a better understanding of the relationship between the variables.

Prior studies have employed earning management as a proxy for financial reporting quality (Habib *et al*., 2015) and restatement (DeFond & Zhang, 2014) the finding provides strong evidence of poor financial reporting quality. This limitation has prompted the consideration for other factors that may be affecting monitoring and those related to financial reporting quality. It is believed that financial reporting index used as a proxy and is well suited for the study as it is capable of detecting potential financial misreports by companies, which are in line with the study objectives.

3.10 Literature Gap

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The issue of lack of enforcement, compliance, and transparency in the corporate governance structure in Nigeria is still reoccurring. The government of Nigeria ordered the World Bank in 2004 (ROSC, 2004) to find out the state and implementation of financial reporting. The World Bank in 2004 observed that the financial reporting by the corporate organization was deficient. Previous studies have examined the financial reporting quality in Nigeria. This conclusion has been supported by many empirical studies including those of Adeyemi (2006), Ebringa and Kule (2014), Ofoegbu and Okoye (2006), Okike (2000) and Wallace (1988). Oluwagbemiga (2014) opines that the Security and Exchange Commission (2012) set up the standard for the corporate governance to address the issue of transparency, honesty, and enforcement of

regulations for listed firms in Nigeria and yet the problem of lack of compliance and transparency still exist. From literature presented, as a above, inconsistencies, board impairment, lack of enforcement and compliance of standards, weak corporate governance therefore there is a need for further comprehensive study.

Agency theory explains the relationship between the agent and principal. The principal (owner) delegates the responsibility to run the business to the agent/manager (Jensen & Meckling, 1976). Consequently, these two parties have divergent goals and objectives known as conflict of interest and this degenerate to information asymmetry, which refers to the scenario where the agents (managers) are having information the advantage as compared to the principals (owners). The managers are involved in the day-to-day running of the business this makes them have the advantage of information that might not be distributed or shared with others including the owners. This unresolved agency conflict still exists and there has not been the solution to address this problem.

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Additionally, issue of poor state of financial reporting is paramount in the annual report in companies quoted on the Nigerian Stock Exchange (NSE) against the scenario of the increased expectation by stakeholders towards the identification of approaches to addressing effectively and efficiently financial reporting quality (Uwuigbe & Ajibolade, 2013; FRCN, 2015; Omoh & Komalafe, 2015; Owolabi & Dada, 2011). This current study would assist the regulatory bodies in improving the enforcement and the compliance of the standards.

The lack of in-depth study on board characteristics, audit quality and financial reporting quality-and the issues of mixed and inconsistent findings from previous

literature still exist. According to Baron and Kenny (1986) and Fairchild and Mackinnon (2014) when there are mixed findings between an outcome variable and a predictor variable a moderator may be introduced. Against this background, this study addresses these contextual issues by extending the literature of board characteristics and financial reporting quality introduced the moderating variable of (Big 4 and audit tenure). Audit quality has the capability to enhance financial reporting from previous study (Al-Shetwa *et al.,* 2010; Gaynor *et al.,* 2016). This study will fill this gap by using big 4 and audit tenure as a moderator in examining the relationship between these variables.

3.11 Chapter Summary

In this chapter, an attempt was made to provide reviews on board characteristics, audit quality and financial reporting quality in Nigeria including the different theoretical models. The chapter conducted a review of the agency theory and the stakeholder theory as they affect financial reporting quality. The agency theory shows the existence of conflicts in companies between shareholders and managers of the separation of ownership control. The stakeholder theory take the cognizance of the board independence, audit committee diligence, financial expertise and audit tenure interaction. The board characteristics and financial reporting quality as mechanisms for mitigating the agency conflict discussed.

An examination of the prior literature on the relationship between board characteristics and financial reporting quality as discussed in this chapter provides equivocal findings. The reasons for these mixed findings could be attributed to country specifics, methodology, and data used for the studies. It is imperative to acknowledge that there

are few studies from Nigeria examining the influence of board characteristics audit quality and financial reporting quality. Specifically, prior studies have ignored the moderating effect of audit quality (Big 4 and audit tenure) on financial reporting quality. The current study fills this gap. The next chapter explains the theoretical framework and research methodology of the study.

