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RESEARCH ARTICLE

Risk Management Committee Effectiveness and International Financial Reporting Standards 7 (IFRS7) Compliance by Listed Banks in Nigeria

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Abstract

This paper empirically assesses the relationship between risk management committee effectiveness and IFRS7 compliance. A sample of fourteen out of nineteen listed banks in Nigeria with financial year ended December 31, 2013 is selected for the study for reason of data availability. Empirical results using OLS regression show significant positive relationship between the dependent variable and the independent variables, which reveal high compliance of 81%. The paper recommends intensive monitoring and enforcement by the newly established regulatory authority- the Financial Reporting Council of Nigeria (FRCN) so as to sustain and even improve compliance in the long run.

INTRODUCTION

Risks are defined by the Institute of Internal Auditors Research Foundation as “threats to achieving the entity’s objectives” (IIARF, 2013). They are risks arising from uncertainties of outcomes that could materially impacton organisational goals (Selim & McNamee, 1999). Risk management is the adequate disclosure of risks, which an entity is exposed to, based on the system of management and supervisory control capabilities of its risks profile. Risk management has assumed a universal eminence with widespread practice in financial institutions (Mike, 2008; PwC, 2005, 2007; Deloitte, 2007). These institutions have now embraced the mission such that without it, the creation of new financial institutions becomes practically impossible (Power, 2003a). Thus, risk management is being encouraged globally by the regulatory authorities (Power, 2003b).The introduction of principles based reporting language by IASB in 2002, which will expectedly leads to greater transparency and comparability of accounting numbers brought over 270 countries from all jurisdictions to embrace International Financial Reporting Standards (IFRS) (PwC, 2013).

This study is an attempt to determine the relations between risk management committee effectiveness and IFRS7 compliance especially in the aftermath of 2008 financial crisis, which revel the weakness in some corporate governance attributes and IFRS compliance apparatus (Amoako & Asante, 2012).In Nigeria for instance in addition to international regulation (i.e. IFRS) new regulations like the Central Bank of Nigeria code (CBN, 2006) and the Securities and Exchange Commission code (SEC, 2004 revised 2011) provide the needed regulatory backing for listed banks in that country.However, there is presently little if any empirical study on risk factors associated with financial institutions especially in developing countries like Nigeria. Risk information is important to both stakeholders and regulatory authorities in view of the RMCs importance in terms of transparency of information and growth (Bhimani, 2009; Subramaniam et al. 2009).

This paper is particularly interested in the relationship between risk management committee Information about company’s risk is important to management and shareholders, suppliers, creditors, employees and other stakeholders. It is also useful tomanagement and shareholders as it indicates the stability of the organisation'sprocesses and expected results. Moreover, it is useful to creditors because it enable them assess company's ability to settle its contractual obligations, which also assist in forming decisions about future credit terms. It further assists employees in assessing the direction of the company and future prospects (Korosec and Horvat, 2005).

2.0 Literature Review

Several compliance studies have focus on the relations between risk management as an effective corporate governance paradigm and accounting standards compliance. This studies include the relations between financial accounting and risk management (Bhimani, 2009; Harney, 2010) corporate governance, firm characteristics and risk management committee formation (Subramaniam, McManus & Zhang, 2009); accounting and measurement of risks (Gasbarro & Zumwatt, 2008; Behr, Schmidt and Xie, 2010) and in some other cases risk management and financial reporting sustainability (Krysiac, 2009).

Recently, the importance of risk management in corporate governance has been stressed by international regulators in an attempt to find a suitable point of reference in financial reporting consequent upon the financial crisis of 2008. These regulators include the Organisation for Economic Cooperation and Development (OECD) principles of corporate governance (2004), the Sarbanes-Oxley act (SOX, 2002). This regulators have extensively turned their focus towards good governance principles and risk management disclosure requirements of IFRS7 brought about by the International Accounting Standards Board, which came into effect in 2007 (IASB, 2007).

The nature and extent of risk disclosure policy and strategies adopted by the board of directors and management impacts all stakeholders, which may have important role to play in company evaluation by current and potential investors. Thus risks disclosure, which are both quantitative and qualitative information arising from financial instruments insurance contracts and related risk management processes may lead to effective compliance with IFRS7 disclosure requirements.

