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Effect of Board Heterogeneity on Audit Quality of Banks in Nigeria

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ABSTRACT

This study examined the effect of board heterogeneity on audit quality of banks in Nigeria. The need to ensure high audit quality in Nigeria birthed this study. The study employed the ex post facto research design using thirteen deposit money banks as the population of study. The data for the study were extracted from the 2014 to 2019 annual reports of the Banks. The ordinary least squares (OLS) regression was used to analyze the data. Audit Quality was measured as Audit fees paid for statutory Audit while board heterogeneity was assigned proxy of gender diversity, ethnic diversity and educational diversity. The results of data analysis showed that Gender diversity and ethnicity diversity of board has significant effect on the audit quality of banks in Nigeria while the effect of diversity in board of directors' educational/professional qualifications on audit quality of banks in Nigeria is not statistically significant. The study recommended amongst others, the need for legislation that pegs the minimum qualification of members of board of directors in terms of financial and professional expertise as this will further improve effectiveness of the Board in their oversight responsibilities.

Keywords: *Board Heterogeneity; Audit Quality; Nigeria*

1. Introduction

The demand for credible and reliable financial information by shareholders of companies has been on the increase all over the world. The multiple cases of institutional failure across the globe in recent times have brought the attention of stakeholders to the makeup of corporate governance. The consequences of ineffective governance systems have severally led to corporate failures which not only affect the shareholders but also, the employees, suppliers, consumers and nations as a whole. Wahid, (2012) highlighted the unfortunate consequence that resulted from the corporate scandals that stormed the United States which led to the collapse of Enron, WorldCom, Dot-Com Bubble, Tyco and Xerox together with the subsequent liquidation of HIH insurance in Australia in the year 2001and Parmalatin Italy which is known as the biggest bankruptcy in Europe with estimated loss totaling $20 billion and Oceanic Bank in Nigeria in 2009, among others.

The collapse of these multinational companies which in most cases is traceable to failed external audit expectations has raised concern over the role played by the structure of the Board of Directors of the companies and this has brought about changes in corporate governance mechanisms one of which is board heterogeneity (Olaoti, 2016). Many practitioners have clamored for this board heterogeneity with the argument that it can mitigate the effect of homogeneous board such as groupthink which is a phenomenon in which members' effort to achieve consensus override their ability to realistically appraise alternative courses of actions (Rhode & Packel, 2010). To this end, considering the pivotal role banks play in mediating between the surplus and deficit units within the economy to ensure economic growth, regulatory agencies have taken appropriate steps to develop and enforce policies that will enhance board heterogeneity aimed at protecting shareholders' interest.

Olaoti, (2016) argued that the structure of the Board of Directors plays a significant role in the quality of Auditors they engage and consequently the quality of the audit report. Rhode and Packel, (2010) similarly stated that many practitioners have clamored for board heterogeneity given that it has the potential to mitigate the effect of homogeneous board such as groupthink which eliminates alternative courses of actions. While the boards are the main tool of internal governance mechanism, their efficacy may vary depending on their diversities. For instance, Enron's board as pointed out by Masulis, Wang and Xie (2010) included two foreign independent directors in its audit committee. This aspect of diversity raises questions about the effectiveness of foreign directors' monitoring of a firm's operations and financial reporting. Asogwa, Ofoegbu, Nnam and Chukwunwike (2019) on the other hand favors board diversity in terms of having women directors in the board stating that companies that have heterogeneous boards perform better than boards without same.

The need to ensure high audit quality cannot be overemphasized and every possible means of achieving it should be adequately explored. Several studies have considered some of the determinant of audit quality such as audit committee characteristics (Moses, Offurum & Egbe 2016; Salawu, Okpanachi, Yahaya & Dikki, 2017) and IFRS adoption (Ahmed, Malek, & Che-Ahmad 2018). This makes the present study imperative and necessary at the moment as it seeks to fill the gap by investigating critically in what way board heterogeneity affects the quality of audit in Nigerian Banks.

