Audit Committee and Firms' Performance in Nigeria: Case Study of selected Nigerian Banks.

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Abstract- The purpose of financial reports is to deliver reliable financial information that is useful for different categories of stakeholders to take well-informed decisions. The primary role of the audit committee is to supervise the internal process of preparing financial report and to ensure that the conflict of interest between management and shareholders is minimized so as to enhance the quality of financial report. The study examined the effect of Audit Committee Effectiveness on the growth of Firms Performance in Nigeria with emphasis on Eight Public Quoted Banks in Nigeria. The data were sourced from the annual reports and accounts of eight banks in Nigeria for 2011-2015 independent variables proxied on the size of audit committee, the frequency of meetings of audit committee and the financial literacy of audit committee members while profit before tax was the dependent variable. The data were analyzed using Ordinary Least Square (OLS) regression and E-view software package was used. The findings revealed that audit committee size, frequency of audit committee's meetings and financial literacy of audit committee members have no significant effect on firms' performance in Nigeria. The variables in the model is insignificant at the 5% critical level and the regression coefficient reveals that 5.31% of the total variation in firms performance is accounted for by audit committee size, 11.18% of the total variation in firms performance is accounted for by audit committee's frequency of meeting and 8.16% of the total variation in firms' performance is accounted for by the financial literacy of audit committee members. It is recommended that Nigerian banks should have a board committee members from diverse professional backgrounds and at least 5-member, at least 20% of the audit committee members should be financially literate for them to be able to interpret items on the financial report, at least four meetings should be held in a year by the audit committee so as to address issues of corporate governance every quarter and resolutions of audit committee meeting should be implemented to make the expenses incurred on them worthwhile.

Index Terms- Audit, Audit Committee, Audit Committee Size, Financial Performance, Nigerian Banks

I. Introduction

The purpose of financial reports is to deliver reliable financial information that is useful for different categories of stakeholders in taking quality decisions. Quality financial reporting is the outcome of a dependable corporate governance system that can guide creditors and investors in making investment decision with minimal risk. Audit committees establishes checks and balances in the internal control system through the association of internal auditors and external auditors to ensure that the management comply with the laid down rules (Buallay, 2018; Saibaba and Ansari,2011). The major function of the audit committee is to improve the board oversight function, enhance the quality of financial reporting, boost auditor's independence and improve the quality of decision making by the management (Alderman *et al*, 2011). Ultimately, external auditors reinforce the oversight function of the audit committee by expressing independent opinions on annual accounts and reports of firms. Auditors opinion about financial report reasonably guarantees objectivity the absence of bias and or material misstatement that can mislead the users of financial report. Therefore, audit committee and external auditors play important role in giving credence to the validity, acceptability and reliability and ultimately guide the users of financial report in decision making (Abdullah *et al.*,2014). Carcello and Neal (2000), posited that audit committee serves as a very germane governance tool because there is potential litigation and reputation risk faced by audit committee members. It is their duty to discharge their responsibilities effectively and efficiently because of the liability their negligence can cause for the organization and the committee members. However, such liability does not affect the audit committee members in Nigeria under the current law except in the law of public opinion. Despite this lacuna, the audit committee plays an important monitoring role to assure the quality of financial reporting and corporate accountability. We thus expect that firms with high-quality audit committees are less likely to have internal control weaknesses than firms with low-quality audit committees.

However, due to collapse of corporate giants such as Enron, WorldCom and Satyam, regulators have called to question the effectiveness and the competence of audit committee and the professional capacity of external auditors in ensuring that financial statements show truth and fairness and audit exercise are conducted objectively without bias. It is very unfortunate that records of corporate scandals that led to the failure of corporate entities in Nigeria are hardly made available for research purpose and thereby making it difficult to domesticate our findings. This local development requires improvement as the audit committee can play a major role in supervising the the audit process and assist in the minimization of areas of dispute between board and the auditor (Helen and Arnold,2011). The weakness of corporate governance is probably one of the most important factors that led to the corporate failure and it also reduced the quality of financial reporting and the perception of the users of financial reports. It is high time we improved the integrity of financial reporting through greater accountability, responsibility, and sound corporate governance mechanisms (Saudagaran, 2003).

