Audit Committee Effectiveness, Risk Management and Financial Performance of Nigerian Listed Deposit Money Banks

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ABSTRACT

This study examined the moderating effect of audit committee financial literacy on the relationship between risk management and financial performance of listed deposit money banks in Nigeria adopting ex-post facto research design to define the structure and strategy of the study, the target population were listed deposit money banks (DMBs) in Nigeria as at 31st December, 2020, which were 19in number. 11 were selected as sample size based on the complete published annual reports and account submitted to the Securities and Exchange Commission for the period of 5 years (2016-2020). The data obtained from annual reports and account of the banks, were analyzed using both descriptive and inferential statistics. The result shows that liquidity risk management, capital adequacy risk management, and operational risk management have positive and significant effect on return on assets, while credit risk management have negative and insignificant effect on return on assets of the banks. However, audit committee financial literacy positively and significantly moderates the relationship between risk management and financial performance of the banks. Therefore, the study recommended that, the board should increase the number of financial literate members on audit committee to assist in identifying risk exposure with a view of monitoring and controlling them.

KEYWORDS: Audit Committee Financial Literacy, Deposit Money Banks, Financial Performance, Risk Management.

1. Introduction

Financial performance of a firm is very important to stakeholders given the current effect of COVID 19 pandemic on the activities of businesses across the globe. The pandemic has a tremendous effect on several business strategies and make the market so dynamic and increase the rate of business risk. Thus, for any business to remain competitive and sustainable, risk management is necessary. In maxi mization of the value of the shareholders, risk management has attained the level of necessity of which any serious minded management would not give it a light thought. Hence, the need for effective risk management to enhance firms' performance is important.

Furthermore, looking at the recent corporate failures, the weaknesses of corporate governance was identified as the main cause of accounting and auditing scandals, consequent to subsequent cor porate failures. Therefore, corporate governance top the highest discussion among many stakeholders. In view of this, as other countries, the Nigerian government established a code of corporate gover nance in 2011 to monitor and control the activities of management of listed companies in Nigeria. The code provides that, each listed company should establish a board of directors and the principal objective of the board is to ensure that the company is properly managed. Thus, oversee the effective performance of the management in order to protect and enhance shareholder value and to meet the company's obligations to its stakeholders. In order to achieve this precarious objective, the board is required to operate through committees. It should determine the number and composition of such committees ensuring that each committee comprises the relevant skills and competences and its members are able to devote sufficient time to the committee's work. Therefore, one of those committees is audit committee, and one of the major responsibilities of audit committee is to oversee management's process for the identification of significant risks across the company and ensure that adequate prevention, detection and reporting mechanisms are in place. To this extent, Ala et al,. (2020), Kristian and Siswanto, (2020), and Oudat et al., (2021) argued that, the effectiveness of the audit committee is determine by the qualities of the constituted members. This corroborates the provision of the Nigerian code of corporate governance that, members of the committee should have certain attributes such as basic financial literacy and should be able to read financial statements. Thus, this study believes that, the extent of financial literacy of the audit committee members would significantly moderate the relationship between risk management and financial performance of listed deposit money banks in Nigeria.

However, given the present business environment, and the role of audit committee, there are limited studies that empirically examined the moderating effect of audit committee financial literacy on the relationship between risk management and financial performance. The few studies conducted such as Ashari and Kristian, (2020), Omotoye et al., (2021), and Omid et al., (2021) considered audit committee characteristics and financial performance; and audit committee characteristics and financial reporting quality. Furthermore, studies such as Vivian et al., (2018), Dyah et al., (2019), and Stephen et al., (2021), examined the relationship between audit committee characteristics and risk management. However, Shatnawi et al., (2019) through their conceptual analyses on the moderating effect of risk management on the relationship between audit committee characteristics and corporate performance in Jordan; suggested that, there is a need for empirical analysis to ascertain the moderating effect of either audit committee characteristics on the relationship between risk management and corporate performance, or moderating effect of risk management on the relationship between audit committee characteristics and corporate perfor mance. Hence, the motivation for this study to examined the moderating effect of audit committee financial literacy on the relationship between risk management and financial performance of listed deposit money banks in Nigeria. To achieve this objective, the following hypotheses were formulated and tested using multi-regression analysis at 5% significant level.

