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Corporate governance and IFRS 7 disclosure in Nigerian banks: A triple model assessment

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Abstract

This study employs three models, pooled OLS, fix effect with white cross-section standard error covariance and panel EGLS data with cross-section random effects to assess the impact of corporate governance and IFRS 7 financial instruments disclosure in the balance sheet of 14 listed banks on the Nigerian Stock Exchange during the period 2008-2012. The empirical evidence illustrates that the chi-square and F-statistics in both pooled OLS and fixed effect are significant hence, not appropriate for estimating the model. We employ the Hausman test and applied the redundant effect equation model to further test for the effect. It is found that the null hypothesis in the correlated random effect has an insignificant probability value of 1.0000 supporting the conclusion that IFRS 7 disclosure is related to board committee, board accounting and board financial expertise and the type of gender in boards of the investigated banks. Based on this analysis, the random effect model which report significant values on three of the independent variables (BC, 0.0014 and BE, 0.0000) at 1% and (GEN, 0.0056) at 10% level of significance is the preferred model. These findings are apropos to managers, accountants and regulatory authorities especially in banks of developing countries which have just embrace or are in the process of embracing IFRS7 in their financial instruments disclosure. We further recommend that existing regulations in Nigeria mandatorily compel listed banks in Nigeria to have at least 15% women as board members because of their positive contribution towards compliance with disclosure requirements.

Keywords: Corporate governance, IFRS7, disclosure, triple model

1. INTRODUCTION

The unfolding events in corporate businesses all over the world since the celebrated collapse of Enron Corporation and WorldCom, the indictment of their external auditors M/S Arthur Andersen as architects of the biggest audit failure in the universe and their subsequent winding up as one of the then worlds "Big 5" audit and accountancy body cast doubts in the accounting and auditing profession and the accounting numbers produce by it (Adekunle & Asaolu, 2013). These corporate collapses were not only peculiar to developed economies as Nigeria an emerging capital market without independent and supportive legal system also had its own fair share due to lack of adherence to good corporate governance (Adekunle & Asaolu, 2013; Mullineux, 2006). For example, in the early nineties proliferation of banks and finance houses brought about cases of financial and accounting scandals which led to the collapse and liquidation of twenty six (36) banks in 1997 (Amao & Amaeshi, 2008). Similarly, the recent post consolidation banking crises of 2009 saw 10 Nigerian banks declared insolvent with executive management team of eight out of the 10 banks sacked by the Central bank of Nigeria (CBN) for fraudulent manipulation and connivance with their external auditors (Sunusi, 2010). This lack of good governance resulted

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in loss of confidence by stakeholders in the banking sector leading to loss of value and employment to thousands of employees (Adekunle & Asaolu, 2013).

The foregoing scenarios coupled with globalised financial and economic contagion, led to the increased attention on corporate governance and financial reporting disclosures in order to reform the world economy (Al-Dhamari & Ismail, 2014; Adams and Mehran, 2003). Nigeria the eighth world's largest producer of oil has since taken steps to align its corporate governance mechanism with those of the international financial reporting standards (IFRSs) framework as a means of enhancing full disclosure and strengthening stakeholder confidence (Gonzalez, Nave & Toscano, 2014). Hence regulatory authorities like Nigerian Stock Exchange (NSE), Central Bank of Nigeria (CBN), the Nigeria Deposit Insurance Corporation (NDIC) and the National Insurance Corporation of Nigeria (NICON) have since directed all registered companies to adopt and disclose information in line with the IFRSs (Adegbite, 2012). Egedegbe (2009) argue that transparent information disclosure is the only way financial statements can enhance useful investment decision making to stakeholders. Adegbite (2012) is of the opinion that transparency is the root of good governance and corporate governance thrives only with full disclosure of relevant information in the annual reports of companies.

