NON-FINANCIAL RISK DISCLOSURE IN FINANCIAL INSTITUTIONS: EVIDENCE FROM NIGERIA

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ABSTRACT

Several empirical studies have reported mixed findings with respect to audit committee characteristics and international financial reporting standards (IFRS) compliance. Few studies reported on non-financial risk disclosure especially of financial institutions in developing countries suggesting the need for more attention in the area. The present study tested whether audit committee matters on non-financial risk information disclosure in financial institutions of developing country such as Nigeria. Drawing on agency and signalling theories, this study examined audit committee characteristics and non- financial risk disclosure among 50 listed financial institutions on the Nigerian stock exchange employing secondary data for 2014. Using Ordinary Least Squares regressions model, the study found a significant positive relationship between audit committee size and non-financial risk disclosure. Similarly, the results indicated that audit committee independence has a significant positive relationship with non-financial risk disclosure. The study also found a significant positive relationship between audit committee meeting and non-financial risk disclosure. On the contrary, no significant relationship was found between audit committee expertise and non-financial risk disclosure. The study shows the importance of disclosure of non-financial risks in the annual report of Nigerian financial institutions to shareholders in their wealth maximisation drive and to the government as regulatory enforcers.

Keywords: Audit committee characteristics, non-financial risk disclosure, financial institutions, Nigeria

1. INTRODUCTION

Risk is acknowledged to cover all aspects of human endeavour. This leads to an increased interest in the risk reporting pattern of firms all over the world (Oliveira, Rodrigues, & Craig 2013). Scholars agreed that, risk is unavoidable in today's complex business and financial transactions which can never be eliminated but managed (Davies et al., 2010; Lipunga, 2015). Management of risk is not a new phenomenon in business organisations universally. What is however not certain is the extent to which risks information is being managed in such businesses as the listed banks and insurance companies of developing economies such as Nigeria (Fadun, 2013; Thompson & McCarthy, 2008).

Banks and insurance companies as intermediate capital providers generally meet up with their objectives through disclosure of information on diverse types of risks. These disclosures assist them to drastically reduce the possibility of incurring losses (Al-Tamimi & Al-Mazrooei, 2007). Several scholars have examined risk information disclosure in annual report, yet the subject is still not clearly explained.

Although risk disclosure is potentially of interest to variety of user groups, recent evidence has indicated that current risk information is lopsided and unhelpful to stake holder groups (Davies, Moxey, & Welch, 2010). For instance, Lajili and Zeghal, (2005) observed that very little is known about non-financial risks hence, financial risk disclosure in annual report. This lack of non-financial risk information has triggered investors to demand for such information to enable them to make some informed business choices that may reduce the possibility of wrong investment decisions and thereby incurring huge losses.

Globalisation increases uncertainty of the business environment by keeping high competition with different possible outcomes especially with regards to non-financial risks (Ernst & Young (EY), 2014; Gjerald & Lyngstad, 2015). These risks also determine organizations' activity and its reporting pattern on current and future company operations (Arshad & Ismail, 2011).

It is an essential aspect in finance literature to demand identification, control and valuationof risks arising from non-financial instruments by both future and prospective investors (Hunziker, 2013). Hence, some risk events such as natural disasters, wars, changes in government regulations, political instabilityand global changes in consumer demand because of greater awareness can consequently affect the survival and growth of the firm (Abhimantra et al., 2013).

Previous studies in developed economies view that non-financial risk information disclosure could be important criteria to achieve high-quality corporate report in firms (Institute of CharteredAccountants in England and Wales (ICAEW), 1999; Canadian Institute of Chartered Accountants (CICA), 2009; Beattie et al., 2004). Other studies from the same jurisdictions observed that having more risk information disclosure help firms in their portfolio investment decisions (Solomon, Solomon, Norton and Joseph, 2011) which also lead to reduction in the risk of investing in the reporting firm (Orens & Lybaerts, 2007).