Objectives of the Study

The main objective of this study is to determine the effect of board heterogeneity on audit quality of banks in Nigeria. While the specific objectives include the following;

1. To determine the effect of gender diversity of board on the audit quality of banks in Nigeria.
2. To ascertain how diversity in board of directors' ethnicity affects the audit quality of banks in Nigeria.
3. To examine the effect of diversity in board of directors' educational/professional qualifications on audit quality of banks in Nigeria.

Research Hypotheses

1. H_o: Gender diversity of board has no significant effect on the audit quality of banks in Nigeria.
2. H_o: Diversity in board of directors' ethnicity does not significantly affect the audit quality of banks in Nigeria.

3. H_0: The effect of diversity in board of directors' educational/professional qualifications on audit quality of banks in Nigeria is not statistically significant.

2. Literature Review

Board Heterogeneity

Desender (2009) defines the board as the internal governing mechanism that shapes firm governance, given their direct access to the two other axes in the corporate governance triangle: managers and shareholders (owners), while (Fama & Jensen, 1983) defined the board of a firm as the composition of separate individuals who are controlled by different bias and varying preconceived notions and are affected by social constraint and power relation. In a modern corporate firm, a corporate board is established to mediate between the owners and the managers of a corporate firm. The board is also responsible for the protection of shareholders from management manipulation and favoring the interest of shareholders.

Board members are either executive or non-executive directors. Executive directors are those that are also involved in activities of the firm. They are part of management while non-executive directors do not work in the firm. Fama (1980) argues that the composition of board structure is an important mechanism because the presence of non-executive directors represents a means of monitoring the actions of the executive directors and of ensuring that the executive directors are pursuing policies consistent with shareholders' interests.

Hillman and Dalziel (2003) describe the two main functions of the Board of Directors as monitoring and providing resources. The theoretical underpinning of the board's monitoring function is derived from agency theory, which describes the potential for conflicts of interest that arise from the separation of ownership and control in organizations. The demand for monitoring is expected to be influenced by the distribution of power amongst the stakeholders and their individual incentives. This demand also births the needs for diversity or heterogeneity of board members.

Management theories, a long time ago proposed that board diversity plays a significant role in an organization's success. Van der Walt and Ingley (2003) stated that board diversity refers to the variety in the composition of the board of directors. Hambrick & Mason (1984) observed that management heterogeneity has a greater tendency to bring about quality decision making. A diverse board is better in securing resources from the environment than less diverse boards, because diverse boards have better access to information and networks.

The term board diversity cuts across so many variables such as age, race, gender, culture, religion, the level of education and background experience. Darmadi (2011) selected three elements of diversity which are gender, nationality, and age. Omoye, Alade and Eriki (2013) groups diversity into two namely: demographic or cognitive diversities. Demographic diversity relates to the observable or readily detectable attributes of directors (Milliken & Martin 1996). These include gender, age, race, and ethnicity. Cognitive diversity relates to the unobservable or less visible attributes of directors (Milliken & Martin 1996) and includes knowledge, education, values, perception, affection, experience, value and personality characteristics. Ilogho (2017 opined that board diversity includes concepts such as independence, ethnicity, experience, education, gender, and tenure.

Adams and Ferreira (2009) highlighted the potential benefits of board diversity to a firm as: creativity, variety of views and perspectives; more resource accessibility and more connections; Public relations, legitimacy and investor relations and finally career incentives through mentoring and signaling. A diverse board also demonstrates a greater equality of representation of the relevant stakeholder constituencies, including the society (Van der Walt & Ingley 2003). Rhode and Packel (2010) also gathered the arguments in favor of diversity as follows; (1) It promotes a better understanding of the market place (2) It increases creativity and innovation (3) It produces more effective problem solving (4) It enhances the effectiveness of corporate leadership (5) It promotes more effective global relationships. (6) It enhances board decision-making and monitoring functions. The importance of diversity in board for proper governance is also backed up by the Nigerian code of corporate governance, which stipulates that the board should be composed in such a way as to ensure diversity of experience without compromising compatibility, integrity, availability, and independence (Obigbemi, Omolehinwa, Mukoro, Ben-Caleb & Olusanmi, 2016).