Recent corporate scandals in the capital market of Nigeria seem to suggest seems to suggest missing link because often time's managements are seen to dominate the affairs of their respective companies. This clearly goes against the provision in regulatory rules such as international financial reporting standards (IFRS) and corporate governance (CG) which vests the responsibilities of monitoring and accountability on the board of directors (Lorsch & MacIver, 2008). For instance, report from the World Bank (2006) indicates accounting disclosure by Nigerian banks as historically poor and the reliability of information rendered in the financial system questionable. According to Adekunle and Asaolu (2013) some banks were found to falsify returns to the CBN through misrepresentation of their financials in active connivance with external auditors. As a result, banks in Nigeria are now facing lots of challenges ranging from inadequate capital due to lack of foreign investments, strict regulatory framework from the apex bank, civil unrest and corruption (IMF, 2013). In trying to boost disclosure practices of banks, the CBN in addition to the code of corporate governance introduce other regulatory measures to forestall the re-occurrence of distress. These measures include regular on-site inspection, supervision, issuance of prudential guidelines and specifying the best direction for banks to follow through circulars (CBN, 2006).

Disclosure is a fundamental precondition for accountability and balance sheet figures in the annual reports of banks serve as a medium through which this banks communicate financial information on their activities to stakeholders , depositors, regulators and employees (Sunusi, 2010; Zainon et al., 2014). According to the CBN (2010) disclosure is nothing more than the requirement for financial institutions to mandatorily prepare their financial, operational and managerial information and render periodic returns with integrity to the regulatory authorities. This also means that returns rendered to the public should depict the true financial position and performance of banks. On the contrary, reports from various sources (World Bank, 2006; Wallace, 1988; Adeyemi, 2006; Nzekwe, 2009; Ofoegbu & Okoye, 2006; Umoren, 2008) all found the Nigerian corporate reporting practices to fall short of these expectations.

Previous studies (see Adeyemi, 2006; Nzekwe, 2009; Okike, 2007; Ofoegbu & Okoye, 2006; Umoren, 2008; Wallace, 1988; World Bank, 2006) principally concentrated on non-financial companies. Only very few (see Andres & Vallelado, 2008; Andres et al., 2012) studied the banking industry. In the same vein, to the best of this researcher's knowledge only one Adekunle and Asaolu (2013) studied the disclosure practices of Nigerian banks. The universal demand for good governance and pivotal role of the banking sector as catalysts for industrial expansion (Levine, 2003) and the need for IFRS disclosure practice uniformity make a study of this kind of paramount importance. The apex bank in Nigeria publically pronounces that weak corporate governance, inadequate disclosure and late rendition of returns are the bane in all known cases of bank distress and eventual failure (CBN, 2006). Given the disturbing scenario, this study set to assess the current disclosure practices of banks in Nigeria through the use of IFRS 7 disclosure requirements. The result of the study is expected to highlight the benefits of disclosure to regulators, bank management, present and prospective investors, employees and the public. This is practicable because there is no known warning signal being used by bank management or regulators to monitor the health of banks in Nigeria (Okezie, 2010). According to Doguwa (1996) bank examination is a double "edged sword" whose frequent application leads to valuable waste of financial resources through audit fess and oversight allowances to CBN staff and none application result in the possibility of failure and distress.

2. REVIEW OF RELATED LITERATURE

Shleifer and Vishny (1997) see corporate governance as the ways and manner in which shareholders not only get a return on their investment but are assured of their financial resources. According to agency theory, if managers are allowed to operate independently, they may make financing, investment, and payout decisions that are detrimental to shareholders (Jensen & Meckling, 1976). Corporate governance research documented several ways of mitigating conflict between managers and shareholders some of which include monitoring by an effective board of directors. According to Levine (2003) corporate governance in banks plays a special role due to the uniqueness of these organizations in terms of complexity and regulations. Similarly, Bhagat and Bolton (2008) recognised that good corporate governance tends to lead to better company performance. Therefore, it is expected that good corporate governance framework in banks enhances their financial intermediating role leading to beneficial relationship with their stakeholders (Wang, 2014).

Following the Basel 11 committee's recommendation on banking supervision (BCBS) the need to study, understand and improve the bank governance mechanism became more pressing (Andres & Vallelado, 2008). Of particular relevance in BCBS is the issue of the board of directors and executive management being the core message centres in enhancing good governance monitoring efficiency. Basel 11 believes that, corporate governance disclosure in annual reports is necessary to forestall information asymmetry, guarantee a sound financial system which is a source of pride to all stakeholders. This governance provides a sound financial system that is the bedrock of a country's growth and economic development (Andres & Vallelado, 2008). This is justified on the grounds that, the nature of their products and their specialised services makes their corporate governance highly specific with a unique framework (Belkhir, 2009). As highly leveraged firms, banks have triple role of deposit taking, safe custodianship and payment guarantee to customers which assist them in reducing their systemic risks (Andres & Vallelado, 2008; Levine, 2003).

