Effects of Audit Committee Diversity on Financial Reporting Quality among Listed Consumer Goods Companies in Nigeria

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Abstract: This study examined the effect of audit committee gender diversity on financial reporting quality. The population of the study comprises of all twenty (20) consumer goods companies listed on the Nigerian Stock Exchange from 2009 to 2019. The study used a purposive sampling technique to select all thirteen (13) consumer goods companies having all required data for the study and consequently published annual reports. The study conducted diagnostic tests such as heteroskedasticity and multicollinearity, after which regression analysis was done with the aid of STATA 15 to examine the effect of audit committee gender diversity on financial reporting quality. The results revealed that having a diverse member in audit committee increases financial reporting quality. Consequently, the findings suggest that the makeup of audit committees be managed to ensure gender diversity to ensure effective oversight functions.

Keywords: audit committee; audit committee diversity; financial reporting quality; gender diversity

JEL Classification: M4

1. Introduction

The audit committee is one of the components that make up corporate governance characteristics. For several years, international corporate governance reform has focused on audit committee formation in response to corporate management's misuse of control, which resulted in financial scandals, accounting fraud, stock valuation problems, and unjustified accounting policy manipulation.

The Audit Team oversees the process of financial reporting and communicates with stakeholders via an annual financial report, which acts as a guide for financial regulation. This group also keeps an eye on management and external auditors. Audit committee size, independence, meetings, expertise, and gender diversity, which are the focus of this research, are indeed considerations that lead to an effective audit.

Creating an audit committee is one of the steps taken to remedy potentially false financial reports (Eyenubo, Mudzamir & Ali, 2017). Eyenubo, Mudzamir and Ali (2017) define an audit committee as a group of representatives of an entity tasked with overseeing the company's accounting and financial reporting as a good corporate governance tool that improves financial reporting integrity. Ramsay (2001) opine that one of the corporate governance principles which strengthen the integrity of an entity's financial report is to constitute an effective audit committee.

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Several business scandals have shown that the details of annual disclosures continue to be a matter of concern for interested parties. According to Eriabie and lzedonmi (2016) and Al-Shaer, Salama, and Toms (2017), high-profile scandals such as those involving Enron and Worldcom in the United States, and Afribank, Intercontinental Bank Plc in Nigeria (2009), and Cadbury in Nigeria (2001), included widespread fraud and falsification of financial statements. According to Yusoff (2010), the honesty of those involved in the preparation of the financial report determines its authenticity and reliability (like directors and auditors). Moreover, audit committees comprised entirely of women executives are most likely to work better than audit committees comprised entirely of men or women executives. As a result, these factors could have an impact on the committee's effectiveness. When linking gender equality in the audit committee to performance, Erhardt, Werbel, and Shrader (2003) discovered that board diversity is positively associated with efficiency. According to Dennis and Kunke (2004), as cited in Wakaba (2011), female audit committee members are more efficient representatives of audit committees because they are increasingly capable, active, emotionally stable, reasonable, autonomous, and less aggressive than their male counterparts. This is according to Dennis and Kunke (2004), as cited in Wakaba (2011).

As a result, a female member of the audit committee could be more alert to the firm's potential for false financial statements. Bernardi, Bean, and Weippert (2005) looked at a variety of issues surrounding female audit committee members and discovered that when the audit committee board included women, Bernardi et al. (2005) also discovered that businesses with higher numbers of women on their boards of directors were more likely to be included in the top 100 most ethical companies to work for. According to these authors, having females on audit committee boards results in better attendance by male members. Increased attendance could result in better audit committee boardroom discussion and higher effectiveness levels, as female influence in this area is critical.

Therefore, this study investigates the effect of audit committee gender diversity on financial reporting quality among consumer goods companies in Nigeria.

2. Literature Review

2.1. Conceptual Review

Financial Reporting Quality

In the context of financial reporting, the term consistency is both inevitable and debatable. Barth, Landsman, and Lang (2008) described financial reporting quality as the capacity of financial metrics to represent the economic status and results. The precision through which accounting information is utilised to communicate ideas about a business performance is referred to as "quality of financial reporting" (Biddle, Hilary & Verdi, 2009).

