

IMPACT OF RISK MANAGEMENT COMMITTEE ATTRIBUTES ON FINANCIAL REPORTING QUALITY OF LISTED DEPOSIT MONEY BANKS IN NIGERIA

Aliyu Salihu Modibbo (Ph.D.)¹ & Hauwa Modu Kumshe (Ph.D.)²

¹Department of Accountancy, Modibbo Adama University of Technology, Yola

²Department of Banking and Finance, Modibbo Adama University of Technology, Yola

^{1&2}Email: salihumodibbo@gmail.com, hajiyakumshe@mautech.edu.ng

ABSTRACT

The financial reports Deposit Money Banks are useful for various decisions making by the users, for the report to be relevant in enhancing decision making; the preparation of financial report depends on the effectiveness of corporate governance mechanisms put in place in the bank. This study examines the impact of Risk management committee attributes on financial reporting quality of listed Deposit Money Banks in Nigeria. To achieve the objective of this study, a descriptive research design was utilized and the population of this study consists of all Deposit Money Banks (DMBs) listed on the Nigerian Stock Exchange and operating as at 31st December, 2017. Data were collected from the annual reports and accounts of fifteen (15) sampled DMBs spanning from 2012 to 2017. The findings of the study disclosed that: Risk management committee size and risk management committee expert has significant positive effect, while Risk management committee meetings has significant negative effect on financial reporting quality of listed Deposit Money Banks in Nigeria. Therefore, this study recommends that the regulators of code of corporate governance in Nigeria for listing requirements (Nigerian Stock Exchange), as well as the DMBs' management, should as a matter of requirement, revisit practices of corporate governance and ensure that all board committees (especially risk management committee) attributes are effectively put in place and efficiently monitored to ensure quality financial report by listed DMBs in Nigeria.

Keywords: Risk Management Committee, DMBs, Financial Reporting Quality

1. INTRODUCTION

Deposit Money Banks (DMBs) are essential privately owned financial institutions in Nigeria that provides a wide range of financial services of accepting deposit, lending of loans, providing overdraft to both the general public and to the firms. Yahaya, Salman, and Murhtar, (2012) DMBs are essential sector in the development of any nation they facilitate efficient mobilization of human and material resources, pooling of savings and allocation of funds to the investment outlets. They provide liquidity and capital to firms in their production processes and facilitate a reliable payment system that provides very effective monetary policies for management.

The issue of financial reporting quality is of tremendous concern not only for the final users, but to the entire economy as it affects and has significant impact on economic decisions; it is the procedures and techniques used in reporting their financial results that determine the quality of their financial reporting (Jerma & Novak, 2014). Financial reporting is considered to be high in quality when financial reports of DMBs present a true and fair position and are in line with Generally Accepted Accounting Standards (Kusnadi, Leong, Suwardy & Wang, 2016). Financial reporting quality serves as a basis and yardstick for assessing the economic performance and financial health of a firm which is used in taking informed judgments and decisions making (Yahaya, Kutigi & Ahmed, 2015).

To ensure reliable and high financial reporting quality, corporate governance mechanism has largely focused on the structure of corporate board of directors' functions. The board of directors has to perform certain functions and these functions are delegated to various sub-board committees; the establishment of board sub-committees has been strongly recommended as a suitable mechanism for improving corporate governance (Laux & Laux, 2006). This study considered Risk management committee on the basis of wide acceptance of risk committee as part of corporate accountability and transparency and the requirement of Security and Exchange Commission (SEC) under the provisions of the Companies and Allied Matters Act (CAMA 1990: Section 359, sub-section 3&4) that all listed DMBs on the Nigerian Stock Exchange (NSE) to establish and include in their annual reports, a summary of activities carried out by their audit committee (SEC, 2003).