There are about 23 banks in Nigeria after the consolidation policy of 2004 and they are all publicly quoted companies which are required by law to publish their financial reports. This study used eight banks as sample and they are First Bank of Nigeria Plc, GT Bank Plc, Zenith Bank Plc, Ecobank Plc, FCMB Plc, UBA Plc, Fidelity Bank Plc, Access Bank Plc. For the purpose of this study, the reports of eight (8) banks shall be considered for a 5year period between 2011 to 2015.The reason for the choice of this data is that these banks are among the top ten banks in Nigeria in terms size and the economy witnessed stability in those years.

II. Literature Review

2.1 Audit Committee in Nigeria

In Nigeria, audit committee is brought into existence by the Companies and Allied Matters Act (CAMA, 1990) and its subset of the board. The external auditor in addition to providing an audit report to the shareholders at annual general meeting is also expected in the case of public company to also make a report to an audit committee which shall be established by the public company (section 359 (3), CAMA, 1990). The audit committee consists of an equal number of directors and representatives of the shareholders of the company (subject to a maximum number of six members) and it has the responsibility to examine the auditor's report and make recommendations thereon to the annual general meeting as it may deem fit. Member of the audit committee are not be entitled to remuneration and their tenor is subject to re-election annually. Any member may nominate a shareholder as a member of the audit committee by giving notice in writing of such nomination to the secretary of the company at least twenty-one days before the annual general meeting. (Section 359 (4-5), CAMA, 1990). Subject to such other additional functions and powers that the company's articles of association may stipulate, the objectives and functions of the audit committee shall be to:-

(a)Ascertain whether the accounting and reporting policies of the company are in alignment with legal requirements and ethical practices;

(b)Review the scope and planning of audit exercise;

(c)Review the findings on management matters in conjunction with the external auditor and departmental responses to the issues raised;

(d)Continually review the effectiveness of the company's accounting and internal control systems:

(e)Make recommendations to the Board on the appointment, removal and remuneration of the external auditors; and

(f)Authorize the internal auditor to carry out investigations into any activities of the company which may be of interest or concern to the committee. (SEC359 (6), CAMA 1990)

2.2 Qualifications of Audit committee Members

According to Companies and Allied Matters Act, CAMA 1990, Section 359 (3 & 4), that relates to qualification and experience of audit committee members, including the chairman provides that: "*The chairman of the audit committee should be a non-executive director, to be nominated by the members of the audit committee. Basically, members of the committee should be able to read and understand basic financial statements, and should be capable of making valuable contributions to the committee''*. The draft rule by the Financial Reporting Council (FRC), requires that membership of the audit committee should have professional qualification to guarantee their understanding of financial statements. Consequently, Financial Reporting Council of Nigeria (FRCN) in its draft rule directed that audit committee members of companies must be members of certified professional accounting body in the Country. The Council had based its argument on the premise that professional accountants are more reliable, noting that their education and training allow for their judgment to be relied upon. However, leaders of renowned shareholder groups had disagreed with this guideline, as they described it as unnecessary and that it should be urgently reversed. The argument of the renowned shareholders group is predicated on the fact that the rule contravenes section 359(3) and (6) of Companies and Allied Matters Act, Cap. C20 which did not state specifically that audit committee member should be professionally certified. The draft rule contained in a circular titled "Transitional Concessions Agreed between the Nigerian Stock Exchange (NSE) and the Financial Reporting Council of Nigeria (FRC) regarding Rules 1& 2 of the FRC's Rules" published by the NSE on March 29, 2016, with reference no: NSE/LARD/LRD/CIR5/16/03/29, states thus: "Chairman of audit committee, to annual report, financial statements, accounts, financial report, returns and other documents of a financial nature, shall be a professional member of an accounting body established by Act of the National Assembly in Nigeria." It, however, states that current chairmen of the audit committee shall be permitted to attest to accounts of financial nature regardless of whether he is a professional member of an accounting body or not for the current financial year only. The FRCN added in the circular that "The foregoing concessionary arrangement shall apply only to entities which, in the case of a holding company shall include its subsidiaries): (i) Which are not currently in court with the FRC and/or having any of its director(s) currently holding FRCN numbers that have been suspended by the FRC. Every subsequent annual report, financial statements, accounts, financial report, returns and other documents of a financial nature of the audit committee shall be attested to by a chairman who is a professional member of an accounting body established by Act of National Assembly in Nigeria in compliance with FRCN Rule 2." Now that the federal government has suspended the FRC's corporate governance draft rule and appointed a new executive team, it will be proper if the controversial corporate governance code is holistically and meticulously addressed. However, the FRC's insistence that members of the audit committee must possess a professional qualification from any accounting body came up as a result of the mediocrity being displayed by some shareholders who occupy audit committee positions. The limitation in their financial literacy affect their judgement on the financial statement. Most times they exhibit ignorance as they lack understanding of the basic accounting principles. This obviously reduced their contribution and ability to by query accounts of companies for further clarifications. The motivation to belong to the audit committee is merely driven by the monetary benefit attached. However, if the current leadership of the FRC follows through with the position of the Council on qualifications for audit committee membership, it should first of all move for the amendment of CAMA. It is only when CAMA is amended and the section 359(3) and (6) of Act, Cap. C20 is expunged that the FRC's proposed rule could be pursued to a logical conclusion.