It is worthy of note that despite these benefits of board diversity, demerits also exist. Imade (2019) argued that even though a diverse board is more likely to have more access to information, experience communication and coordination problems due to the failure to accept other members' expertise in the problem-solving process.

Gender diversity of board

Many countries strive for more women at the top of firms in their country to increase board diversity and increase firm performance (Lamars, 2016). The Nigerian corporate governance code for private sector provided for a requirement to establish and disclose a summary on gender diversity for the board to assess annually, which makes a lot of sense as researches have push in the need for gender-based diversity.

Women are perceived to be more conscientious in performing their tasks, more risk-averse both in investing their own assets and in investing on behalf of others, and more other-oriented (Remus, 2015). These perceptions are particularly relevant to long term stakeholders, who are generally more risk-averse, especially in turbulent economic times, or as the company is approaching insolvency. Ertac and Gurdal (2012) found that women are more risk-averse than men, in both when deciding individually and when they are part of a group while Adams and Ferreira (2009) also find that gender-diverse boards put more effort in the monitoring function. They argue that a higher presence of women in boards leads to better supervision and accountability of the CEO. This is partly due to the fact that women attend more meetings, they improve the attendance behavior of male directors and are more likely to be assigned to monitoring-related committees than men. Moreover, they take their non-executive director roles more seriously, preparing more conscientiously for meetings. A woman may bring not only different perspectives, valuable skill and knowledge to share, but also share different values, norms and understanding which may consequently increase the quality of strategic decision making and promote better governance in firms (Zainal, Zulkifli& Saleh, 2013). In contrast, Adams &Ferreria (2009) found that gender diversity among board members could result in poor firm performance due to over-monitoring which increases the agency cost of monitoring, restricts too much managers' discretion and decreases shareholder value.

Board of directors' ethnicity

Ethnicity is based on claims or myths of common history, ancestry, language, race, religion, culture and territory (Edewo, Aluko and Folarin, 2014). Ilogho (2017) stated that in a nation like Nigeria, ethnic diversity is of key importance. Smith, Smith and Verner (2005) opined that ethnically diverse board would usually experience more differences which could eventually improve the quality of decision making, of which may never offset negative effects of a slower decision-making process should the firm's market place demand quick responses. Anderson, Reeb, Upadhyay and Zhao (2011) however contradicts this stating that culturally diverse groups have slower, more difficult and more confused communication which is frequently a source of misunderstanding. Ethical diversity could also reduce the trust level among group members (Bjornskov, 2008). and Marimuthu (2011) studied the effect of ethnical diversity on performance. Ilogho (2017) used the names of board members to determine their ethnic background. The ethnic groups were narrowed to Yoruba, Ibo and Hausa.

Board of directors' educational/professional qualifications

This relates to the experience, skill and judgment of individual executive and non-executive directors can contribute to this resource and thus strengthen board development, operations and accountability. Directors with diverse educational/professional backgrounds can contribute to creative strategy formulation, because they can offer a variety of experiences and better quality of judgement (Rindova, 1999) and are more likely to engage in constructive dissent or challenge assumptions associated with strategic proposals. Differences among these interests, especially those based on occupational and professional affiliations, may lead to varying and differing views on proposed strategic changes. Indeed, the greater the diversity of board interests, the greater the potential for conflict (Mueller, Ingley& Cocks, 2010). Setiyono and Tarazi (2014) opined that diversity in professional background and education positively impacts performance.

Audit Quality

Financial statement audit is a monitoring mechanism that helps reduce information asymmetry and protect the interests of the various stakeholders by providing reasonable assurance that the management's financial statements are free from material misstatements. Farouk and Hassan (2014) stated that external audits performed in accordance with high quality auditing standards can promote the implementation of accounting standards by reporting entities and help ensure that their financial statements are reliable, transparent and useful.