Kantudu (2006) observe that disclosure is a commitment which is aimed at reducing a firm's cost of capital with credibility and not self-serving. The author argues that banks have incentives to withhold or manipulate information in certain situations (e.g., poor performance). Thus, to effectively reduce the cost of capital, banks have to commit to disclose information in a truthful and non-selective manner (Verrecchia, 2001). Disclosure whether voluntary or mandatory is the willingness of companies to disclose information regardless of its realization, provided that they are properly enforced (Hodgdon et al., 2009). Several studies have analysed the relationship between various corporate governance characteristics and information disclosure capacity of IAS/IFRS principles to provide useful information to investors for making sound business judgments (Andres and Vallelado, 2008; Belkhir, 2009; Kantudu 2006; Umoren, 2008). The present study is of particular significance because it focuses on IFRS 7 which deals with "risk factors" principally financial instruments disclosure in annual report (Hopwood, 2009).

2.1 IFRS 7 financial instruments risk disclosure

This framework was first issued in August 2005 and became effect on January 1, 2007 after modification following the need for a new principle regarding financial instrument evaluation. Previous studies have measured the level of compliance with mandatory disclosure requirements (Hodgdon et al. 2009; Street & Gray, 2001). The most common approach is the dichotomous or Cooke's method (Hodgdon et al. 2009). According to Cooke (1992) the method gives equal prominence to each item of disclosure thus, reducing subjectivity and bias (Owusu-Ansah & Yeoh, 2005). If the information is disclosed, it is scored "1" and if not, it is scored "0". This is commonly referred to as the dichotomous method. The disclosure index for each company is a relative measure, defined as the ratio of mandatory information actually provided by the bank in a particular year "t" to the maximum possible of score applicable for the bank. This method is defined using the formula:

$$CS_J = \frac{T\sum_{i=1}^{m} di}{M = \sum_{i=1}^{n} di}$$

Where:

CS_J = total compliance score for each company in which $0 \leq CSj \leq 1$
T = Total number of items disclosed (d_i)
J = name of the company under consideration
$M \leq n$; where m is the total number of applicable items the company j is to disclose

2.2 The Independent Variables

Prior studies use various corporate governance proxies to report disclosure (Hodgdon et al., 2009). This study uses corporate governance attributes found to influence disclosure practices of banks in developed economies to test whether they can equally influence disclosure of banks in developing capital markets (Andres & Vallelado, 2008; Andres et al., 2012).

2.2.1 Board Size

According to Monks and Minow (2011) in overseeing management, larger boards devote ample time and put in significant effort unlike small boards. Xie et al. (2003) opined that earnings misstatement is unlikely with larger boards. Similarly, Yu (2008) confirm the inability of small boards to detect earnings manipulation. Prior studies found significant positive relationships between board size and disclosure (Abdul Rahman & Ali, 2006; Andres & Vallelado, 2008). On the contrary, Xie et al. (2003) found a negative association. Other studies also found board size to be of informational advantage to institutional investors (Gompers & Metric, 2001; Dahlquist & Robertson, 2001). Based on the above discussion, the following hypothesis is proposed.

H1: There is significant positive relationship between board size and IFRS 7 disclosure.

2.2.2 Board Committees

The increase in board committees may be necessitated more by the idea to have women financial experts' (Arute, Bernardi & Bosco, 2015). Vafeas (1999) observed that boards make use of standing committees in discharging its responsibilities. The presence of specialized sub-committees such as audit, risk management and governance and remuneration indicates greater diligence on the part of board directors. The Nigerian code of corporate governance vests the power of creating committees in the hands of the board of directors but three committees: audit committee, risk management committee and governance and remuneration committee are expressly mentioned as of paramount importance (SEC, 2011). Based on the above discussion, it is hypothesized that:

H2: There is significant positive relationship between audit committee and IFRS 7 disclosure.