H_{01}: Risk management and audit committee financial literacy have no significant effect on the financial performance of listed deposit money banks in Nigeria.

H_{02}: Audit committee members' financial literacy has no significant moderating effect on the relationship between risk management and financial performance of listed deposit money banks in Nigeria. The significance of this study lies in its contributions to knowledge in the area of corporate governance, risk management and financial performance of listed deposit money banks in

Nigeria, since there is dearth of empirical analysis on the concepts in developing countries. More so, the study would benefit policy makers especially the Nigerian Stock Exchange, Central Bank of Nigeria, and the Securities and Exchange Commission on the level of compliance and the impact of the provisions of code of corporate governance among deposit money banks in Nigeria. It would further enlighten the management of the banks on the role of audit committee financial literacy and it oversight function on risk management and consequently improve financial performance.

2. Literature Review

This section provides the literature review for the study.

2.1 Financial performance

The concept of corporate performance has received a tremendous attention in finance theory by both policy makers and finance scholars. However, there is no generally accepted definition of the concept. Hence, the concept was defined in various terms based on the objectives of the studies. Didier (2002) viewed performance as achieving the goals that were given to you in convergence of enterprise orientations. While, Jenatabadi (2015) stated that, performance is arepeatable activities that utilize corporate resource to attain organizational goal.

To this effect, Rolstadas (1998) believes that the performance of an organizational system is a complex relationship involving seven performance criteria that must be followed: effectiveness, efficiency, quality, produc tivity, quality of work, innovation, and profitability. Hence, this study is based on profita bility performance measure. To measure corporate financial performance, two measurements are in use such as market based system and accounting based system. However, the most adopted financial performance of a company by previous scholars is accounting based system that used profitability and relates it to other variables of the financial statement (Kristian & Siswanto, 2020). This is based on the reason that, it provides management, analysts, and other stakeholders with information that is timely and reasonably accurate for decision making which is in line with the organizational goals (Chamberlain, 2010).

The accounting base indicators of financial performance according to Rateb (2018), and Ahmed and Ombaba (2019) includes returns on assets, returns on equity, and returns on capital employed.

2.2 Risk Management

Ahmad (2014) defines risk management as the increase in organization's value by elevating its focus from tactical to the strategic. While, Shatnawi et al. (2019) viewed risk management as comprises of integrated management of threat to achieving organizational objective, which manifested as a result of operational activities, financial activities, and strategic activities based on corporate policies. Risk is associated with advancement in technology, human capital, goodwill, regulatory power, globalization, and diversification (Carey, 2001). These factors cause both pure and speculative risks that may have an impact on business performance. Thus, to attain the company's objectives; risk has to be managed or controlled in a systematic way across the firm (Beasley et al., 2017). Firms commonly adopt good risk management tactics to connect with their policies, cost, accounting, guidelines, and long-term projection with the aim of regulating assets and interest in an effective manner (Cohen et al. 2017). Furthermore, Nair et al. (2014) described risk management as a process, created by the board of directors, management, and other employees, operated in a strategy situation and across the enterprise, developed to identify potential incidents that may affect the corporate, and regulate risk to be within its risk appetite, to provide practical assurance concerning the realization of corporate objectives.

However, many organizations are not adopting effective risk management process and little is known about why they are not effectively implementing risk policies despite its importance (Bually, 2018). Furthermore, there are limited studies that examined the relationship between risk management and financial performance (Ayayi, 2012; Asare-Bekoe, 2010). This justifies the need for further research in financial institutions especially with respect to assessing the level of current risk management practices among banks in Nigeria.The few studies that examined the relationship such as Oluwafemi et al. (2014), Edogbanya and Karmardin (2015), and Inegbanya et al. (2020), revealed contradicting results. Thus, it is necessary to observe the moderating effect of effective board of directors on the implementation of risk management framework in money deposit banks. Hence the motivation of this study in adopting audit committee members' financial literacy to examine its interactive effect on the relationship between risk management and financial performance of deposit money banks in Nigeria. This is indeed a landmark contribution to the body of knowledge by this study.

Golshan and Rasid (2012) suggested that the decision to implement risk management policies commences in the boardroom and gains support and commitment from other committees in order to influence the manner firms' should think positively about risk and plan for eventualities. Failure to develop an effective risk management process can result in a severe financial loss and consequently business failure (Owojori et al., 2011).