2.3 Firm's Performance

Firm performance is critical to the economic well-being of the shareholders and other interested stakeholders. However, the integrity of financial reporting is not reliable without sound oversight function of the Audit Committee and the macroeconomic system may be exposed to a major risk. For instance, Flamholtz, Das and Tsui (1985) appraised the concept of performance and its measurement from traditional perspective, where they regarded the term as an element of the planning and control cycle that captures performance data, enables control feedback, influences work behaviour. In the words of Simons (1990), the concept of performance centers around monitoring of organization's objectives and the implementation of strategy to achieve the set objectives. Generally, performance measurement plays an important role in the development of strategic plans and evaluating the achievement of organizational objectives and serves as a pointer to organization's growth (Simons, 1990: Ittner and Larcker ,1998). Therefore, Khan, Shah, and Atta (2009) with respect to the company's present and future performance opined that performance can be seen from many perspectives, such as profit before tax, profit after tax, growth in earnings per share, or market share of a firm. According to them, investors are keen on dividend and growth in market price of shares, which attracts investors toward investment in shares that will further raise the demand in the stock market and will lead to increasing stock prices and performance of the stock market. However, Sonnentag and Michael (2001) posited that when conceptualizing performance, one has to differentiate between an action (that is behavioural) and an outcome of the action which ultimately results in performance. According to them, the behavioural aspect of the action refers to the consequence or result of the individual behavior. The outcome aspect described behaviours which may result in outcomes such as increased output, growth in sales figures and so on. Based on this, financial performance is defined as a subjective measure of how well a firm can utilize its assets generate revenues from its primary business activities. The term also depicts the overall financial health of the firm over a given period of time.