The DMBs through its governance mechanism protect the interest of shareholders by providing safety and returns to their investment, government and the public are more

interested in a safe and stable banking systems and the employees are more interested in sustained employment. The reverse has been the case, the inability of these DMBs in Nigeria and elsewhere around the world to perform adequately their duties have been attributed to ineffective corporate governance (Sunusi, 2011). Inadequate reporting framework, weak capacity and enforcement and resorting to creative accounting by managers to boost figures in financial statements are other problems that hinder the compliance with standards (International Monetary Fund, 2013; Sanusi & Izendonmi, 2014). In a similar fashion, Imeokparia (2013) consider inadequate financial report disclosure and non-compliance with requirements of financial reporting standards attributed the crisis in Nigerian DMBs. Eriabie and Izendonmi (2016) and Al-Shaer, Salama, and Toms (2017) consider Enron and Worldcom in the US and other high profile financial scandals like the Afribank in Nigeria. Based conflicting results on the review of related literatures on the impact of risk management committee attributes on the financial reporting quality, this study therefore, examined impact of risk management committee attributes on the financial reporting quality of listed DMBs in Nigeria.

2. LITERATURE REVIEW

Raghunandan, Read, and Rama (2001) report that committees such as the Risk Management Committee, which include independent members with at least one having accounting or financial expertise, are more likely to consult longer with the chief internal auditor, review the internal audit program and results, and review management's relationships with the internal audit unit. Risk committee members with advanced financial background are more likely to succeed than those with inadequate financial and accounting knowledge of the risk disclosure requirements of the standards. Members should, therefore, have both technical and specialized knowledge in auditing and risk reporting to independently examine the significance of the risk report presented by the management or external auditors (McDaniel et al., 2002). The rule in the Sarbanes-Oxley Act (SOX) is that companies should disclose whether their board committees such as the RMC have financial experts and, if not, they should explain the reason why (SOX, 2002). According to McDaniel, Martin, and Maines (2002) found that putting financial experts on committees such as the RMC was likely to transform the corporate governance structure and impact positively the financial reporting risk disclosure especially of financial institutions. Klein (2002) observed that independent members in RMCs serve as superior

monitors of the financial reporting and risk disclosure process of the entire board. Due to their degree of importance as effective monitors, both the Sarbanes-Oxley (SOX) and the SEC code of corporate governance in Nigeria suggested the need for more independent members in boards and on committees such as the RMC.

Xie, Davidson, and DaDalt (2003) recorded that financial literacy mitigates earnings management as a result of higher risk disclosure while the study of Mitchell (2003) committees such as RMC members with financial expertise have greater ability to handle risk reporting issues in the event of a dispute between professional auditors and management. Previous empirical studies have investigated the different effects of financial expertise and financial literacy on the credibility of financial reporting of risk disclosure in annual reports. Practical support on the impact of the frequency of RMC meetings on the level of financial reporting disclosure quality is mixed. Liu, and Tiras (2004) found that committees such as RMC that meet on a regular basis improve disclosure transparency of reported earnings and enhance earnings quality. Liu, and Tiras (2004) suggested that financially literate members in board committees such as RMC increase the disclosure of earnings in financial report. Agency theory argues that the risk management committee size helps in evaluating and monitoring risks identified by management and ensuring compliance with company policies and programs and the reporting of findings to the main board. The study found a larger risk management committee size helped in reducing time and fatigue in these committees and thus increased the ability to rigorously review management, internal control or audit report and processes as such provide better quality disclosure in annual reports.

The study found negative relationship exists between the number of meetings in board committees such as the RMC and disclosure of earnings management. Other prior studies also failed to find significant outcomes between committee meeting frequency and the disclosure of earnings (Yang & Krishnan, 2005; Davidson et al., 2005). Hence, more demand for board committees such as the RMC to share the responsibilities due to decision complexities (Peasnell et al., 2005). Piot (2005) found a positive relationship between risk management committee size and a company's volume of operation. Defond, Hann, and Hu (2005) concluded that the market showed positive optimism for financial expertise on board committees while Yang and Krishnan (2005) failed to find the impact of financial expertise on financial

reporting quality. Overall, the results have been mixed. Several authors found that smaller committee size like RMC could enhance the quality of earnings (Ahmed et al., 2006). RMC of board meets frequently, the level of risk disclosure increases. Therefore, it is expected that an increase in RMC meetings will likely increase disclosure. However, Lin, Li, and Yang (2006) did not find any evidence of a relationship between meeting frequency and financial expertise on earnings restatement. Akhigbe and Martin (2006) document positive SOX influence on the market valuation of shares in financial institutions with the majority of their committee members being independent on both the RMC and the entire board.