2.3 Audit Committee Financial Literacy

According to CAMA (2004), the audit committee (AUC) is a committee of shareholders and non-executive directors charged with the responsibility of liaising between the external auditor and the board of directors on one hand, and between management and the external auditor on the other hand. Every public company is required under Section 359 (3) and (4) of the CAMA to establish an audit committee. It is the responsibility of the board to ensure that the audit committee is constituted in the manner stipulated and is able to effectively discharge its statutory duties and responsibilities. Thus, to fulfil this important responsibility, Ahmed and Ombaba (2019), and Rateb (2018) were of the view that, the effectiveness of audit committee is determined by the quality of the constituted members. Thus, Ida and Asuka (2016) mentioned one of those attributes such as the financial literacy of the members. This corroborated the provision of the Nigerian code of corporate governance, that at least one board member of the committee should be financially literate, that is having knowledge of accounting or finance. Thus, members of the committee should be able to read financial statements. In the same vein, Ala et al. (2020) emphasized that, the extent of financial literacy of audit committee members will assist in the oversight of the integrity of the company's financial statements, compliance with legal and other regulatory requirements, assessment of qualifications and independence of external auditor; and performance of the company's internal audit function as well as that of external auditors, consequently, improve corporate effectiveness. Therefore, the financial literacy of the audit committee members is a very important attribute that may moderate the relationship between risk management process of listed deposit money banks and financial performance of the banks.

2.4 Empirical Review

The concepts of risk management and financial performance have attracted the attention of both policy makers and scholars in the field of finance and management. Thus, several studies were conducted and examined the relationship between risk management and financial performance. The following are the analysis of some of the empirical studies carried out by various scholars.

Mwangi (2014) examined the effect of risk mana gement on financial performance of 43 listed commercial banks in Kenya for a period of one year, 2013. Using regression analysis to analyze the data collected, the study found that, credit risk management, liquidity risk management, interest rate risk management and capital adequacy risk management have positive and significant effect on return on assets of the banks. This result was corroborated by the study of Oluwafemi et al. (2014), which assessed risk management and financial performance of 10 banks in Nigeria over a period of 3 years (2006-2009). Using panel data estimation techniques, the result of the analysis revealed that, liquidity risk management, credit risk management, and capital adequacy risk management were positively and significantly related to return on assets and returns on equity of the banks. A study was also carried out by Mutuku (2016) on the effect of risk management and financial performance of 42 commercial banks in Kenya over a period of 5 years (2011-2015). The result of the study indicated a positive and significant relationship between capital adequacy risk management, interest rate risk management and returns on equity of the banks over the period of the study.

However, the result of the study conducted by Mardian et al. (2018) on the effect of risk management and financial performance of 5 Islamic banks in Indonesia with corporate governance as a moderator over a period of 5 years (2011-2016) shows a negative effect of capital adequacy risk management, operational risk management, non-performing loan risk management on return on assets of the banks. This finding was confirmed by the result of the study conducted by Chukwunuku et al. (2019), on risk management and the performance of Nigerian listed commercial banks over a period of 22 years (1994-2016). The study reported a negative relationship between credit risk management and return on assets, and no significant relationship between liquidity risk management, operational risk management and returns on assets of the banks. In the recent study conducted by Inegbedion et al. (2020) on risk management and financial performance of 5 banks in Nigeria over a period of 7 years (2010- 2017) it was revealed a positive and significant relationship between liquidity risk management, capital adequacy risk management and return on assets, while credit risk management was found to have a negative effect on return on assets of the banks.

Looking at the trend of the results of the various previous studies, the findings were inconsistent, hence inconclusive, given the contradicting results. Hence the need for further study to introduce either moderating or mediating variable in order to observe its interactive effect on the relationship between risk management and financial performance (Shatnawi et al., 2019). Thus, the motivation for this study to adopt audit committee financial literacy to observed its interactive effect on the relationship between risk management and financial performance of listed deposit money banks in Nigeria.