2.2.3 Board Meetings

Meeting frequency is a positive indicator of the effectiveness of a board. Infrequent meeting is seen by users of financials as lack of devotion by members to oversee the reporting process. Xie et al. (2003) show that frequent meeting is associated with reduced levels of earning management. Bryan et al. (2004) argue that regular meetings improve transparency and improve earnings quality. Zhang et al. (2007) use number of meetings, to measure financial reporting quality. Ruzaidah and Takiah (2004) find that good financial reporting company directors meet more frequently. In contrast, Vafeas (2005) found a negative relationship. Bedard et al. (2004) and Lin et al. (2006) find no association. Based on this discussion we hypothesized that:

H3: There is significant positive relationship between board meeting frequency and IFRS 7 disclosure.

2.2.4 Board Expertise

Dependency theory argues that boards of directors are an essential advice source to CEOs (Daily et al., 2003). Xie et al. (2003) suggest that corporate financial expertise is critical in disclosing earnings manipulation. Bedard et al. (2004) observed that the presence of financial expert in board committees negatively relate with destructive earnings management. Karamanou and Vafeas (2005) find positive market reaction on the appointment of experts in earnings forecast disclosure. Based on the discussion, we propose the following hypothesis:

H4: There is significant positive relationship between board expertise and IFRS 7 disclosure

2.2.5 Audit Quality

The big 4 audit firm whose report is to shareholders significantly influences IFRS 7 disclosure in annuals (Ahmed & Nicholls, 1994; OECD, 2012). Big audit firms have more skills and expertise to detect irregularities and ensure adequate information disclosure smaller firms. Big firms invest more to maintain their reputation as providers of quality audit. Ahmed and Nicholls (1994) find audit quality to have significant influence on disclosure. In contrast, Osma (2008) did not find significant impact on disclosure. Based on this discussion, we hypothesized that:

H5: There is significant positive relationship between audit quality and IFRS 7 disclosure.

2.2.6 Board Gender

Banks in Nigeria follow the trend of corporate governance regulation of developed economies on gender equality on boards. However, the consequences are still not clear (Abdullah, Ku Ismail & Nachum, 2015). Studies argue that women directors are effective in connecting firms with resources, attract and retain female employees (Hillman et al., 2007). Thiruvadi and Huang (2011) find that the appointment of female members in U.S. firms to have significant market returns compared to males. Other studies maintain that females in emerging market boards negatively relates to earnings management (Abdullah & Ku Ismail, 2013). In contrast, Lee and James (2007) found negative reaction on the appointment of women on board. In Nigeria the SEC code of corporate governance is not specific on the appointment of women on board. Based on this arguments, we propose the following hypothesis:

H6: There is significant positive relationship between women on board and IFRS 7 disclosure

3. EMPIRICAL METHOD

This study is limited to the 19 banks currently quoted on the Nigerian Stock Exchange out of which 14 actively trading during the study period of five years (2008-2012) are drawn. Data collected is regressed to observe disclosure trends through the unweighted scoring approach (Barako, 2007). This method is preferred due to its assumption that each disclosure item is equally important thus avoiding subjectivity and provides neutral assessment of items (Owusu-Ansah & Yeoh, 2005).

PricewaterhouseCoopers (PwC) suggest a total of 12 IFRS 7 disclosure required items in a typical balance sheet (PwC, 2013). Nigeria adopted IFRS on January 1, 2012 but banks voluntarily comply with IFRS 7 requirements before mandatory adoption of the standards because of the inherent benefits (Sunusi, 2010). These disclosure items include, income and expenses, interest rate risks, assets and liability (group), investment and securities, off balance sheet items, asset & liability (maturity) and asset and liability (concentration). Others are, loan and advances, risks (general), collateral securities, other activities and related party transactions.