Although firms consider most non-financial information as substantially sensitive that if disclosed may expose their competitive advantage over their pairs, both current and prospective investors view that disclosure of these vital information could help reduce information asymmetry and act positively in their business and economic interests (FRC, 2011; Miihkinen, 2013).

Uyar and Kilic (2012) opined that non-financial information disclosure is important for emerging capital markets since they need finance for growth and development. Following Qiu, Shaukat, and Tharyan, (2016) thisstudy attempt to test whether non-financial risk information of listed financial institutions can be used to reduce risks in firm's annual report of developing economies such as Nigeria through the twin enforcement of risk corporate governance mechanisms and non- financial risk disclosure.

2. LITERATURE REVIEW

Listed financial institutions in Nigeria are required to comply with financial instruments disclosure which are adopted from International Financial Reporting Standards since January 1, 2012 (Ebaid, 2016). They are also required to comply with the corporate governance rules and regulations contained in the Nigerian Financial Reporting Council Act 2011. These risks information and the corporate governance which discuss the role of the audit committee characteristics are disclosed in listed firms' annual report. However, disclosure of information according to the efficient market hypothesis should be guided by what is reported to the public aimed at increasing shareholder confidence (Core, 2001; Ohlson, 1995).

Previous studies provide evidence that disclosure of listed financial institutions is affected by the extent to which such information is provided in the annual report (Andres & Vallelado, 2008; Andres, Romero-merino, Maros Santamaria and Vallelado, 2012; Al-Akra & Ali, 2012). Same result was obtained by Gamerschlag (2012) on human capital disclosure and Anam et al., (2011) on intellectual capital disclosure. Qiu et al. (2016) hypothesized that social and environmental disclosure of information isbelieved to give competitive advantage to the firm.

Studies specifically on non-financialrisk disclosure especially in developed economies found mixed results. For instance, Oliveira et al. (2013) argue that risk information must be given adequate attention to avert future financial crisis. Cains et al. (2011) found derivative financial instruments to be the main cause of the 2008 financial crisis. Bischof et al. (2014) and Radin (2007) found non-financial risk disclosure to be an effective managerial tool of analysis which provides higher financial information to stakeholders in annual reports. The World Bank risk information report on financial institutions argue that non-financial risk disclosure is the only regulation in financial reporting that provide the needed interaction between quantitative and qualitative disclosure in annual report (World Bank, 2014).

In same vein, Latifah, Asfadillah and Sukmana (2012) found evidence that financial institutions in Nigeria have taken advantage of the active oversight in the application of the Securities and Exchange Commission code of corporate governance 2011. Fadun (2013) observe various categories of risks which affect financial institutions of developing countries. Similarly, the international financial reporting standards adoption of 2012 in Nigeria enables the boards and board audit committee oversight of financial institutions to curtail the 2008 financial and economic crisis through regulatory enforcements (Zango et al., 2015). In contrast, other studies found otherwise. For instance, Miihkinen (2013) found risk disclosure to have negative relationship with information asymmetry.

Signalling and Agency theories

Earlier empirical literature has found reasons why some theories help to explain why prior research on risk disclosure is of poor quality and lacking in value and relevance (Abraham & Shrives, 2014). In deviating away from the traditional use of the agency theory alone to explain corporate governance attributes and IFRS disclosure, this study also adds another forward-looking theory to explain disclosure of information in corporate annual reports. This theory is the signalling theory. Anam, Fatima and Majdi (2011) argue that a firm try to create fair value of its capital resources by disclosing more information to signal the fact in the annual reports to shareholders and other stakeholders.

Similarly, Uyar and Kilic (2012) observed that firms make non-financial information disclosure to signal good news to investors. Mavlanova et al., (2012) believes high performing firms have more incentives to disclose information to investors to signal that the firm has better performance among its pairs. Similarly, agency theory posits that managers gain higher rewards through disclosure of both financial and non-financial information to show worthy corporate governance oversight by lowering agency conflicts (Sheu et al., 2010).