III. THEORETICAL REVIEW

Agency theory

The agency theory is a relationship between the owners of economic resources (the principals) and managers (the agents) who are charged controlling these resources to achieve the objectives of the owners and the agents are to be rewarded (Sarens and Abdolmohammadi,2007). Principals appoint agents and delegate some decision-making authority and as a result this, the principals place their trust in their agents to act in the principals' best interests. Jensen and Meckling (1976), states that in agency theory, agents have superior information than the principals and this information asymmetry negatively affects the principals' ability to monitor the extent to which their interests are being properly protected by the agents. Mostly, the agents use the access to superior information to their own advantage at the detriment of the principal. Sarens *et al*, (2007), opine that an assumption of agency theory is that principals and agents are rational and to maximize their wealth through the contract. However, moral hazard may ultimately work against this assumption. Jensen and Meckling (1976), opine that agents may be tempted as a result of moral hazard to act in their own interest as opposed to acting diligently to maximize the principal's wealth. Since principals do not involve in the day-to-day running of the organization, access to valuable information may be limited and thereby are unable to determine whether or not the agent's actions are in the best interest of the firm. To minimize the impact of moral hazard, principals engage in contract to achieve the set objectives by the establishment of monitoring processes such as auditing. Watts (1998), observes that auditing is considered as a bonding cost paid by agents to a third party to satisfy the principals' demand for accountability by the principal. Like any other cost of running the business, the cost of auditing is borne by principals to protect their economic interests. Farouk and Hassan (1992), discussed the importance of the separation of ownership and control and they posited that the more diluted the ownership of a company, the more robust the choices of the owners and managers, and the more effective and reliable the control mechanism established by the principals in monitoring the agents. Thus, as the dilution of ownership increases, so does the need for effective monitoring. Thus, a well-structured auditing processes will be required to monitor the agent's actions once there is separation of ownership from management. Louise (2005), states that audit serve as a fundamental objective in reinforcing confidence and promoting trust in financial information. The principal-agent relationship as depicted in agency theory is important to understanding the origin of the role of an auditor.

IV. EMPIRICAL EVIDENCE

Kamolsakulchai (2015) examined the impact of the Audit Committee effectiveness and audit quality on Financial Reporting Quality of listed company in Stocks Exchange of Thailand. The study investigated the relationship between the audit committee effectiveness and audit quality on Financial reporting quality. Panel data were collected from the Form 56-1 and financial statements of listed, including three industry groups, in Stock Exchange of Thailand from 2008 to 2012; and data was analysed using Panel Fixed Effects Models. The results show that audit committee effectiveness had a significantly positive relationship with financial reporting quality and as the size of audit committee increased, financial reporting quality was improved.

Rahimi and Amini (2015) examined the relationship between audit quality and the profitability in the companies listed on Tehran's securities exchange market. The researcher used two variables to measure the audit quality, auditor and the auditor's tenure. The 52 companies listed on Tehran's securities exchange market represented the sample of the study. The study findings show that there is a positive and weak relationship between the auditor size and the auditor's tenure period and the company's profitability.

Al-Mamun *et al* (2014) examined the relationship between Audit Committee Characteristics, External Auditors and Economic Value Added of Public listed Firms in Malaysia. The study used EVA as performance measurement tool. The sample is

75 firms and the of year observations is 2008-2010. The findings of the study show that audit committee independence is positively associated with firm performance while audit quality is negatively associated with Firms performance. Generally, audit committee characteristics have a positive effect on firm performance.

Sayyar (n.d) examined the impact of audit quality on firm performance for Malaysian listed companies for the period of 2003 to 2012. The study used audit fees and audit firm rotation as proxies for audit quality. Return on assets and Tobin's Q are used as measures for firm performance. The findings show that there is an insignificant relationship between audit fees and audit firm rotation and Return on Asset. The audit fee is significantly and positively related to Tobin's Q. However, audit firm rotation is insignificantly related to Tobin's Q.

Farouk and Hassan (2014) examined the impact of audit quality on financial performance of quoted Cement Firms in Nigeria. The study is descriptive in nature and it used ex-post facto design in carrying out this research. Data were obtained basically from the published annual reports and accounts, and notes to the financial statements of the four firms that represent the sample of the study. Multiple regression analysis using the SPSS Version 15.0 was employed in analyzing the data and testing the stated hypotheses. The results of the findings show that auditor size and auditor independence have significant impact on the financial performance of quoted cement firms in Nigeria. However, auditor independence has more influence than auditor size on financial performance. The study recommends that the management of quoted cement firms in Nigeria increase the remuneration of auditors to boost the auditor's independence in order to improve their financial performance. The study further recommends that management should employ the services of audit firms whose character and integrity is beyond question.