The performance of an accounting standard that describes an unmeasurable concept that necessarily requires approximations and discretion and has the propensity for unintended discrepancies and deliberate prejudice, like earnings management, is referred to as financial reporting efficiency (Ewert & Wagenhoper, 2010). The primary importance of business statements is to provide an evaluation of the financial entities, specifically financial companies, such that strategic decisions are taken (Beest, Braam & Boelens, 2009; IASB, 2008). According to Beest et al. (2009), financial information informs administrators about the entity's assets, liabilities, equity, revenue and expenditures (including profits and losses), contributions from and distributions to stakeholders, and cash flows (IASB, 2008; 2010).

Investigators, experts, and policymakers, on the other hand, have not given a consistent definition of what makes quality financial reporting (Mbobo & Adebimpe, 2016). For instance, SOX (2002) requires audit committees and auditors to address the consistency, not only the acceptability, of a company's financial reporting practices. While the act did not specify consistency in financial reporting, the statement claims. Previous studies have emphasized factors that threaten to hinder increased financial reports, such as earnings management, misinterpretations, and corruption, instead of just describing "effectiveness" (in financial reporting). Davidson, Goodwin-Stewart, and Kent (2005), as well as Rahman and Ali (2006) cited these points as proof of a failure in the financial reports or close to zero financial analysis. Accounting information conformity with accounting and auditing requirements has also been used as an indicator of financial disclosure accuracy (Beasley, 1996; Abbott, Park & Parker, 2000; Song & Windram, 2004). Financial reporting quality refers to the financial and non-financial data in financial reports that can be used to make decisions (Akeju & Babatunde, 2017). Regulatory bodies, shareholders, researchers, and the accounting profession have all been interested in the quality of financial reporting (Hassan, 2013).

Financial reporting standard, according to Hassan (2013), encourages transparency and produces high-quality annual reports through detailed disclosure. This has influenced the creation of accounting principles and laws governing financial reporting (Hassan, 2013). Regulatory bodies, shareholders, scholars, and the accounting profession have all been interested in the accuracy of financial reporting (Johnson, Khurana & Reynolds, 2002). This is because financial reporting has long been a primary way of transmitting financial data to external users. Hassan (2013) documents that financial reporting assesses a business's economic performance and condition in order to track management activities and assist in making economic decisions (Warren & Reeve, 2004). According to Faraj and Akbar (2010) and, Dimitrova (2012), the reliability of accounting information reflected in the company financial statements is an integral part of which users of financial statements use to make a very reasonable decision. As a result, a trustworthy financial statement allows investors to make sound financial decisions. Consistent corporate failures have cast doubt on financial statements, integrity, and transparency in the minds of many stakeholders (Uadiale, 2012). Furthermore, the audited financial statements' reliability makes the report more reliable and independent, because if the audited report raised a signal of independence, it would lead to collusion between agents and auditors who would mislead the principals and provide false accounting information to the public (Abdelfatah, Alrshah, & Faudziah, 2015).

Audit Committee

The audit committee is one of the company's key functional bodies, and it oversees financial reports and transparency. The main goals of forming an audit committee are to improve the quality of auditing and reduce the amount of time the board of directors is questioned when external auditors are performing their duties (Salawu, Okpanachi, Yahaya & Dikki, 2017). The structure of the Audit Committee (AC) and how it exercises its governance and supervisory responsibilities have a direct impact on the organization's overall internal management process. Committee members ought to have honesty, commitment, and a comprehension of the company's operations (Osemene & Fakile, 2018).

The audit committee believes it is important to maintain the organization's accountability. Members of the audit committee are also members of the board of directors, which is responsible for formulating strategies to maintain the company's financial results. Sections 359(3) and (4) of the CAMA require every public company in Nigeria to establish an audit committee. The Audit Committee is in charge of monitoring the company's accounting policies and procedures (Moses, Ofurum & Egbe, 2016).