3.1 Model specification and measurement of the variables

The study’s model are based on the proxies specified for the dependent variable i.e. IFRS 7 disclosure and the independent variables board size (BS), board committees (BC) board expertise (BE), board meetings (BM) and audit firm size (AFS) while the control variable is board gender (GEN).

$$IFRS\ 7_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 BE_{it} + \beta_3 BC_{it} + \beta_4 BM_{it} + \beta_5 AFS_{it} + \beta_6 GEN_{it} + \varepsilon_{it}$$

Variable	Measurement
IFRS 7 Disclosure	
Board Size	Total number of directors on board
Board Expertise	Number of directors with accounting/financial management
Board Committees	Number of committees of the board
Board Meetings	Number of board meetings per annum
Audit Firm Size	Dummy “1” if audited by a Big 4 (Delloite, PwC, KPMG, Ernst & Young) or “0” otherwise
Board Gender	Number of women on board

4. EMPIRICAL ANALYSIS

Having looked at the empirical method, model specification and variable measurements above, this paper proceed with the regression analysis below.

4.1 Regression analysis

This study runs three different models {pooled OLS (OLS), fixed effect (FE) and random effect (RE)} to compare and select the model that best explains the relationship between the IVs and DV. The study apply redundant fixed effects test to tests the null hypothesis of no time-specific effect of estimates. Abu et al. (2013) argue that if the test shows the presence of effects, it is highly probable that the OLS estimator will not be a good predictor of the cross section over the time period. Similarly, we apply the Hausman test to test the hypothesis that the RE estimates are consistent and preferable to FE estimates. The rule is that, if the chi-square or F-Statistic value is significant, this means that the FE model is appropriate and can be reported otherwise, the RE model should be explored.

Table 4.1 Panel Ordinary Least Squares

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.521282	0.068133	7.650948	0.0000
BS	-0.007121	0.002265	-3.144263	0.0025
BC	-0.011697	0.003805	-3.074063	0.0031
BM	0.002275	0.001792	1.269635	0.2089
BE	0.026449	0.004464	5.925080	0.0000
AFS	0.074329	0.028639	2.595340	0.0117
GEN	0.030752	0.008398	3.661656	0.0005
R-squared	0.547919			
Adjusted R-squared	0.504863			
Durbin-Watson stat	0.901725			
Prob(F-statistic)	0.000000			

Table 4.1 shows the results of the OLS estimations. This model is not consistent as it does not consider the constant and unobservable heterogeneity of banks in the sample and endogeneity of our independent variables. The results show a nonlinear relation between board size and disclosure and between board committee and disclosure inconsistent with our hypothesis. Thus, bank disclosure decreases as the number of directors and board committees increases. This result goes for small boards as oppose to larger boards (Yermack, 1996).

Table 4.2: Panel Least Squares (FE Model)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.551683	0.077435	7.124471	0.0000
BS	-0.000190	0.003466	-0.054695	0.9566
BC	-0.009007	0.005027	-1.791813	0.0792
BM	-0.002380	0.002446	-0.972978	0.3352
BE	0.026946	0.006404	4.207789	0.0001
AFS	-0.053902	0.031248	-1.724970	0.0907
GEN	0.029036	0.009928	2.924592	0.0052
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.849907			
Adjusted R-squared	0.792872			
Durbin-Watson stat	1.982374			
Prob (F-statistic)	0.000000			
Redundant Fixed Effects Tests				
Equation: Untitled				
Test cross-section fixed effects				
Effects Test		Statistic	d.f.	Prob.
Cross-section F		7.738489	(13,50)	0.0000
Cross-section Chi-square		77.182466	13	0.0000

The OLS results in previous model may be due to non-consideration of fixed effect and presence of correlation among explanatory variables. Table 4.2 reports panel least squares model of the independent variables. In this table, four IVs are found to be statistically significant at 10% level. However, the Prob (F-statistics) is highly significant with a value of 0.0000. Applying the redundant effect assumption, it means that this model is not appropriate. Hence the study goes for the random effect model.