V. METHODOLOGY

The data used for this study were sourced from the annual reports and accounts of the following banks, First Bank of Nigeria Plc, GT Bank Plc, Zenith Bank Plc, Ecobank Plc, FCMB Plc, UBA Plc, Fidelity Bank Plc and Access bank for the (5) year period of 2011- 2015. The target population for the study is made up of all the 23 banks in Nigeria. The criteria used by the study for the determination of appropriate sample size are among top 8 banks. For the purpose of this study, the basis of measuring audit committee effectiveness are audit committee size, frequency of meeting and financial literacy of audit committee members. To examine the effect of audit committee effectiveness on firms 'performance. Firms' performance is the dependent variable while Audit committee size, Audit committee frequency of meeting and audit committee financial literacy are the independent variables and Ordinary Least Square Regression Model is used to show their linear relationship. The level of significance is 5%.

The model developed for this study was adapted based on a previous model used by Al-Khaddash *et al* (2013); which is given as :

$$\text{AuditQ} = \alpha + \beta_1\text{Intersys} + \beta_2\text{Independ} + \beta_3\text{Efficiency} + \beta_4\ \text{Reputation} + \beta_5\text{Fee} + \beta_6\text{Size} + \beta_7\text{Specialty} + \varepsilon$$

Where AudiQ denotes audit quality, Intersys is internal control system, Independ is auditor independency, Efficiency is auditing efficiency, Reputation is the reputation of auditing office, Fee is the auditing fees, Size is the size of auditing office, Specialty is the specialty and proficiency of auditor and **ε** denotes the random error.

The model for this study is adapted from the above model as follows:

$$\text{FirmsP} = \alpha + \beta_1\text{Size} + \beta_2\text{Freqmeeting} + \beta_3\text{Literacy} + \varepsilon$$

Where FirmsP denotes Firms' Performance, Size denotes the size of audit committee, Freqmeeting denotes the frequency of audit committee meeting, Literacy denotes the financial literacy of audit committee members and ε denotes error term.

Size means Audit Committee size and the minimum acceptable for this study is 5members and the parameter is for Audit committee size for 5members and above is 1 otherwise 0

Freqmeeting means Frequency of Audit Committee Meeting and the minimum acceptable for this study is 4times. For Frequency of Audit committee meeting size 4 above 1 is 1 otherwise 0

Literacy means Financial literacy of Audit Committee members and the minimum acceptable for this study is 20%. For Financial literacy of members and the minimum is 20% and above is 1 otherwise 0

The following are the hypotheses of the study,

Ho_1 : Size of audit committee has no significant effect on firms' performance in Nigeria .

Ho_2 : Audit committee meeting frequency has no significant effect on firms' performance in Nigeria.

Ho_3 : Audit committee members' financial literacy has no significant effect on firms performance in Nigeria.

TEST OF HYPOTHESIS 1

Ho_1 : Size of audit committee has no significant effect on Firms performance in Nigeria

Model 1: OLS, using observations 1-40
Dependent variable: Firms'Performance

Table 1

	Coefficient	*Std. Error*	*t-ratio*	*p-value*	
Const	38.9079	9.07619	4.2868	<0.0001	***
Audit_Commitee size	−1.01635	2.00852	−0.5060	0.6152	

Mean dependent var	35.31000		S.D. dependent var	39.58521
Sum squared resid	76375.02		S.E. of regression	39.88917
R-squared	0.05306		Adjusted R-squared	-0.015417
F(1, 48)	0.256058		P-value(F)	0.615158
Log-likelihood	−254.2316		Akaike criterion	512.4633
Schwarz criterion	516.2873		Hannan-Quinn	513.9195

Source: Researcher's Compilation (2016)

TEST OF HYPOTHESIS 2

Ho_2 : Audit committee meeting frequency has no significant effect on firms' performance.