2.1 Risk information requirements of IFRS7

Paragraph 33 of IFRS7 specifies the necessary guidelines for risks arising from financial instruments, which this paper intends to explore. These risks requirements include:

a) Risk governance structure indicates whether there is sound governance structure in a particular bank that can identify, define, assess, monitor, mitigate and report risks. This is specific on the establishment of board risk management committee with clear line of responsibility or charter, which can lead to risk management compliance.
b) Business support risk indicates whether the business support group is capable of identifying and applying risk based approach to capital management, reinsurance, asset allocation and new product development.

According to Hossain (2014) there are twelve risk disclosure items in the balance sheet of banks. This includes income and expense, interest rate risks, assets and liability (group), investment and securities, off balance sheet items, asset and liability (maturity), asset and liability (concentration), loan and advances, risks (general), collateral securities, other activities and related party transactions.

2.2 Risk governance requirements in the banking sector

Risk management committee effectiveness is determined by the committee's ability to effectively address risks issues with a view of ensuring transparent and comparable accounting figuresin annual report. According to Bank of International Settlement (BIS, 2014) risk items to pay special attention to by risk management committee include credit (CR), liquidity (LQ) and market risks (MK), interest (IN), currency (CU) and other price risks (OP). Others include equity price risk (EP), commodity price risk (CP) and risk of early repayments (RE),credit quality (CQ), collateral security (CS) and credits performance (C).

3.0 Methods and Data

This paper uses secondary data from fourteen Nigerian banks out of a pool of nineteenlisted in the capital market i.e. Nigerian Stock Exchange with financial year ended December 31, 2013 (NSE, 2013). The paper assesses risk management disclosure effectiveness with twelve IFRS 7 disclosure items in the balance sheet identified and used in prior compliance studies (Hossain, 2014; PwC, 2013).

3.1 Disclosure items and operationalization

According to Deloitte (2014) risk items in the balance sheet are grouped into classes based on their nature and significance. Generally this items falls into either qualitative or quantitative risk disclosure requirements.

Under the qualitative risk disclosures are credit (CR), liquidity (LQ) and market risks (MK).Furthermore, there are three categories of disclosure under the market risk, which include interest (IN), currency (CU) and other price risks (OP). Moreover, other price risk is further dissected into equity price risk (EP), commodity price risk (CP) and risk of early repayments (RE).Under the quantitative risk characteristics are credit quality (CQ), collateral security (CS) and credits performance (C).

3.2 Scoring Procedure

There are three procedures for scoring an item in accounting research (Hodgdon et al. 2008). These are the dichotomous method, the partial compliance method and the Saidin index method. The dichotomous method scored an item as '1' if disclose or" 0' otherwise and there is no penalty for non-disclosure (Abdullah, 2013; Owusu-Ansah, 1998).The partial compliance computes the ratio of compliance by adding the extent of compliance for each standard and divide the sum by total number of standards applicable to the studied company (Abdullah, 2013; Al-Shiab, 2003). The Saidin index applies a weight sum to each IFRS with each weight measuring the ratio of companies, which claim to disclose (Hodgdon et al. 2008; Spetz & Baker, 1999).This paper uses the unweighted scoring method consistent with prior studies (Abdullah, 2013; Hodgdon et al. 2008; Owusu-Ansah, 1998; Street & Grey, 2001).

3.3 Theoretical model

This paper's theoretical model is depicted in the following regression equation.

$$IFRS7 = \boldsymbol{\beta}_0 + \boldsymbol{\beta}_1 RMC + \boldsymbol{\varepsilon}$$

Based on the regression analysis in Table 4.4, the equation is:

$$IFRS7 = 0.0450 + 0.841RMC$$

4.0 Findings and Analysis

4.1 The dependent variable (IFRS7) compliance

Table 4.1 reports the level of compliance with IFRS7 disclosure requirements by the sampled listed banks in Nigeria. This result is obtained using the unweighted scoring procedure as done in prior studies (Abdullah, 2013; Amoako & Asante, 2012; Hossain, 2014).