Audit Committee Gender Diversity

Hambrick, Finkelstein, and Cannella (2008) found that personal traits (especially sexuality) of chief executives were connected to the quality of financial reporting. (2008). According to Varman (2010), there seems to be a considerable gap between the performance of leadership teams and the efficacy of influencing variables. Female-majority audit committees would behave differently than mixed-gender audit committees. Top executives affect accounting knowledge output (Hillery & Hsu, 2011). While Erhardt, Werbel, and Shrader (2003) found that gender diversity in the audit committee is linked to performance, they also discovered that board diversity is positively associated with profitability. According to agency theory, this variation in top managers' personalities can affect a firm's financial reporting quality (Ling, 2012).

A gender-diverse audit committee is just as necessary. Different genders have varying attitudes and ethical standards when it comes to carrying out their responsibilities. Females have been discovered to be more ethical in their duties than males (Bilic & Sustic, 2011). A female board member helps unhealthy companies run better, and their presence is seen as a complement to male directors. Furthermore, audit committees with both genders represented perform better than committees with only one gender represented.

Personal characteristics, such as gender, have been linked to financial reporting quality (Hambrick, Finkelstein & Cannella, 2008).

2.2. Theoretical Framework

Audit committees recommend the need for autonomous bodies to ensure that management is working to boost the company's efficiency by growing the company's wealth (Al-Matari, Homaid & Alaaraj, 2016). The audit committee's job is to help shareholders reduce the amount of information needed for proper and timely decision-making, which is then used to deal with any issues that arise from the agency (Aldaoud, 2015). According to Turley and Zaman (2004), the audit committee's successful oversight and observation safeguards and supports shareholders' interests in the preparation of annual financial statements, the annual report for everlasting consumers, and the organization's internal control framework. Based on the research results, the audit committee is critical in managing the company's activities and preventing any problems that could harm the shareholders (Islam, Islam, Bhattacharjee & Islam, 2010). Priority is confined to agent-principal relationships, with several other interested parties being set aside in terms of priority. Jensen and Meckling (1976) stewardship theory holds that trustees would behave in the principal's best interests without the assistance of the board of directors and audit committee.

The agency theory explores and reflects on the relationship between a company's management and its owners. Agency theory, which relates governance to executing contracts and suggests that agents run the business on behalf of their principals, who may enforce penalties if the agent fails to fulfil contractual requirements, is very instructive in this study. Since agents are responsible for protecting principals' interests and privileges, minimising managerial expropriation and working in the principal's best interests, their role in the business represents the accountability relationship between principals and agents. According to agency theory, the principal and agent have opposing interests, resulting in agency issues and, as a result, financial misstatements.

By combining these interests, agency theory explains the specific oversight positions of external auditors and the board of directors. With its assistance, the principal agent conflicts should be mitigated. The agency theory recognises independent auditors as a systematic way to reduce information asymmetry between management and investors or shareholders by improving financial statement fairness and truthfulness. Thus, agency theory clarifies the importance of an independent audit from a theoretical standpoint. Audit independence, however, eliminates the risk of a dispute between theory and agent by ensuring that financial statements are error-free (Abdelfatah & Faudziah, 2015).

Similarly, it reduces the likelihood of account fraud and unlawful reporting values such that the financial market participant or customer can rely on those reports or facts. Auditors often use their skills to improve the reliability of results. Good corporate governance practices, according to regulators, are essential for companies to perform well and in the best interests of their shareholders (Abdelfatah & Faudziah, 2015).

However, the agency theory used in this study ensured that high-quality financial reporting is primarily concentrated on the audit committee system, which is responsible for overseeing the financial reporting process and financial statement audit. Expectations would be high for audit committees to be more involved and participatory in ensuring the proper management of the firms, which is understandable. Thus, audit committees are required to settle agency disputes between fund managers and fund vendors, thus improving the consistency of financial reporting.