Based on signalling and agency theories, this study argue that financial institutions audit committees in Nigeria have incentive to disclose more non-financial information to investors regarding risks to signal its underlying risk information quality to other parties. They also signal through their audit committee meetings that large sizedaudit committees in firms can create value and protect the overall interest of investors (ICAEW, 1999; Connelly et al., 2011). Hence without adequate information (both financial and non-financial) through expertise in audit committees, stakeholders may not be able to know how firm manager's stewardship on non-financial risk information has been fulfilled and accountability ensured (ICAEW, 1999).

Previous studies argue that disclosing only financial information may not sufficiently describe the risks information to increase investor's confidence in the firm (Andres et al., 2012; Beattie et al., 2004). The increasing complexity of financial institutions regulations makes it difficult for investors to appreciate only financial information without an independent representative in audit committees to present clear explanations on non-financial aspects of the financial institutions operations (Beretta & Bozzolan, 2004). Hence consistent with Abdullah et al. (2015) this paper argues that disclosing non-financial risk information may provide better quality financial statements in financial institutions annual report which assist in attracting more investors by reducing the cost of capital (ICAEW, 1999).

Review of Empirical Studies and Hypotheses Development

ACS and Non-Financial Risk Disclosure

Prior studies found positive relationship between audit committee size (ACS) and IFRS compliance (Alles, Datar and Friedland, 2005; Andres et al., 2012; Subramanian, McManus and Zhang 2009).

Other empirical papers also established positive relationship between ACS and companies 'scope and quantum of operations' (Coles *et al.*, 2008; Lehn *et al.* 2009). Bradbury (1990) and Piot (2005) found positive relationship between audit committee size and a company's volume of operation. This paper hypothesised that:

H1: ACS has positive relationship with non-financial risk disclosure

ACE and Non-Financial Risk Disclosure

Zhang et al. (2007) found lesser internal control weakness in firms with financial experts in committees such as the audit committee that likely to impact positively on the financial reporting risk disclosure of especially financial institutions. Xie, Davidson and DaDalt (2003) record financial literacy to be a powerful mitigate of earnings management because of higher risk disclosure. Bryan, Liu and Tiras (2004) suggest that financially literate members in board committees such as audit committee increase the disclosure of earnings in financial report. It is therefore hypothesised that:

H2: ACE has positive relationship with non-financial risk disclosure

ACI and Non-Financial Risk Disclosure

Independent members in audit committee act as shareholder representative that comes in with power, experience and external connections and higher reputational value on behalf of the shareholders. Goh (2009) found financial reporting quality to positively relate with committee member's independence. Deli and Gillan (2000) argue that there is reduction in non-financial risk disclosure in firms with certified independent audit committee members in financial institutions. Audit committee as a specialised committee indicates greater monitoring on the part of board members (Vafeas, 1999). Klein (2002) observe that independent members in audit committee serve as superior monitors of the financial reporting and risk disclosure process of the entire board. Ii is hypothesised that:

H3: ACI has positive relationship with non-financial risk disclosure

ACM and Non-Financial Risk Disclosure

Audit committee meeting frequency has been documented as an effective corporate governance mechanism in prior literature (Raghunandan et al., 2001). Bryan, Liu and Tiras (2004) and Bronson *et al.*, (2006) found positive relationship while Vafeas (2005) found negative relationship with IFRS compliance. Abbott and Parker (2000) observe that it is unlikely to have financial statement fraud in firm's audit committee that meet at least twice per annum Other studies found no relationship with disclosure (Yang & Krishnan, 2005; Davidson *et al.*, 2005). This study's hypothesis is developed that:

H4: ACM has positive relationship with non-financial risk disclosure

Control variable (Audit Quality)

Previous literature document positive relationships between some corporate governance characteristics and risk reporting disclosure quality. These variables which is also included in this study as control variable in the regression model is audit quality represented by big4 and nonbig4 audit firm. As evidenced from prior studies, this variable is shown to have some impact on corporate risk disclosure (Abraham & Cox, 2007; Linsley & Shrives, 2006; Ali & Taylor, 2014).