Table 4.1: IFRS7 compliance score

S/N	Bank Name	Total compliance index	maximum complied	% complied	Std. Deviation
1	Access	12	8	67	.33
2	Diamond	12	6	50	.50
3	Eco	12	6	50	.50
4	Fidelity	12	6	50	.50
5	First	12	9	75	.25
6	First City	12	6	50	.50
7	GTBank	12	9	75	.25
8	Skye	12	5	42	.58
9	Stanbic	12	8	67	.33
10	Sterling	12	5	42	.58
11	UBA	12	8	67	.33
12	UBN	12	3	25	.75
13	Unity	12	6	50	.50
14	Zenith	12	9	75	.25

4.2 The independent variable (RMC effectiveness)
Table 4.2 report the level of compliance with risk management characteristics disclosure requirements by the sampled listed banks in Nigeria.The risk management committees are expected to ensure full compliance of the risk items to ensure effective discharge of their responsibilities to shareholders. This result is obtained using the unweighted scoring procedure as done in prior studies (Abdullah, 2013; Amoako & Asante, 2012; Hossain, 2014).

Table 4.2: Risk management compliance scores

S/N	BANK	CR	LQ	MK	IN	CU	OP	EP	CP	RE	CQ	CS	C	TL	%
1	Access	1	1	0	0	0	1	1	0	1	1	0	1	7	58
2	Diamond	0	1	0	1	0	1	1	1	1	1	0	1	8	67
3	Eco	1	1	0	1	0	1	0	0	0	1	1	1	7	58
4	Fidelity	0	1	0	1	0	0	0	1	1	1	1	0	6	50
5	First	1	1	0	1	0	1	1	0	1	1	1	1	9	75
6	First City	0	1	1	1	1	0	0	1	1	1	0	1	8	67
7	GTBank	1	1	1	0	1	0	1	1	1	0	1	1	9	75
8	Skye	0	1	0	1	1	0	1	0	1	1	0	0	6	50
9	Stanbic	1	1	1	0	1	0	0	1	1	1	1	0	8	67
10	Sterling	0	1	0	1	1	1	0	1	0	0	0	1	6	50
11	UBA	1	1	0	1	0	1	0	0	1	1	1	1	8	67
12	UBN	0	0	0	1	0	1	1	0	0	0	0	0	3	25
13	Unity	1	0	1	1	1	0	1	1	0	0	0	0	6	50
14	Zenith	1	1	1	1	0	1	0	1	1	1	1	1	9	75
TOTAL:		8	10	5	11	6	8	7	8	10	10	7	9		

4.3 Empirical results

4.3.1 Descriptive statistics

Table 4.3: Descriptive statistics

	Mean	Std. dev.	**N**
IFRS	.5607	.15138	14
RMC	.6129	.16155	14

Table 4.3 reports descriptive statistics of the dependent and independent variables with mean of 56% and 61% and standard deviations of 0.15 and 0.16 consistent with Street and Grey (2001) with mean of 72% and standard deviation of 19% and Hodgdon et al. (2009) with mean of 58% (1999) and 64% (2000) and standard deviation of 21% and 19% respectively using similar unweighted scoring method.

4.4 Regression analysis

Table 4.4: IFRS7 Compliance model results

Variables	Coefficients	t-statistic	ρ-value
Constant	0.045	0.599	0.561
RMC	0.841	7.068	0.000
R-square	0.806		
Adj. R-square	0.790		

Empirical evidence from IFRS7 equation 1 is reported in Table 4.1 (total compliance) and the results in Table 4.4 for the regression analysis reveals that there is a positive relationship between International Financial Standards 7

(IFRS7) and Risk Management Committee (RMC) as predicted. This can be seen from the coefficient (β_1) with a value of 0.841. This means that one unit change in RMC will lead to corresponding increase in IFRS7 compliance by 0.841 with an economic assumption that other factors remain constant. Moreover, at 1% level of significance the coefficient of RMC is statistically significant because the p-value is less than 1%. Therefore, RMC is found to be significant in explaining changes in IFRS7. Furthermore, with an R^2 of 0.806, it means that RMC accounted for 81% of all variations in IFRS7 compliance.

5.0 Summary and Conclusion

This paper uses a sample of fourteen Nigerian listed banks to examine the relationship between risk management committee effectiveness and IFRS 7 compliance with disclosure requirements.The results using OLS reveal high level of compliance and positively relates with risk management committee effectiveness. This paper contributes to the existing literature examining factors, which explain compliance with IFRS7 disclosure requirements. However, unlike prior studies, this paper examines compliance for only one year because Nigeria mandatorily adopts IFRS in 2012. The paper use cross-sectional statistical technique to measure compliance. This study provides strong evidence of the importance of risk management committee oversight on IFRS compliance.

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