3. Empirical Review

The role of the management board affects the results and judgement. Audit committees must have knowledge of financial auditing and should be led by seniors (Qi & Tian, 2012). A prime source of job issues also originates in the senior audit committee. Longer service with the audit committee yields increased knowledge. This would have a direct impact on productivity and overall performance (Wardhani & Joseph, 2010).

In companies with gender diversity on audit committees as well as the presence of professional and financial experts and female directors, the chances of finding high-quality auditors improve. As concluded by Ud Din et al. (2020), female AC chairs have greater accounting ability than their male counterparts. The skills of AC chairwomen strengthen corporate governance processes and ICSs (e.g., control environment, control activities, and information and communication).

The audit committee director’s gender is analysed in the surveys undertaken by Huang, Yan, Fornaro, and Elshahat (2011). The research speculated that female audit committee members would act in a progressive and appropriate way. Thus, the appointments sent a strong image to financial institutions. The audit committee gender diversity review covered all audit committee assignments for US-traded foreign firms from 2002 to 2009. The appointment of female audit committee members had substantial beneficial abnormal returns compared to male audit committee members’ recruitment.

Gender diversity in audit committee members’ specific effects has just come to light. Ittonen, Miettinen, and Vahamaa (2009) found that businesses with women on the audit committee had a lower risk of errors. Because they uncovered a correlation regarding gender diversity and reduced audit fees, their results have implications for external auditing. According to Huse and Solberg (2006), female directors are better equipped for committee meetings than male directors, leading to enhanced board conduct and efficacy.

Halpern (2000) found that gender-mixed groups perform better than single-gender groups. Burgess and Tharenou (2002) contend that female directors are expected to reduce corporate losses. Shawver, Bancroft, and Sennetti (2006) claim fewer female IPO accountants are participating in earnings management than their male counterparts. According to Grosvold, Brammer, and Rayton (2007), having more female directors on boards benefits both businesses, stockholders, and consumers. According to Stewart and Munro (2007), female audit committee members have greater communication skills and meeting preparations. According to Ittonen et al. (2009), gender diversity in audit committees can lead to decreased audit fees. Ethisphere Magazine ranks the world’s most ethical companies based on the presence of women on their boards of directors (Bernardi, Bosco & Columb, 2009). Reports say that companies with female CFOs use better discretionary accruals (Peni & Vahamaa, 2010).

4. Methodology

This study used a longitudinal (panel) research design, which is a good technique for evaluating variables in time order. All consumer goods companies listed on the Nigerian Stock Exchange make up the study’s population. Purposive sampling was used, and out of all the listed consumer goods firms as of June 30, 2020, the study selected twenty (20) firms from the Nigerian Stock Exchange with appropriate information and data available from 2009 to 2019. The researchers used assumption tests to determine the normality and heteroscedasticity of the data. Panel regression analysis was done with the aid of STATA 15 to examine the effect of audit committee gender diversity on financial reporting quality.

Model Specification

Based on the prior literature and theoretical framework, and as adopted from Dechow, Sloan, and Sweeney (1995).

$$FRQ_{it} = \beta 0 + \beta 1ACDV_{it} + \beta 2FMSZ_{it} + \beta 3LEV_{it} + \mu_{it} \quad (1)$$

Where:

FRQ = represents the quality of financial reporting measured by the inverse of absolute discretionary accounting accrual of the ith firm at time t

ACDV + represents audit committee diversity measured according to Varman (2010) as the Proportion of female members in the audit committee.

FMSZ = represents firm size, which is measured with the natural log of total assets

LEV = represents leverage, which is measured with the Ratio of total debt to shareholders’ equity.

5. Results and Discussions

Before moving on to regression analysis, diagnostic tests must be run to determine the data’s efficiency and accuracy. The heteroskedasticity test, Ramsey test, Multicollinearity test, and Normality test were used to test these hypotheses.