DeAngelo (1981) stated that audit quality is the market assessed joint probability that a given auditor will both (1) discover a breach in the client's accounting system and (2) report the breach. She argued that longer-term audit firms have higher audit quality due to a greater level of independence because any given client is immaterial to a large firm audit practice. Audits add credibility to financial information by providing independent verification of management-provided financial reports, and helping to reduce investors' information risk. Audit quality is determined by factors such as the quality of accounting standards, accounting education, auditor expertise, audit committees, corporate governance, auditor discipline, liability and nature of GAAP. Audit quality measures include proxies such as: Abnormal working capital accrual or AWCA; Discretionary accruals; Accruals; and Audit fees and hours (Darmadi, 2011). This study will make use of discretionary accruals as a proxy for audit quality.

Discretionary Accruals

Bartov, Gul and Tsui (2000) opined that discretionary accruals are sometimes used by management to shift reported income among fiscal periods. Discretionary accruals are those adjustments that capture distortions induced by the accounting system or that result from earnings management. Subramanyam (1996) affirms that discretionary accruals do not occur because of inefficiency of the market, but instead due to the fact that managers use accruals to smooth revenues and improve the persistence and prediction of earnings. The modified Jones' model and the relationship between accruals and cash flows are used to calculate discretionary accruals.

Board Diversity and Audit Quality

Ahern and Dittmer (2012) mentioned that monitoring systems (intensified by the diversity of the board) can restrict the managers' opportunistic behaviors. An external audit system is considered an essential monitoring system that may also assist in reducing a management's ability to manage earnings. Hence, external auditors play a crucial role in monitoring companies to assure financial reports are free from material error and misstatement. A higher quality of audit has a greater ability to constrain earnings management, hence reduce the uncertainty in the reported earnings (Ching, Teh, San & Hoe, 2015). Based on resource dependency theory, auditor selection depends on the various attitudes of board of directors. The presence of different interests, professional opinions, gender, ethnicity and other forms of diversity in the board could be influential in choice of auditors, audit processes and in the long run, audit quality.

Female directors improve the efficiency of board monitoring functions. Therefore, they have strong tendency to hire high quality auditor to protect their reputation (Mustafa, Rashidi, Lateef and Ado, 2019). Directors with accounting and financial qualification possess a strong tendency to engage with Big4 auditor to properly enhance board monitoring function (Hillman& Dalziel, 2003). This is supported by Agrawal and Sahiba (2005) that level of education of board of directors' influence positively to improve clients' ability to demand high audit quality.

In Nigeria, regulatory agencies have responded by compelling companies to comply with corporate governance codes to ensure sound and efficient financial reporting especially for public companies (companies listed on the Nigerian Stock Exchange). Despite the interventions of the regulatory authorities, the challenges of ensuring credibility in financial reporting and auditing are still prevalent.

METHODOLOGY

This study employed the Ex-post facto research design. The population comprises all the 13 Deposit Money Banks listed on the Nigerian Stock Exchange as at December 31st, 2019. The study used secondary data collected from the published financial statements of the banks covering the period of six years (2014-2019). In analyzing the collected data, multiple regression analysis was used.

Variables Measurement

(a) Audit Quality (Dependent Variable)

Audit Quality is the dependent variable and is measured as Audit fees paid for statutory Audit.

(b) Board Gender diversity

The board gender variable is measured as the ratio of women directors to the total board size. This is also in line with the measurement of Erhardt, Werbel and Shrader (2003), where they measured board gender as ratio of female directors to total board size.

(c) Ethnic Diversity

There are three major tribes in Nigeria, the Hausa-Fulani, Igbo and Yoruba. This makes the total number of groups to be 3, meaning each director can fall only in one group at a time. Therefore, for any group to be present on the board it assumes a weight of 1, which means, where all three groups are present on the board, they assume a weight of three, giving each group a chance of equal measurement and fair representation. Therefore, ethnicity is measured as the ratio of total number of ethnic group present to the weight of three (3). Our expectation based on these variables is that all are expected to be positively significant.

(d) Educational and professional qualification

For Educational and professional qualification, the number of educational and professional qualifications for each of the directors is assigned a weight of 1 for each qualification.