3. METHODOLOGY

This study concentrates on only the 50 financial institutions listed on the floor of the Nigerian stock exchange because their stock in trade are mainly risk assets hence expects to have an effective risk disclosure (Linsley & Shrives, 2006). The study employs only 2014 financial year data because prior studies found that disclosure is not affected by the number of years (Abdullah, 2015; Abraham & Shrives, 2014; Miihkinen, 2013; Zaini, 2014). For instance, Abraham and Shrives (2014) found risk management to remain constant overtime indicating disclosure inertia. The statistical relationship between the independent variables and non-financial risk disclosure is tested through the following model:

$$NFRD = \beta 0 + \beta_1 ACS + \beta_2 ACE + \beta_3 ACI + \beta_4 ACM + \varepsilon$$

Table 1: ***Variable Definition and Measurements***

Variables	Variable definition	Expected Sign	Hypothesis
DV: Non-financial risk	Measured by total number of risk sentences in annual report		
IVs: Audit committee Size (ACS)	Measured by total number of audit committee members	+	H_1
Audit committee Expertise (ACE)	Measured by the proportion of members with accounting /financial expertise in risk mgt. committee	+	H_2

Audit committee independence (ACI)	Measured by the proportion of independent members in risk mgt. committee	+	H_3
Audit committee Meeting(ACM)	Measured by total risk mgt. committee meeting in the year	+	H_4
Control Variable Audit quality	Represented by big4 and non-big4	+	

Non-financial Risks Disclosure (NFRD)

Prior literature observed that information asymmetry and agency cost is reduced through adequate risk information disclosure (Jensen & Meckling 1976; Linsley & Shrives 2006). Following Al- Shammari, (2014), this study measure risk disclosure through content analysis. This method is consistent with other scholars such as Linsley and Shrives (2006) and Abraham and Cox (2007). These scholars use various units of analysis like words (e.g., Deegan & Gordon, 1996); sentences (Beretta & Bozzolan, 2004; Linsley & Shrives, 2006; Abraham & Cox, 2007) and proportions of a page (Guthrie & Parker, 1990). Following the work of Linsley and Shrives (2006) this study chooses sentences because it is argued that they are more reliable than any other content analysis method.

This study adopts keyword search proposed by Ali and Taylor (2014) for sentences in which the key words appear in the annual report which will be counted for all the sampled banks for the period as indicated in Table 2

Table 2: Keywords

Basic Key Word	**Other Key Words**
Risk	Danger
	Jeopardy
	Peril
	Hazard

	Menace
	Threat
	Chance

Table 2 reports basic non-financial risk keywords used to identify usage of risk and risk related words in the annual reports of Nigeria's listed financial institutions for the financial period ended 2014.

Table 3: ***2014 Keyword Summaries***

Company	Sentences	Percentages	Company	Sentences	Percentages
Access	358	2.45	Cornerstone	232	1.59
Diamond	289	1.98	Custodian	198	1.36
Eco	266	1.82	Equity Ass	226	1.55
Fidelity	197	1.32	Gold link	279	1.91
First	181	1.24	Great Nig.	193	1.32
First City	360	2.47	Mansard	265	1.82
Guaranty	455	3.12	Guinea	257	1.76
Skye	332	2.28	Inter-Wapic	302	2.18
Stanbic	405	2.78	Inter Energy	225	1.54
Sterling	364	2.50	ADIC Insu.	264	1.81
U B A	467	3.12	Lasaco	297	2.17
Union	409	2.80	Law Union	312	2.14
Unity	403	2.76	Linkage	327	2.24