According to Gujarati and Porter (2009), heteroskedasticity can be avoided by using White Heteroscedasticity Consistent Variance, which can then be removed in robust regression analysis using Stata software.

Diagnostic Tests

Table 1. Test for Model Specification and Heteroscedasticity

	Chi2	*F*	*P* – Value
Breusch-Pagan Test	0.08	-	0.7729
Ramsey Test	-	7.16	0.3129
Ho (null)			Accept

Note: Ho (null): Constant variance (homoscedasticity)

The non-significance of the Breusch-Pagan Test with p-values of 0.7729, as shown in Table 1, indicates that there is no heteroscedasticity problem. Ramsey test non-significant, on the other hand, indicates that the model is not misrepresented.

Pearson Correlation and Multicollinearity

First, the Pearson correlation matrix is used to display the direction, context, and strength of the relationship among parameters. The correlation coefficients in behavioural sciences of 10, 30, and 50 are referred to as low, medium, and strong. Table 2 shows the strength of the relationship between variables using correlation coefficient (r) values. It's worth noting that audit committee diversity (ACDV) is positively related to financial reporting efficiency (FRQ), while leverage (LEV) and firm size (SIZE) are negatively related to FRQ. Table 2 also reveals that the variance inflation factor for the variables is less than ten. This shows that the multicollinearity assumption was not broken and that the independent variables were not profoundly associated.

Table 2. Summary of Pearson Correlation and Multicollinearity Test

	FRQ	ACDV	LEV	SIZE	VIF
FRQ	1.0000				
ACDV	0.0864	1.0000			1.04
LEV	-0.1276	-0.16110	1.0000		1.04
SIZE	-0.0752	0.01051	0.0595	1.0000	1.01
Mean VIF					**1.03**

**. Correlation is significant at the 0.01 level (2-tailed).*

Regression Analysis

Regression needs to be used to estimate the effect of audit committee diversity on financial reporting quality. Relationship orientation is determined by whether the dependent variable is negative or positive. If weight is considered, the most critical and best indicator of dependent variables are any variables with the highest standardised beta or weight. Table 3 indicates that audit committee diversity and financial reporting quality have a positive relationship. With a beta coefficient of 0.016858, a t-value of 0.38, and a p-value of 0.706, these can be represented. This means that increasing the proportion of women on the audit committee will help boost the standard of financial reporting in Nigerian consumer goods companies. This finding is consistent with Peni and Vahamaa's (2010) results, which indicate that companies with more gender diversity have higher-quality discretionary accruals. It also supports the claim made by Grosvold, Brammer, and Rayton (2007) that having more female directors on boards benefits all businesses, stockholders, and customers.

On the other hand, the control variables, leverage, and firm size, have a non-significant negative relationship with financial reporting efficiency. With a beta of -0.0073611 and a p-value of -1.44 for leverage and a beta of -0.0058055 and a p-value of -1.33 for firm scale, the outcome is demonstrated.

Table 3. Result of regression analysis (Dependent variable = FRQ)

Variables	Expected Sign	Coefficient	*t* - value	*P - value*
ACDV	+	.016858	0.38	0.706
LEV	+	-.0073611	-1.44	0.153
SIZE	+	-.0058055	-1.03	0.305
Number of Obs			117	
F (3, 105)			1.25	
R^2			0.0242	
Prob >F			0.2958	

Note: *FRQ = Financial Reporting Quality, LEV = Leverage (debt to equity ratio), SIZE= log of total asset.*
Source: Author's Computation (2021)

6. Conclusion

This study examines the impact of audit committee diversity on financial reporting quality among consumer goods companies listed on the Nigerian Stock Exchange. According to the findings, having a diverse board of directors, including women, improved the standard of financial reporting among Nigerian consumer goods companies. In general, it is assumed that improving audit committee attributes would improve financial reporting efficiency.

As a result, the study suggests that audit committee composition be controlled to ensure gender diversity by appointing more women to the committee, so that women's monitoring quality can be harnessed to improve financial reporting quality among publicly traded consumer goods companies.

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