Thus, the primary duty of the RMC is to oversee the company's risks and hedging policies as well as risk reporting for improved performance of the firm. Neal (2006) found having at least a member with financial expertise was associated positively with RMCs disclosure oversight function thus reducing the possibility of destructive earnings. The study further found both types of expertise (accounting and non-accounting) from experienced bankers, financial analysts, venture capitalists, actuaries and experienced CEOs of companies assisted in risk management assessment and financial reporting disclosure thereby reducing earning manipulations in companies with weak corporate governance mechanisms. According to the Australian Stock Exchange (ASX), listed firms should establish RMCs to review the firm's hedging and risks policies (ASX, 2007). Prior literature found that firms with RMC perform significantly better than companies without such committees (Subramanian et al. 2009).

Moreover, the existence of an RMC has caught the attention of scholars to investigate the relationship between RMC and the recent financial scandals. Subramanian, McManus, and Zhang (2009) observed a drastic reduction in fraudulent financial risk reporting with the establishment of RMC. Other empirical studies also established a positive relationship between RMC size and a company's scope of operations (Lehn et al. 2009). Rajab and Handley (2009) states that an independent member of the RMC acts as shareholder representative and can bring a wealth of experience and external connections with high reputational values to serve in the best interests of shareholders. Goh (2009) found financial reporting quality to positively related with committee member's independence. RMC as a specialized committee indicates greater monitoring on the part of board members.

Subramanian, McManus, and Zhang (2009) argued that large risk management committee size exists due to the likelihood of high agency costs as a result of high leverage and greater complexity in a company's operation. The study found that a RMC of a board of directors functions the key governance support mechanism overseeing the risk management strategy of a company. They also found effective policies in larger boards headed by an independent chairman associated with separate risk committees. Moreover, Subramanian et al. (2009) argued that a larger RMC has a better opportunity of obtaining the financial resources to organize itself for effective oversight responsibilities. Handley-Schachler (2009) examined RMC disclosure quality in three different periods (1998, 2001, and 2004). The study found a trend of increasing amounts of risk disclosure in the annual reports influenced by the UK accounting regulations and the accounting institutes recommendations.

The Code of Corporate Governance in Nigeria specifically states that the board of directors should establish RMC in order to oversee and monitor the risk management framework of all listed companies (SEC, 2011). The Code of Corporate Governance provides that the members of RMC should include executive directors, non-executive and management staff in charge with risk matters should serve in the RMC of DMBs in Nigeria. This, according to the code, is to enable the board to draw upon from a member's specialist knowledge of risk matters to assist the board in carrying out their responsibilities for better corporate governance and financial reporting (SEC, 2011). This is done in order to effect greater compliance with and align the quality of a company's risk information to international best practices that can lead to improve performance (SEC, 2011). A risk management committee (RMC) as a sub-committee of the board of directors refers to the number of members serving in the board risk committee (Andres et al. 2012).

In conclusion, these studies reviewed above have conflicting results in assessing the risk management committee as a board committee and the studies failed to examine the effect of Risk management committee on the financial reporting quality of the banks being compulsory committees on listed DMBs in Nigeria. This study therefore, examined the effect of Risk management committee on the financial reporting quality of the DMBs in Nigeria.

3. METHODOLOGY

This study adopted descriptive research design where the population of this study comprised all sixteen (16) DMBs listed on the Nigerian Stock Exchange and operating as at 31st December 2017. Purposive sampling technique was used where sample size of the study was drawn from the population using listing as criteria of filtering. Base on the year of listing of 2012 considered by this study, Jaiz Bank was dropped as not listed as at that year. Data was sourced through the annual reports and accounts of the listed DMBs. Multiple regression technique was used to analyze the data based on the application of panel data from listed DMBs using STATA version 14 software, this is because the OLS-multiple regression explained the variation of the dependent variable due to variation in any of the independent variables. Hair, Black, Babin and Anderson (2010) insisted that multiple regression analysis is the best framework for use with a single dependent variable and multiple independent variables as in this study. Stata software was selected for this study because it is free of errors and one of the most commonly used software in panel data study. The panel data methodology was employed because panel data are more informative, more efficient with higher degree of freedom and lesser collinearity. This is in consistence with the prior studies of Amoako and Asante (2012); and Hossain (2014).