Table 4.3 Panel EGLS Random effects

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.539922	0.081881	6.594021	0.0000
BS	-0.001925	0.002023	-0.951415	0.3450
BC	-0.011223	0.003360	-3.340337	0.0014
BM	-0.001170	0.002279	-0.513621	0.6093
BE	0.026948	0.005527	4.876164	0.0000
AFS	-0.010163	0.058647	-0.173290	0.8630
GEN	0.029226	0.010177	2.871631	0.0056
R-squared	0.629679			
Adjusted R-squared	0.594410			
Durbin-Watson	1.605519			
Prob(F-statistic)	0.000000			

Table 4.3 show the random effect test of independent variables. In this model three independent variables are found to be statistically significant at 1% level. Similarly, the Prob (F-statistics is significant with a value of 0.00000. Applying the redundant effect assumption gives almost similar result with those of fixed effect model. We further subject this result an additional test known as the Hausman test to choose between the results in FE and RE.

Table 4.4: Correlated Random Effects - Hausman Test

Test Summary	**Chi-Sq.**	**Chi-Sq. d.f.**	**Prob.**
Cross-section random	0.000000	6	1.0000

Table 4.4 reports the result of the correlated random effect Hausman test. The result as shown gives a p-value or chi-square of 1.0000 indicating that the RE is an appropriate model because it shows no presence of effects in the estimate. This result confirms the superiority of the random effect model over and above the OLS and fixed effect models.

5. EMPIRICAL FINDINGS

The result of this study shows no significant relations between board size and disclosure reflecting higher accounting quality of IFRS7 financial instruments disclosure for banks who comply with the disclosure requirements (Barth et al., 2008).. We argue that the relationship between the board size and disclosure depends on the interactive benefit of director's skills, expertise and cost arising out of management decision as the number of director's changes. As the coefficient of board size is negative and the probability is significantly positive, it appears that disclosure takes on a V shape as board size becomes so large (Street & Grey, 2001). The same argument is adduced for board committees (Arute, Bernardi & Bosco, 2015).

The findings of the study indicate that, high level disclosures lead to more transparent financial statement that is useful to investors and other users (Pownall & Schipper, 1999). Our finding indicate that IFRS7 financial instruments disclosure and the presence of women on board in banks of developing economies could constrain some potentially harmful managerial actions that are shrouded in secrecy with regard to accounting policies and practices being followed by management (Hope, 2003). Thus, banks wishing to signal transparency and accountability have the chance to communicate their disclosure practices under IFRS7 financial instruments disclosure and the presence of more women on board (Hope, 2003).

Our regression analysis suggest that female directors create economic value of information requirements to shareholders (Abdullah et al., 2015).The positive results is a signal of the benefits which accrued to females on boards of banks. Yet more than half of the banks studied did not have any women on board, and only one-third had a woman (Abdullah et al., 2015). The presence of women on board may also contribute to the level of significance obtained on the expertise of board members consistent with findings in other studies (Abdullah et al., 2015). Audit quality proxy by big 4 audit firms has a significant positive relationship with disclosure as expected. This may be due to their positive role as effective monitors with vast experience in international auditing and the need to protect their name, reputation and to attract more clientele (Ahmed & Nicholls, 1994).

6. CONCLUSIONS

This study empirically tests the three models of data analysis to determine the relationships between the dependent and the independent variables. The result shed some light as regard the implication of using only a single model to make generalizations. Specifically, we find an inverse relationship between some of the corporate governance variables and the disclosure pattern of banks in Nigeria with regard to information asymmetry reduction. We found that only the Houseman fixed effect specification test reports an insignificant probability value confirming the relationship between board committee, board accounting and financial expertise and board gender with IFRS 7 disclosure by Nigerian listed banks. Based on our findings we conclude that, corporate governance and disclosure regulation is the answer in today's globalized complex banking industry. We further conclude based on existing evidence that, the challenges in governance regulation of banks are peculiar to that industry which may not be relevant in the corporate governance of other companies or institutions. For instance, some corporate governance mechanisms are weak which resulted in information asymmetry to be more severe. This may impede the monitoring of managers which may lead to the advent of new conflicts of interest between the regulator and stakeholders. Bank board play significant role in monitoring managers or advising them on design and implementation of strategies. These also confirm our hypothesis that certain characteristics of corporate governance such as board accounting/financial expertise and board gender reflect the motivation and monitoring abilities of boards in their supervisory and advisory duties. We therefore recommend that regulatory authorities urgently look into the possibility of regulatory amendment in line with developed economies on gender diversity to provide for at least 15% of mandatory women in corporate boards in view of their significant positive contributions.

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