2.5 Theoretical Review

There are various theories adopted by previous studies to explain the concepts of risk management, financial performance, and corporate governance. Some of the theories as mentioned by Inegbedion et al. (2020) are commercial loan theory, credit risk theory, and shift-ability theory. Therefore, this study was anchored on credit risk theory. This theory explained the relationship between lender of credit and receiver with a tendency of default. As simply put it by Inegbedion et al. (2020), as the likelihood of a customer to whom the bank has extended credit may not pay on time or may not even pay at all, hence, increases rate of banks risk. Since, there is a likelihood that a customer would default, hence, the bank might risk recovery both the principal and the interest, therefore, affects its performance. In order to minimize credit risk, prospective borrowers are subjected to extensive background check to determine their credit worthiness. This may necessitate an insurance policy on the part of the borrower. In general, risk is directly proportional to interest rate that the borrower is made to pay, which implies that the higher the risk, the higher the interest rate that the borrower will be required to pay on the debt (Owojori et al., 2011). Therefore, this study used credit risk theory to explain the relationship between risk management process of deposit money banks and financial performance of the banks with an effective audit committee financial literacy to moderate the relationship of the variables.

3. Methodology

The study adopted EX-post facto research design to define the structure and strategy of the study. The target population consists of all the listed deposit money banks in Nigerian as at 31st December, 2020, which were nineteen (19) in number. Out of the nineteen (19), eleven (11) were selected based on the complete and available required financial reports and accounts of the banks over the period of the study. The required data were collected from the annual reports and accounts of the banks for the period of five (5) years (2016-2020). The data collected were analyzed using both descriptive and inferential statistics. Two models were developed to analyze the variables of the study. These models are presented as follows:

Model 1 was developed to evaluate the direct effect of risk management indicators (LRM, ARM, CRM, ORM), and audit committee financial literacy (AFL) on return on assets (ROA) of the banks, while controlling banks size (BSZ).

$$ROA_{it} = \beta_0 + \beta_1 LRM_{it} + \beta_2 ARM_{it} + \beta_3 CRM_{it} + \beta_4 ORM_{it} + \beta_5 AFL_{it} + \beta_6 BSZ_{it} + e_{it} \text{ ……………...Model 1}$$

Model 2 was developed to examine the moderating effect of audit committee financial literacy (AFL) on the relationship between risk management (LRM, ARM, CRM, ORM) and financial performance (ROA) of the banks.

$$ROA_{it} = \beta_0 + \beta_1 LRM_{it} + \beta_2 ARM_{it} + \beta_3 CRM_{it} + \beta_4 ORM_{it} + \beta_5 AFL_{it} + \beta_6 LRM_{it} * AFL_{it} + \beta_7 ARM_{it} * AFL_{it} + \beta_8 CRM_{it} * AFL_{it} + \beta_9 ORM_{it} * AFL_{it} + \beta 10 BSZit + eit \text{ …………………………………Model 2}$$

The variables of the study are identified and presented in Table 1. This gives information in respect to the measurement as used by the previous studies.

Table 1:Variables Identification, Measurement and Sources

Label	Variable	Description	Sources
ROA	Return on assets	Profit before tax divide by total assets	Chukwunulu et al., 2019
LRM	Liquidity risk management	Average liquidity ratio	Inebegdion et al., 2020
ARM	Capital adequacy risk management	Capital adequacy ratio	Mardiana et al., 2018
CRM	Credit risk management	Proportion of non-performing loan to total loan	Inegbedion & Obadiaru, 2018
ORM	Operational risk management	Proportion of expected lost to actual lost	Okere et al., 2018
AFL	Audit committee financial literacy	Proportion of audit committee members with B.Sc. in accounting or finance	Ajeka et al., 2021
BSZ	Banks size	Natural logarithms of total assets	Mutuku, 2016

4. Results and Discussions

The outcome of the analyses are presented into tables, which consists of the results of descriptive statistics, correlation analyses, diagnostics test results and regressions results.