4. DATA ANALYSIS AND DISCUSSION

In the quest to achieve the stated objective of this study, data were presented analysed and results were discussed in this subsection. Table 1 presents the descriptive statistics involving the mean, minimum, maximum, standard deviation, skewness and kurtosis of the independent and the dependent variables of the study.

Descriptive Statistics

The descriptive statistics is presented on Table 1 below:

Table 1
Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max	Skewness	Kurtosis
FRQ	90	3.341	0.287	3.044	4.007	1.310	3.527
RMCSZ	90	7.000	1.683	3.000	14.000	1.224	4.207
RMCIND	90	0.621	0.087	0.4000	0.857	0.683	3.881
RMCMT	90	4.300	0.917	1.000	7.000	0.163	4.499
RMCEXP	90	0.239	0.140	0.010	0.500	0.076	1.914
PROFT	90	0.113	0.104	-0.028	0.353	0.891	2.370
LEVRG	90	0.743	0.287	0.001	0.995	-1.940	5.093
AUDQL	90	0.467	0.502	0.000	1.000	0.134	1.018

Note: IFRS7-C=International Financial Reporting Standard-7 Compliance; FRQ=Financial Reporting Quality; RMCSZ=Risk Management Committee Size; RMCEXP=Risk Management Committee Expertise; RMCIND=Risk Management Committee Independent; RMCMT=Risk Management Committee Meeting; PROFT=Profitability; LEVRG=Leverage; AUDQL=Audit Quality.

From the result of the descriptive statistics in Table 1, it is evident that financial reporting quality of the listed DMBs in Nigeria is averagely moderate with the (mean=3.341), minimum value 3.044 (moderate), maximum is 4.007 (Good Financial Reporting Quality). This is an indication that there is adequate financial reporting quality in the listed Deposit Money Banks in Nigeria.

Furthermore, from the result of descriptive statistics in Table1 Risk Management Committee size (RMCSZ) has an average value of 7 members, minimum of 3 members, maximum of 14 members, and a standard deviation of 1.683 (narrow variation between the sampled DMBs in regards to (RMCSZ). To Risk Management Committee independence (RMCIND), the mean value is 0.621(62.1% are non-executive directors), minimum value is 0.40(40%), a maximum value of 0.857(85.7%), and a standard deviation of 0.087. Regarding Risk Management Committee Meeting (RMCMT), the average meeting is 4 times, minimum meeting is once (1), the maximum times of meeting is 7, while the standard deviation 0.917 (narrow variation between the sampled firms in terms of RMCMT). Additionally, Table 4.1 shows that Risk Management Committee Expertise (RMCEXP) has an

average value of 0.239 at (23.9%), a minimum value of 0.010 at (1%), a maximum of 0.50 at (50%), with a standard deviation of 0.140.

In consideration to the control variables in this study, profitability (PROFT) has a mean value of 0.113 at (11.3%), a minimum value of -0.028 at (-2.8%), a maximum value of 0.353 at (35.3%), with a standard deviation of 0.104. leverage (LEVRG), its mean score is 0.743, minimum score is 0.001, while the maximum score is 0.995, and the standard deviation stood at 0.287. For audit quality (AUDQL), the mean score is 0.467(46.7%), minimum of 0(non-big 4) and maximum of 1(big4), with a standard deviation of 0.502.

Discussion of Multiple Regression Results

The results of Hausman specification test exhibited significant p-value results. The results indicate excellent variables behaviour under the Fixed Effect models. The Fixed Effect model has been used as the main regression utilized in the interpretation of the results of this study. Worthy of note, the Random Effect model assumes that individual effect is characterized as random and inference relating to the population from which a sample was drawn randomly (Baltagi, 2008). Moreover, Baltagi added that the random effect model is the most fitting specification where N individuals are drawn randomly from a large population. However, the Fixed Effect model assumes the existence of individual heterogeneity, and it is normally related with one or more regressors. Thus, if one is concentrating on a specific N firm and the behaviour is limited to the behaviour of the said firm. Hence, the results of Fixed Effect models are presented in Table 2.