Model Specification

The model is specified below as follows;

AQ = f (GDV, DET, EPQ) …………………………… (1)

The ordinary least squares (OLS) regression was used to estimate the impact and the equation is given below:

$AQ_{it} = \beta_0 + \beta_1 GDV + \beta_2 DET + \beta_3 EPQ$ …………………………… (2)

Where:

$\beta_0, \beta_1, \beta_2 \ldots\ldots\ldots \beta_3$ are parameter coefficients estimated with our expectation.

The a priori expectation is $\beta_1, \beta_2, \beta_3, > 0$

β_0= Constant

AQ = Audit Quality

GDV = Gender Diversity

DET = Diversity of ethnicity

EPQ = Educational and professional qualification

ϵ_{it} = error term

it = Combination of firms and time.

DATA ANALYSIS

The data were analyzed using descriptive statistics. Results are presented below:

Table 1: Descriptive Statistics

	AUDIT_FEE	GENDER_DIVERSITY	ETHNIC_DIVERSITY	EDUCATIONAL_DIVERSITY
Mean	8.549291	0.265121	2.384615	5.346154
Median	8.574950	0.285700	3.000000	5.000000
Maximum	9.579800	0.571400	3.000000	7.000000
Minimum	7.875100	0.000000	1.000000	3.000000
Std. Dev.	0.392535	0.091715	0.742596	1.054698
Skewness	0.412231	-0.657828	-0.747932	-0.057749
Kurtosis	2.974908	5.459088	2.191399	1.950671
Jarque-Bera	2.211191	25.27872	9.397199	3.621902
Probability	0.331014	0.000003	0.009108	0.163499
Sum	666.8447	20.67940	186.0000	417.0000
Sum Sq. Dev.	11.86444	0.647693	42.46154	85.65385
Observations	78	78	78	78

Source: E-Views 9.0

The descriptive statistics for the variables used in the model contained in table 1 above provides the mean, maximum, minimum, standard deviation and Jarque-Bera Values. Jacque-Bera Statistics showed that the data for audit quality and educational diversity were not normally distributed with p values greater than 0.05. This does not significantly affect our analyses as the assumption of normal distribution does not need to be satisfied for regression. The mean value for liquidity is 8.55. Average for gender diversity stood at 26.51%. This implies that on the average, banks have about 26% of female directors in their board composition. The highest margin was 57.14%. The mean value for ethnic diversification is 2.385 with maximum value of 3.00 and minimum value of 1.00. On educational diversity, the mean value showed 5.346 while the maximum value and minimum value show 7.00 and 5.00 respectively. How much these data differ from each other is depicted by the standard deviation (the highest value of 1.055 for educational diversification).

Hypotheses Testing

Table 2: Regression Estimate of study Variables

Dependent Variable: AUDIT_FEE
Method: Panel Least Squares
Date: 04/05/21 Time: 12:58
Sample: 2014 2019
Periods included: 6
Cross-sections included: 13
Total panel (balanced) observations: 78

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	7.902643	0.321881	24.55143	0.0000
GENDER_DIVERSITY	0.080203	0.487409	1.921501	0.0436
ETHNIC_DIVERSITY	0.180015	0.060186	2.990962	0.0038
EDUCATIONAL_DIVERSITY	0.036684	0.040694	0.901457	0.3703

R-squared	0.619624	Mean dependent var	8.549291
Adjusted R-squared	0.583933	S.D. dependent var	0.392535
S.E. of regression	0.375701	Akaike info criterion	5.929872
Sum squared resid	10.44517	Schwarz criterion	5.050729
Log likelihood	-32.26502	Hannan-Quinn criter.	5.978254
F-statistic	3.351650	Durbin-Watson stat	1.336303
Prob(F-statistic)	0.023431		

Source: E-Views 9

The result from the Panel least square regression table above is used to test the hypotheses of this study. The coefficients in this model show that a positive relationship exists between the dependent and independent variables. This shows that a unit increase in each of the independent variables will cause a sum of about 8%, 16% and 4% increase in the audit quality. The R-squared statistic is 0.6196 while the Adjusted R Square statistic is 0.5839. The Adjusted R Square statistic defines the explanatory power of the model. The model thus has an explanatory power of 58.39%. Hence, the independent variables are able to explain the variations in the dependent variable to the degree of about 58%. The F–Statistic indicates the significance of the model at 5% level of significance. The F statistic = 3.3516 has a p value of 0.024<0.05. From the results, the model is significant and thus of good fit.