Table 2: Descriptive Statistics

Variables	Mean	Stand. Dev.	Minimum values	Maximum values
ROA	.210	.102	.001	.421
LRM	.321	.003	.121	.603
ARM	.182	.012	.003	.581
CRM	.403	.162	.017	.743
ORM	.209	.032	.001	.486
AFL	.214	.130	.018	.638
BSZ	.392	.201	.013	.810

Source: STATA 13 Descriptive Statistics Result (2021)

The descriptive statistical result presented in Table 2 revealed that, the average return on assets of the banks was 0.210 at the maximum of 0.421 and minimum of 0.001 with a standard deviation of 0.102. While the lowest proportion of liquidity risk management of the banks over the period was 0.121 and the maximum value was 0.603, with a mean value of 0.321 and standard deviation of 0.003. In respect to capital adequacy ratio, the result shows a mean value of 0.182 with a standard deviation of 0.012 and maximum and minimum values of 0.581 and 0.003 respectively. The result further shows that, the average value of 0.403 for credit risk management, with a standard deviation of 0.162 in between the minimum value of 0.017 and the maximum value of 0.743.Operational risk management indicates the average value of 0.209, while standard deviation was 0.162 with a minimum of 0.001 and a maximum of 0.486. The average value of audit committee financial literacy of the banks was 0.214, in between the minimum of 0.018 and the maximum of 0.638, with a standard deviation of 0.032. In respect to corporate characteristics of the banks, the descriptive result in Table 2 shows that, banks size has a mean value of 0.392, with a standard deviation of 0.201, while 0.012 and 0.521 were minimum and maximum values respectively. After the analyses of the descriptive statistics, the correlation analysis was carried to determine the direction and the magnitude of the correlation between the variables of the study using Pearson product moment correlation statistics and the results are presented in Table 3.

Table 3: Correlation Matrix

	ROA	LRM	ARM	CRM	ORM	AFL	BSZ
ROA	1						
LRM	.013	1					
ARM	-.141	.412	1				
CRM	.341	.381	.363	1			
ORM	.416	.648	-.014	.192	1		
AFL	.271	.392	.203	.274	-.012	1	
BSZ	.513	-.031	.391	-.041	.043	.432	1

Source: Correlation matrix-STATA 13 (Level of Significant @ 5%)

The result of the correlation matrix presented in Table 3 indicates the correlation coefficient magnitude between LRM and ROA, ARM and ROA, BSZ and LRM, ORM and ARM, ORM and CRM, BSZ and CRM, AFL and ORM, and BSZ and ORM were negligible with a correlation coefficients ranges between 0.00 and 0.20. While the correlation between CRM and ROA, AFL and ROA, CRM and LRM, AFL and LRM, CRM and ARM, AFL and ARM, BSZ and ARM, and AFL and CRM were low with a correlation coefficient ranges between 0.21 and o.40. However, the correlation between ORM and ROA, BSZ and ROA, RAM and LRM, and BSZ and AFL were moderate with a correlation coefficient ranges between 0.41 and 0.60. But the correlation between ORM and LRM was high with a correlation coefficient of 0.648. In respect to the direction of the correlation, all the correlation values were positive correlated except the correlation between ARM and ROA, ORM and ARM, BSZ and LRM, BSZ and CRM, and AFL and ORM which were negatively correlated. Since all the value of the statistics in Table 3 are less than 0.800 critical level of multicollinearity problem (Hair et al., 2009), thus, the conclusion that, there is absence of multi-collinearity problem. This is evidence as shown in Table 3 that, the highest value of correlation is between operational risk management (ORM) and liquidity risk management (LRM) with positive correlation coefficient of 0.648. In order to carry out regression analyses, a diagnostic tests was conducted and the results are presented in Table 4.

Table 4: Result of VIF, Standard Skewness, Standard Kurtoses, and Durbin Watson Test

Variables	VIF	1/VIF	Std. Skewness	Std. Kurtoses
LRM	4.108	0.243	0.782	-0.532
ARM	2.140	0.467	0.813	0.741
CRM	1.582	0.632	0.341	0.842
ORM	2.301	0.435	0.627	-0.641
BSZ	1.244	0.804	0.416	-0.538
Durbin Watson test = 1.248				
Chi^2- prob. = 0.000				

Source: STATA 13 Output (Level of Significant @ 5%)