CHAPTER FOUR

RESEARCH FRAMEWORK AND METHODOLOGY

4.1 Research Framework

Based on the evidence from existing literature, the current study develops a research framework that shows the link relating to board characteristics, audit quality, and financial reporting quality. The relationships between these key factors are illustrated in a framework for this research as depicted in Figure 4.1. From previous studies, the researcher develops a linkage that an understanding and knowledge of board characteristics and their application in organizations are likely to contribute positively to audit quality and by implication to the financial reporting quality (Botti, Boubaker, Hamrouni & Solonandrasana, 2014; Tao & Greenwood, 2014). Hence, the conceptual framework in this study looks into the relationships that exist among the main conceptualized constructs including their proxies. Theoretically, agency and stakeholder theories provide the basis for these inter-relationships as conceptualized in this research framework to find out the outcome and suggestions for improving the financial reporting quality in Nigeria. Below is the conceptual framework for the study.

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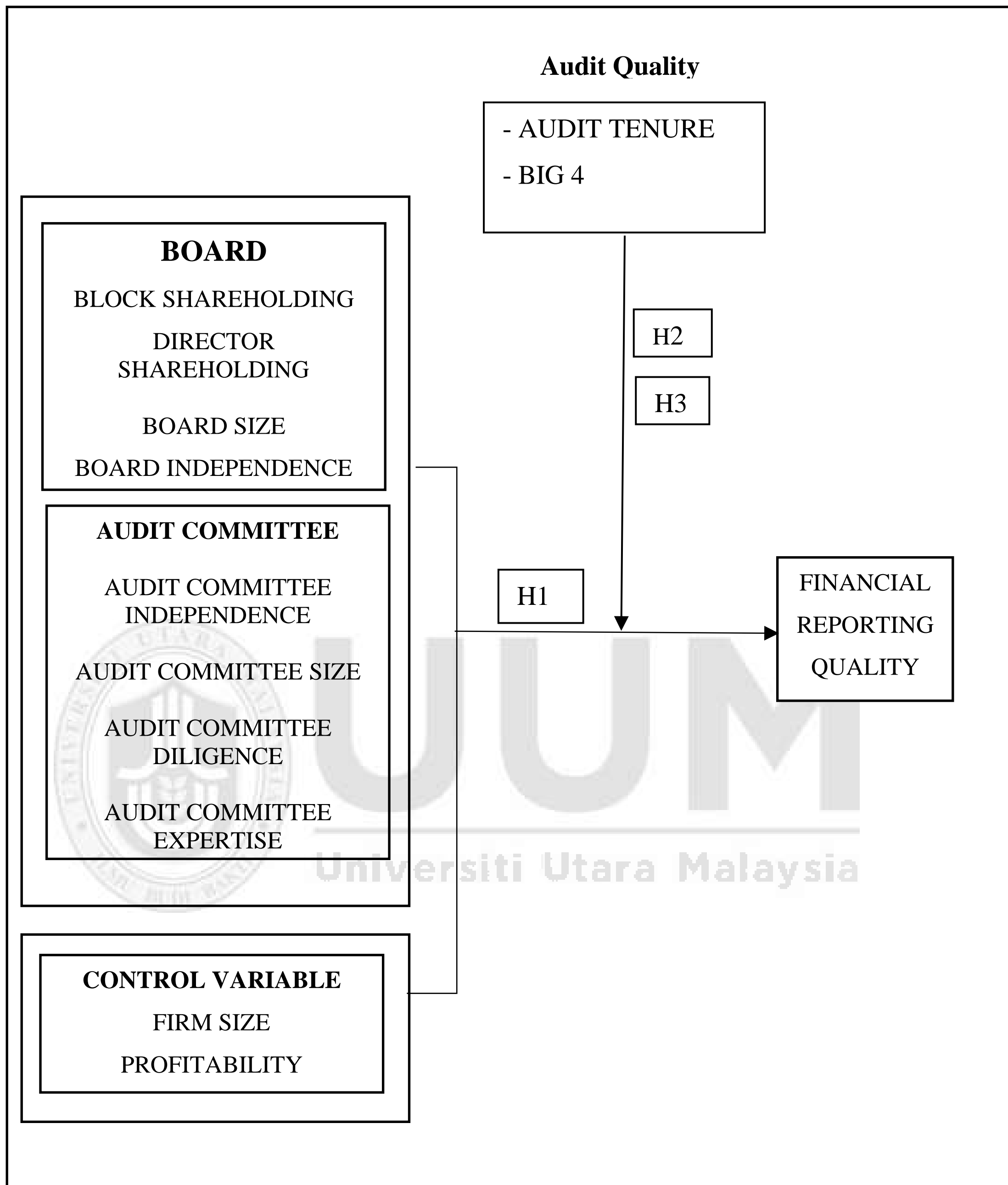