Zenith	359	2.46	Mutual	325	2.23
Wema	154	1.16	NEM	254	1.74
NPF Mic	208	1.43	Niger	228	1.56
Abbey	382	2.62	Oasis	338	2.42
Aso Sav.	295	2.13	Prestige	259	1.78
Resort	262	1.80	Regency	236	1.62
Union H.	199	1.36	Sovereign	247	1.69
FBN Ins.	281	1.93	Starco	226	1.55
AIICO	280	1.92	Standard	283	1.94
Lead way	335	2.40	Unic Ins	352	2.42
Consol. Hal	321	2.30	Unity Kap	282	1.93
Con. Re	351	2.41	Universal	265	1.82

Source: *Authors computations*

4. EMPIRICAL RESULTS AND DISCUSSIONS

Descriptive Statistics

The descriptive statistics for continuous variables are listed in table 4. There is a total of 50 observations, or non-financial risk disclosure firms. The data is derived from 2014 audited financial statements of listed financial institutions of Nigerian Stock Exchange. From Table 4.5 non-financial risk disclosure shows the overall mean score of 2.00, standard deviation of 0.49 and minimum and maximum disclosure score of 1.06 and 3.20 respectively. The descriptive statistics also show ACS to have a mean of 5.9, standard deviation of 0.54 and minimum and maximum of 4.00 and 8.00 respectively. The mean and standard deviation of ACE are 0.21 and 0.07 with minimum and maximum score of 0.13 and 0.33 respectively. Audit committee independence shows mean and standard deviation of 0.85 and 0.14 respectively. The minimum and maximum disclosure score for ACI is 0.5 and 1.00 while the mean and standard deviations of Audit committee meeting frequency are 4.30 and 0.65 respectively. The ACM variable has a minimum and maximum score of 3 meetings and 6 meetings respectively. The standard deviation reported in this study shows its closeness to the average which is termed the measure of location. The implication in this study is that, with the low standard deviation, the studied variables are well within limit and known end up in a trash.

Table 4: ***Descriptive statistics***

Variable	Obs.	Mean	Std. Dev.	Min	Max
NFRD	50	2.00	0.49	1.06	3.20
ACS	50	5.90	0.54	4.00	8.00
ACE	50	0.21	0.07	0.13	0.33
ACI	50	0.85	0.14	0.50	1.00
ACM	50	4.44	0.70	3.00	6.00
BIG4	50	0.58	0.50	0.00	1.00

Pearson Correlation Coefficient

The Pearson correlation coefficient in Table 4.6 of this analysis identifies the relationship among the variables and whether there is multicollinarity problem. Multicollinarity exists when two variables are highly correlated. According to Tabachnick and Fidel (2007) correlation exceeding 0.9 may affect accuracy of the multi-regression test result. In this study the highest correlation between audit committee independence and audit committeeexpertise of 0.4457 indicates that multi-collinearity is not of much concern. Moreover, correlation between big4 and audit committee independence of 0.3801, audit committee independence and non-financial risk disclosure is 0.2405, big4 and audit committee expertise is 0.2360, and audit committee meeting and non-financial risk disclosure is 0. 2209.

Further check for multi-collinearityusing the variance inflation factor (VIF) was conducted for each independentvariable in the regression model. Although no clear rule for VIF that should give cause for concern, scholars suggest that collinearity may be a problem where the VIF value exceeds 10 (Neter et al., 1983; Mendenhall & Sincich, 1989). In this study, the highest value of VIF as presented in Table 7 which is 1.42 did not appear to pause any fundamental problem for interpreting the regression results.

Table 5: ***Correlation Coefficients***

Variable	NFRD	ACS	ACE	ACI	ACM	BIG4	VIF
NFRD	1.00						
ACS	0.20	1.00					1.08
ACE	-0.01	-0.18	1.00				1.32
ACI	0.24	-0.18	0.45	1.00			1.42
ACM	0.22	-0.20	0.24	0.16	1.00		1.11
BIG4	0.18	-0.01	0.24	0.38	-0.04	1.00	1.20

Table 6 shows the result of audit committee characteristics and non-financial risk disclosure of listed financial institutions in Nigeria. The R^2 of the model explains about 21% of the variation in non-financial risk disclosure by the estimated variable. This result is lower than that found by Al-Shammari (2014) in the Kuwaiti non-financial companies studied. The adequacy of the model as shown by the f-value is 2.27 and the prob (F) is 0.21. H1 predicts a significant association between audit committee size and non-financial risk disclosure, the coefficient is positive and significant at β = .241, p <. 060.