The result in Table 4 indicated that the standard skewness of each of the risk management indicators do not exceed the range of ±1.96 evidencing the normality of the data and it was confirmed by the standardkurtosis statistics valuesof all the explanatory variables which do not exceed the normality range of ±3 (Haniffa & Hudaib, 2006).Hence, the data were normally distributed. Furthermore, the result of the VIF indicated that the highest VIF was 4.108 and the highest tolerance coefficient is 0.804, while the lowest VIF is 1.244 and the lowest tolerance coefficient was 0.243. Therefore, there was no unacceptable level of multicollinearity among the study variables, confirming that there was no need for concerned about multicollinearity issue (Hair et al., 1995). The result of Durbin Watson test statistics is 1.248 which is less than 2 (Adefila, 2014). Hence, the conclusion that, there was no problem of autocorrelation among the variables of the study. Furthermore, the result of Hausman model specification test was significant with chi-square probability of 0.000, hence the null hypothesis was rejected (random effect) in favor of fixed effect. Since the data collected were normally distributed and no problem of multicollinearity and autocorrelation, regression analysis was conducted and the results are presented in Table 5.

Table 5: Result of Regression Analyses

Models	Model 1		Model 2	
Variables	Coefficient	p-value	Coefficient	p-value
Intercept	0.321	0.002	0.382	0.000
LRM	0.104	0.014	0.114	0.001
ARM	0.281	0.043	0.412	0.010
CRM	-0.372	0.068	0.381	0.011
ORM	0.041	0.037	0.182	0.014
AFL	0.397	0.021	0.410	0.010
BSZ	0.417	0.000	0.417	0.000
LRM*AFL			0.342	0.000
ARM*AFL			0.217	0.010
CRM*AFL			0.304	0.000
ORM*AFL			0.413	0.000
R^2 = 0.607	Adj. R^2 = 0.508		R^2= 0.721	Adj. R^2 = 0.571

Source: STATA 13 Output (Level of Significant @ 5%)

The result of the regression analysis of model 1 presented in Table 5 indicates a coefficient of determination (R^2) of 0.607 and Adjusted R^2 of 0.508. This implies that the indicators of risk management, audit committee financial literacy and bank size included in model 1 account for 50.8 percent variation in financial performance of the selected banks, while 49.2 percent was explained by other factors. Given the p-value of 0.002 at 5% significant level, is significant, thus model 1 is significant and has a good explanatory power.

In respect to the indicators of risk management in model 1, the result of the regression analyses in Table 5 revealed that, liquidity risk management (LRM), capital adequacy risk management (ARM) and operational risk management (ORM) have positive and significant effect on return on assets of the selected banks, while credit risk management (CRM) was found to have negative but insignificant effect on return on assets of the selected banks over the period of the study. However, audit committee financial literacy (AFL) and bank size (BSZ) shows a positive and significant direct effect on return on assets of the banks. Adopting a moderator, audit committee financial literacy, to observe its interactive effect on the relationship between risk management and financial performance of the banks. The result of the regression analysis of model 2 presented in Table 5 shows a coefficient of determination (R^2) of 0.721 and Adjusted R^2 of 0.571. This implies that, the interaction of audit committee financial literacy and indicators of risk management included in model2 account for 57.10 percent of the variation in return on assets of the banks, while 49.9 percent was explained by other factors. Furthermore, the p-value of 0.000 at 5% significant level is significant, thus model 2 has a good predictive power.

Furthermore, audit committee financial literacy has positively and significantly moderates the relationship between all the indicators of risk management and returns on assets of the banks over the period of the study. In addition, introducing a moderator “audit committee financial literacy” in model 2 has resulted to the change in $R^2$of 11.4 percent (72.1-60.7), thus a conclusion that, audit committee has a positive and significant moderating effect on the relationship between risk management and financial performance of listed deposit money banks in Nigeria.

5. Conclusion and Recommendations

The direct regression analyses of the indicators of risk management and return on assets shows that, LRM, ARM and ORM have positive and significant effect on ROA, while CRM have negative effect on ROA of the banks. However, the regression result of model 2 shows that, audit committee financial literacy has positively and significantly moderated the relation ship between all the indicators of risk management and return on assets, hence the conclusion that, audit committee financial literacy has a positive and significant moderating effect on the relationship between risk management and financial performance of listed deposit money banks in Nigeria over the period of the study. This implies that, those banks with higher members of audit committee that have knowledge in accounting and finance performed financially better than their counterpart who do not have or have limited financially literate members on audit committee.

Therefore, the study recommended that, in constituting audit committee, the banks should ensure that, the majority of the members are financially literate, this will increase the proportion of competent hands in managing risk in the banks, consequently improve financial performance of the banks.

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