Figure 4.1 Conceptual Framework

Adapted from Alrshah (2015)

Figure 4.1 offers a framework that explains financial reporting quality. The framework was adapted from Alrshah (2015) and some of these variables have been tested from previous studies. The variables include audit committee independence, size, diligence

and expertise with mixed findings. According to Baron and Kenny (1986), the maximum numbers for moderating variable can be used is two variables. The audit quality proxy are the big 4 audit firms, audit tenure, audit competence, audit specialization and accrual quality are used in direct study with financial reporting quality. Lim and Tan (2009) used big 4 and audit tenure while Zandi *et al*. (2019) and Kalker et al. (2012) also used big 4 and audit tenure with financial reporting. Furthermore, Balam *et al*. (2018) and Jorjani *et al*. (2018) also have used big 4 and audit tenure as a moderator but they did it separately. In this study will combine big 4 and audit tenure as a moderator since in the prior studies the result are inconsistencies. Therefore, necessitate the need for further study, where the moderating impact will then strength and the capability to improve financial reporting quality (Jones *et al*., 2018; Jorjani *et al*., 2018). The first part of the framework presents the relationships postulated between board characteristics and financial reporting quality. This shows the dimensions of the board and their direct impact on financial reporting quality. The second model is the interaction association between the moderator, which is audit quality (auditor tenure and Big 4), board characteristics, control variables and financial reporting quality.

The framework premised on the agency theory where an agency relationship occurs where a principal engages another person as an agent to do a service at his behest. Notably, such an arrangement may result in the delegation of accountability by the principal, which necessitates the placement of trust in an agent to act in the principal's best interest (ICAEW, 2005). Thus, some concerns also arise about the trust as well as conflict of interests due to the differing motives of agents and the principals. It is argued that the agent likely pursues objectives that differ from the goals of the owners

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thus creating an agency conflict. Thus, in this study, firm owners (shareholders) represent the principals while the managers are the agents. Due to the divergent interests between the shareholders and the managers, agency problems could arise. While the owners would desire high quality reporting in order to know the state of the firm, the managers could attempt to hide information. This information asymmetry is the fundamental basis for agency conflict. For that reason, agency theory proposes several instruments of monitoring such as board characteristics and the external auditors to mitigate the agency problem and align the interests of the owners/principals and managers/agents (Jensen & Meckling, 1976).

The second theory employed in this research is the stakeholders' theory. This theory goes further than the agency theory of principal and agent in that it recognizes that others exist in organizations whose interests matter other than the shareholders. These additional interests include employees, creditors, government, suppliers, customers and even the host community (Ayuso, Rodriguez, Garcia-Castro, & Arino, 2014). The school of thought premised on the view of John and Senbet (1998) which recognized other interested parties in the affairs of a firm to the position of agency theorists. Further, a recent variant of the stakeholder theory, the enlightened shareholder theory attempts to go beyond the stakeholders versus shareholders dilemma (Jensen, 2010). This new approach recognizes the primacy of meeting shareholders' interests, but it also acknowledges the importance of satisfying stakeholders' interests as well (Jensen, 2010; Mallin, 2010; Tricker & Tricker, 2015). Thus, the stakeholders also desire to obtain high-quality information on the state of affairs of a firm since their interests are adversely affected in the event of any financial statement. This theory advocates for a win-win scenario that recognizes the need for organizations to serve the interests of all

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stakeholders through high-quality reporting. Conclusively, this study adopts the stakeholders' theory and it could aid in establishing a linkage that exists between the shareholders, company management, audit committee members, external auditors, government agencies and the public. It is therefore included in this study as a complementary theory (Evans & Weir, 1995).