Table 2
Result of Fixed Effect and Random Effect Regression Models

Variables	Fixed effect model	
	Coef.	t-stat.
Constant	5.8232	4.83***
<i>Independent</i>		
RMCSZ	0.1523	1.44*#
RMCEXP	0.2108	1.80*
RMCIND	-0.2205	-2.88***
RMCMT	0.1076	1.09
<i>Control:</i>		
PROFT	-0.9962	-2.45**
LEVRG	-0.0109	-0.28
AUDQL	-0.0605	-1.80*
Observations	90	
Categories	15	
F (11, 64)	3.01	
Prob>F	0.0022***	
R ²	0.7638	
Adj. R ²	0.6663	

Note: ***, **, * indicate statistically significant at 1%, 5% and 10%, respectively; *# = significant @ 10% two-tailed. IFRS7C=International Financial Reporting Standard; RMCSZ=Risk Management Committee Size; RMCEXP=Risk Management Committee Expertise; RMCIND=Risk Management Committee Independent; RCMC=Risk Management Committee Meeting; PROFT=Profitability; LEVRG=Leverage; AUDQL=Audit Quality.

From the regression result in Table 2, the R² value under the Random Effect model is 0.3417, indicating that the explanatory variables in this study accounted for 34.17% of the variations in the dependent variable (Financial Reporting Quality). In addition, the model is significant based on the Wald chi² (38.98, p<0.01), indicating a goodness of fit and validity of the model. Moreover, risk management committee size (RMCSZ) has a significant positive effect on FRQ but at 10% level of significance ($\beta=0.1992$; $p<0.10$). Similarly, risk management committee expertise

(RMCEXP) has a significant positive influence on FRQ at the 0.05 significant level ($\beta=0.2745$; $p<0.05$).

Furthermore, under the RE model, Risk Management Committee Meeting (RMCM) has a significance positive effect on FRQ at 10% level of significance two-tailed test ($\beta=0.1359$; $p<0.10$). However, the result from Table 2 shows that risk management committee independence (RMCIND) has a significant negative impact on FRQ at 1% level of significance ($\beta=-0.2483$; $p<0.01$). Other explanatory variables have insignificant positive and negative impact on FRQ as shown by the regression result under the RE model. In consideration to the control variables in this study, the result for RE model shows that profitability (PROFT) has a significant negative effect on FRQ at the 0.05 significant level ($\beta=-0.8579$; $p<0.051$), whereas, leverage (LEVRG) and audit quality (AUDQL) have insignificant negative effect on FRQ.

More importantly, the main regression result utilized by this study is that of Fixed Effect Model as shown in Table 2. The result shows that the Fixed Effect (FE) model has a R^2 value of 0.7638, indicating that the explanatory variables in this study accounted for 76.38% of the variations in Financial Reporting Quality (FRQ). Moreover, the model has an adjusted R^2 value of 0.6663, signifying that only those explanatory variables that are significant have accounted for 66.63% of variations in the financial reporting quality of listed Deposit Money Banks in Nigeria. Equally important, the model as a whole is statistically significant ($F = 3.01$, $p<0.01$), showing the goodness-of-fit and the validity of the model utilized which is good for statistical inference.

Additionally, the Fixed Effect regression result from Table 4.2 portrays that risk management committee size (RMCSZ) has a significant positive effect, two-tailed ($\beta=0.1523$; $p<0.10$) on financial reporting quality of listed Deposit Money Banks in Nigeria, indicating that an increase in the number of members of risk management committee will result to an increase in the quality of financial reports of listed DMBs in Nigeria. This result opposes hypothesis which states that risk management committee size has no significant effect on financial reporting quality of listed Deposit Money Banks in Nigeria. However, the result validates with agency theory which argues that the risk management committee size helps in evaluating and monitoring risks identified by management and ensuring compliance with company

policies and programs and the reporting of findings to the main board. This is in line with the findings of Lehn *et al.* (2009), Pilot (2005), and Subramanian *et al.* (2009). More so, the result from Table 2 portrays that risk management committee expertise has a significant positive effect on the financial reporting quality of listed Deposit Money Banks in Nigeria at 10% statistical significance ($\beta=0.2108$; $p<0.10$). This result does not support hypothesis which states that risk management committee expertise has no significant effect on financial reporting quality of listed Deposit Money Banks in Nigeria), but supports the preposition of agency theory and resource dependence theories and also align with the findings of Brayn *et al.* (2004), McDaniel *et al.* (2002), and Xie *et al.* (2003).