Model 2: OLS, using observations 1-40
Dependent variable: Firms'Performance

Table 2

	Coefficient	*Std. Error*	*t-ratio*	*p-value*	
Const	38.7142	7.27933	5.3184	<0.0001	***
Committee Meeting_Frequency	−1.89125	2.56722	−0.7367	0.4649	

Mean dependent var	35.31000		S.D. dependent var	39.58521
Sum squared resid	75924.01		S.E. of regression	39.77122
R-squared	0.11180		Adjusted R-squared	-0.09420
F(1, 48)	0.542714		P-value(F)	0.464896
Log-likelihood	−254.0836		Akaike criterion	512.1671
Schwarz criterion	515.9912		Hannan-Quinn	513.6233

Source: Researcher's Compilation (2016)

TEST OF HYPOTHESIS 3

Ho_3 : Audit committee members' financial literacy has no significant effect on firms' performance.
Model 3: OLS, using observations 1-40
Dependent variable: Firms' Performance

Table 3

	Coefficient	*Std. Error*	*t-ratio*	*p-value*	
Const	36.0174	5.74442	6.2700	<0.0001	***
Committe_Members_Financial_Lit	−42.6148	67.8023	−0.6285	0.5326	

Mean dependent var	35.31000		S.D. dependent var	39.58521
Sum squared resid	76155.70		S.E. of regression	39.83186
R-squared	0.08163		Adjusted R-squared	-0.012501
F(1, 48)	0.395032		P-value(F)	0.532646
Log-likelihood	−254.1597		Akaike criterion	512.3195
Schwarz criterion	516.1435		Hannan-Quinn	513.7757

Source: Researcher's Compilation (2016)

VI. Discussion of Findings

From table 1, the r-squared (regression coefficient) result reveals that 5.31% (represented by 0.05306) of the total variation in firm performance is accounted for by audit committee size with other variables in the stochastic term accounting for the remaining 94.69 of variations in firm performance. The adjusted R-squared valued at -0.015417 implies that even if other variables accounted for in the stochastic parameter were included in the model, audit committee size would still account for 0% of the variations in firm performance. Therefore, null hypothesis 1 is hereby accepted indicating that audit committee size has no significant effect on firms' performance. This contradicts the argument of Vafeas (1999) that larger audit committee size can lead to inefficient governance because frequent meetings will lead to an increase in expenses.

From Table 2, the r-squared (regression coefficient) result reveals that 11.18% (represented by 0.1118) of the total variation in firm performance is accounted for by committee meeting frequency with other variables in the stochastic term accounting for the remaining 88.82% of variations in firm performance. The adjusted R-squared valued at -0.015417 implies that even if other variables accounted for in the stochastic parameter were included in the model, committee meeting frequency would still account for 0% of the variations in firm performance. Therefore, null hypothesis 2 is hereby accepted indicating that audit committee meeting frequency has no significant effect on firms' performance. This finding also contradicts with Evans et al., (2002) who found that there is a poor performance by significantly increasing board meeting frequency possibly due to the increased cost of holding meetings and reverse of decisions taken in earlier meetings but agree with Rebeiz and Salameh (2006) who found out that there is no relationship between audit committee frequency and firm performance.

From Table 3, the r-squared (regression coefficient) result reveals that 8.16% (represented by 0.08163) of the total variation in firm performance is accounted for by committee members' financial literacy with other variables in the stochastic term accounting for the remaining 91.84% of variations in firm performance. The adjusted R-squared valued at -0.012501 implies that even if other variables accounted for in the stochastic parameter were included in the model, committee members' financial literacy would still account for 0% of the variations in firm performance. Therefore, null hypothesis 3 is hereby accepted indicating that audit committee members' financial literacy has no significant effect on firms' performance. This is contrary to the findings of Rasidah and Mohamed (2006) that the audit committee members with experience in financial institutions are effective monitors in reducing earnings management.

VII. RECOMMENDATIONS

The findings of this study revealed that audit committee effectiveness has no significant effect on firms' performance in Nigeria. This implies that the audit committee as integral part of the board is not really affecting the performance of these banks. None-the-less, banks in Nigeria should pay particular attention to the financial literacy of audit committee members, the size and frequency of their meeting so as improve the public rating of their financial reports. Based on the study, the following are recommended that Nigerian banks are encouraged to have a board with members from different backgrounds and at least 5-member is recommended, at least 20% of the audit committee members should be financially literate for them to be able to interpret items on the financial report, at least (4) four meeting should be held in a year by the audit committee so as to address issues of corporate governance every quarter and resolutions of audit committee meeting should be implemented to make the expenses incurred on them worthwhile.

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