This result implies that audit committee size positively enhanced non-financial risk disclosure and thus supports the hypothesis that there is a significant relationship between audit committee size and non-financial risk disclosure. Hypothesis 3 states that there is a significant relationship between audit committee independence and non-financial risk disclosure, the coefficient is positive and significant at β = .979, p < .094. Hypothesis 4 states that there is a significant relationship between audit committee meeting and non-financial risk disclosure, the coefficient is positive and significant at β = .127, p < .054. Contrary to expectations however, hypothesis 2 i.e. audit committee expertise records insignificant relationship with non-financial risk disclosure having negative coefficient and insignificant at β = -1.341, p <. 252. The control variable i.e. audit committee quality represented by big4 indicates insignificant relationship with non-financial risk disclosure with positive coefficient and significant at β = 0.126, p < .384.

Table 6: ***Multiple Regression Analysis***

Variable	Coeff	Std. Err.	t-ratio	*p*-value
ACS	0.241	0.125	1.930	0.060*
ACE	-1.342	1.155	-1.160	0.252
ACI	0.979	0.572	1.710	0.094*
ACM	0.194	0.098	1.980	0.054*
BIG4	0.127	0.144	0.880	0.384
CONST	-0.918	1.033	-0.890	0.379
R^2	0.21			
Adj. R^2	0.12			
F	2.27			
Prob (F)	0.12			

***, **, * indicate that the parameter estimates is statistically significant at 1%, 5% and 10%, respectively

5. SUMMARY AND CONCLUSION

Issues related to non-financial risk disclosure and audit committees are of considerable interest to regulators, accounting profession and stakeholders. As earlier stated however, there is little empirical evidence about non-financial risk disclosure and audit committee characteristics in such organisations as the financial institutions in Nigeria as a developing country. Notwithstanding however, there seem to be improvement with the results obtained in the previous studies on the subject. For instance, while Cain et al. (2011) found non-financial risk disclosure as one of the causes of the 2008 financial crisis, it is found from the result of current study and in those of Fadun (2013) and Zango, Kamardin and Rokiah (2016) that IFRS adoption by Nigeria in 2012 has greatly assisted Nigerian banks in exposing both financial and non-financial risks in their portfolio.

This study attempts to address the scarce empirical evidence, based on a survey of audit committees of 50 publicly listed companies in Nigeria. In the sample of study, it is found that audit committee size is positive and significantly influences non-financial risk disclosure. Independent members in audit committees have positive and significant influence on the management and the board of directors on non-financial risk disclosure information in financial report. However, the competence (finance or accounting background) of audit committee members is far below expectations perhaps due to inadequacy and monitoring capability of members on compliance issues on account of expertise which was also ineffective.

One possible conclusion is that audit committee expertise (ACE) is not the only factor that determines disclosure. Other factors such as size, independence and meeting frequency of the audit committee may influence non-financial risk disclosure and offset the impact of ACE on disclosure of non-financial information in annual report of the sampled financial institutions.

This study believes that, more stringent regulatory enforcement of expertise, training of audit committee members and adequate compensation to draw more expert members to assist in risk disclosure must be given priority by the board and management of Nigerian banks

The limitations of this study include very limited period of study. The sample of the study is limited to only public financial institutions, so results of the study may not be generalizable to all financial institutions in Nigeria. Thirdly, this study employs secondary data. Future study may use questionnaire to find out the effectiveness of audit committee through respondents which may provide more information that differs from the archival data affecting the results of this study. Future studies should expand the sample of the study to include non-public limited liability companies. Finally, it may be of interest to examine the issues covered in this study in other developing countries to see whether the results are consistent.

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