Past studies have used both board characteristics and audit committee variables in their investigations for example, Husnin, Nawawi & Putch Salin (2016) employed board and audit committee characteristics in a study of Malaysian companies. In addition, Samaha, Khlif, and Hussainey (2015) examined the relationship between the board of directors, audit committee characteristics and voluntary disclosure. Similarly, Zhou *et al*. (2018) investigated the board of director and audit committee characteristics in the relationship with firm performance. Further, Said *et al*. (2009) examined the relationship between corporate social responsibility disclosure, corporate governance and audit committee characteristics in Malaysian public listed companies. In these previous studies, they combined both board and audit committee characteristics in the same study in order to conduct their investigations. In the light of the foregoing, this study is also employing board characteristics, which comprise of the components of the board characteristics and the audit committee in achieving comprehensive insights and in depth understanding of the relationship of the variables.

The moderating variable is audit quality. This is expected to influence the relationship between board characteristics and financial reporting quality. Barron and Kenny (1986) and Mackinnon (2011) asserted the reason for including the moderating variable in research is to enhance the strength of the relationship between the

independent and dependent variables. The justification for using the Big 4 is that there is a high degree of objectivity in their reports, which could enhance financial reporting quality. Secondly, reports have shown that they have a high degree of reliability, accuracy in their result of financial reporting quality (Knechel *et al*., 2010). Cohen, Hoitash, Krishnamoorthy and Wright (2013) opine that Big 4 firms could have the capability of detecting fraud and existing material misstatement and errors in the financial statements. Thus, these Big 4 firms could moderate the relationship between board characteristics and financial reporting quality.

The audit tenure is adopted in this thesis to enhance the independence, objectivity, and transparency of the financial reporting quality. This is in line with the view of Teshima and Shuto (2008) who asserted that audit tenure could likely check the irregularities and correct accounting material errors and fraudulent practices in the financial statements. This is because long-serving auditors could better understand the financial reports of the firms where they serve (Firth *et al.,* 2012).

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The selection of the variables of the study was based on previous empirical literature. The financial reporting quality in Nigeria documented from a prior study to be poor (Uwuigbe & Ajibolade, 2013). In Nigeria, Onuorah and Friday (2016) posit that audit committee size and board independence are negatively associated with financial reporting quality. Bello (2013) also document that board independence, audit committee size, institutional, block, and managerial shareholding are positive and significant in influencing financial reporting quality. Dabor and Dabor (2015) aver a negative relationship between board composition and financial reporting quality

revealed that there is no significant relationship between board size, expertise, and financial reporting quality.

In Malaysia, Haji (2013) found a positive relationship between financial reporting quality and board size. Abidin *et al*. (2009) asserted a positive relationship between board independence and financial reporting quality. Othman *et al*. (2014) aver that there is no relationship between audit committee independence, expertise, meeting, and size with voluntary disclosure. However, Abernathy *et al.* (2014) found the positive relationship between audit committee, expertise, and financial reporting quality.

In the US, Barbu *et al*. (2014) found firm size to be significant with voluntary disclosure. In addition, Samaha *et al*. (2015) document that board size; board composition and audit committee have a significant positive effect on voluntary disclosure while CEO duality has no significant impact on voluntary disclosure. Zhou *et al*. (2018) found that audit committee; board independence negatively associated with firm performance while board size is significant and positive with firm performance. Alrshah (2015) has tested these variables audit committee independence, size, diligence, and expertise. The results above are inconsistent which showed that further studies are still required between board and audit characteristics and financial reporting quality.

The need for companies to ensure high financial reporting quality has been advocated in prior studies such as (Popova *et al*., 2013; Boshnak, 2017; Dou *et al*., 2013). Against this background, there is a need to identify factors that could promote high financial reporting quality in Nigeria. This is especially important in a developing country like