Hypothesis One

H_o: Gender diversity of board has no significant effect on the audit quality of banks in Nigeria.

Decision: When the p value of the t-statistic is less than 0.05 we reject null hypothesis and accept the alternate hypothesis. However, when the p value of the t-statistic is greater than 0.05, we accept null hypothesis and reject the alternate hypothesis.

From the result in table 2, we can see that the p value for gender diversity is 0.0436 and a t-Statistics of 1.9215. This implies that the null Hypothesis is rejected while the alternate hypothesis is accepted. It is therefore accepted that gender diversity of board has significant effect on the audit quality of banks in Nigeria. This is in line with the findings of Olaoti, (2016) and Akpotor, Osemwengie and Imuentinyan (2019) who found that gender and ethnicity of board directors had positive and significant impact on banks financial performance but not consistent with the results of Kasyoki, (2016) which showed that gender diversity led to a significant decline in firm financial performance.

Hypothesis Two

H_o: Diversity in board of directors' ethnicity does not significantly affect the audit quality of banks in Nigeria.

Decision: When the p value of the t-statistic is less than 0.05 we reject null hypothesis and accept the alternate hypothesis. However, when the p value of the t-statistic is greater than 0.05, we accept null hypothesis and reject the alternate hypothesis.

From the result in table 2, we can see that the p value for gender diversity is 0.0038 and a t-Statistics of 2.991. This implies that the null Hypothesis is rejected while the alternate hypothesis is accepted. It is therefore accepted that diversity in board of directors' ethnicity significantly affects the audit quality of banks in Nigeria. These findings also agree with that of Olaoti, (2016) and Akpotor, Osemwengie and Imuentinyan (2019) who found that gender and ethnicity of board directors had positive and significant impact on banks financial performance.

Hypothesis Three

Ho: The effect of diversity in board of directors' educational/professional qualifications on audit quality of quoted banks in Nigeria is not statistically significant.

Decision: When the p value of the t-statistic is less than 0.05 we reject null hypothesis and accept the alternate hypothesis. However, when the p value of the t-statistic is greater than 0.05, we accept null hypothesis and reject the alternate hypothesis.

From the result in table 2, we can see that the p value for educational diversity is 0.3703 and a t-Statistics of 0.901. This implies that the alternate Hypothesis is rejected while the null hypothesis is accepted. It is therefore accepted that the effect of diversity in board of directors' educational/professional qualifications on audit quality of banks in Nigeria is not statistically significant. This finding is similar to that of Ayila, (2015) whose results showed that professional qualification is significantly related to the levels of compliance with accounting standards disclosure requirements.

CONCLUSION AND RECOMMENDATIONS

This study examined the effect of board heterogeneity on audit quality of banks in Nigeria. Board heterogeneity was proxied by gender diversity, ethnicity diversity and educational diversity while audit quality was measured by audit fees. The ordinary least squares (OLS) regression was used to analyze the data and it was found that Gender diversity and ethnicity diversity of board has significant effect on the audit quality of banks in Nigeria while the effect of diversity in board of directors' educational/professional qualifications on audit quality of banks in Nigeria is not statistically significant.

Based on findings, the following recommendations were made;

1. The need for legislation that pegs the minimum qualification of members of board of directors in terms of financial and professional expertise as this will further improve effectiveness of the Board in their oversight responsibilities.

2. Corporate organization should consider the increase of the proportion of board gender (i.e. female representation) in order to sustain and maintain the significant relationship between gender diversity and audit quality as observed in this study.

3. Corporate organization should also consider bringing in directors of different ethnicity into the board as this brings variety of cultural and social experience for the functioning of entire board.

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