However, the result of Fixed Effect model from Table 2 depicts that risk management committee independence (RMCIND) has a significant negative effect at 1% statistical significance ($\beta=-0.2108$; $p<0.01$) on financial reporting quality of listed Deposit Money Banks in Nigeria. This indicates that any increase in the independence of members of the risk management committee may result to a decrease in the quality of financial reports of listed Deposit Money Banks in Nigeria. Likewise, this result does not support hypothesis which states that risk management committee independence has no significant effect on financial reporting quality of listed DMBs in Nigeria and agency theory and resource dependence theory as well as the findings of Goh (2009), and Vafeas (1999).

On the other proxy of risk management committee characteristics, Table 2 depicts that risk management committee meeting has a positive, but insignificant effect ($\beta=0.1076$; $p>0.10$) on the financial reporting quality of listed Deposit Money Banks in Nigeria. This result supports hypothesis and the result of Lin *et al.* (2006), and Yang and Krishnan (2005) which states that risk management committee meeting has no significant effect the financial reporting quality listed DMBs in Nigeria but contradicts agency theory and findings of Brayn *et al.* (2004) and Vafeas (2005).

For the control variables in this study, the regression result in Table 2 shows that profitability (PROFT) has a significant negative effect at 5% statistical significance ($\beta=-0.9962$; $p<0.05$) on the financial reporting quality of listed Deposit Money Banks in Nigeria. In the same vein, audit quality (AUDQL) has a significant negative effect at 10% statistical significance ($\beta=-0.0605$; $p<0.10$) on the financial reporting quality of listed DMBs in Nigeria. Nevertheless, based on the regression result in Table 2,

leverage has an insignificant negative effect ($\beta=-0.1076$; $p>0.10$) on the financial reporting quality of listed Deposit Money Banks in Nigeria.

5. CONCLUSION AND RECOMMENDATIONS

Conclusion

Based on the major findings presented on the effect of Risk management Committee on financial reporting quality of listed Deposit Money Banks in Nigeria, this study concludes that:

1. Risk management committee size, and risk management committee expert have a significant positive effect on financial reporting quality of listed Deposit Money Banks in Nigeria. This portrays that an increase in risk management committee experts and size would result to an increase in the FRQ of the listed Deposit Money Banks in Nigeria.
2. Risk management committee meetings have a significant negative effect on financial reporting quality of listed Deposit Money Banks in Nigeria. This implies that whatever the number of meetings of the risk management committee will not improve the quality of financial reporting of DMBs in Nigeria.

Recommendations

Based on the finding and conclusions of this study, the following recommendations were made:

1. The supervisors of code of corporate governance in Nigeria for listing requirements (Nigerian Stock Exchange) and best practices for DMBs (Central Bank of Nigeria), as well as the DMBs management, should as a matter of requirements, revisit their practice of corporate governance and ensure that all board committees (especially risk management committee) assign to effectively and efficient committee members at the right time to carrying out their duties. This is on the ground that most of the risk management committee characteristics have no significant influence on the quality of financial reports of Deposit Money Banks listed in Nigerian.
2. The overseers of Code of Corporate Governance in Nigeria should also, from time to time review the exiting code where necessary to meet the

requirements of the global best practice of Code of Corporate Governance without conflicting the Nigerian company laws. This will help in ensuring that corporate governance codes are effectively observed in the operations of the listed Deposit Money Banks in Nigeria, especially in relation to the board of directors and their standing committees.

Suggestion for Future Research

This study dwells only on two board committees of the board; future studies can cover other committees like board investment committee, board credit committee, and board human resource committee which may have a significant influence on the quality of financial reports of listed Deposit Money Banks in Nigeria. Moreover, future studies should also consider other domain like insurance companies, manufacturing firms and micro finance banks. This may assist in making generalization or otherwise of the results obtained by future studies and the one obtained by this study.

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