

# The Effect of Corporate Governance Attributes On Audit Quality in Nigeria



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**Abstract:** An excellent relationship between corporate governance attributes and audit quality is another monitoring mechanism that enhances the reliability of financial information. Though, one of the strategies of achieving the qualitative audit is that auditors must be independent of mind and appearance. As such, an active board and audit committee may support in monitoring the reliability of an entity's audit quality. The objective of this study is to investigate the effect of corporate governance attributes on audit quality for the Nigerian listed companies. The population of the study includes all the companies in the eleven sectors of the economy, excluding the financial sector from 2012-2017. The study used only sixty-three companies as a sample after filtration and screening. The data was obtained from the annual reports and accounts of the selected companies. Multiple regression was carried out in testing the relationships between the dependent and independent variables. The result of the regression highlighted an insignificant negative relationship for board independence and positive significant and negative significant for meetings and gender of the audit committee, respectively. Agency is the main theory employed, which is supported by earnings management theory. Thus, the findings support and contradict the theories. For the implication, this study provides clarification on the contributions of the board independence and audit committee meetings and gender towards the audit quality of the Nigerian listed companies, and this will help the users of the financial information and relevant scholars in literature development.

**Keywords:** Corporate Governance; Audit Quality; Nigerian Listed Companies.

## I. INTRODUCTION

Reliability is the major concerned for the quality of financial information that every potential investor is after in

the financial report of the company. A qualitative audited financial information automatically makes the financial report to be reliable (1). However, (2) suggests that corporate governance mechanisms and external audits can be substituted for each other, which implies that greater internal control will be attributed to lower audit fees. In Nigeria, the financial crisis related to the external auditors is immensely increasing, which provide the need to look for indicators of reliable audit quality. World Bank, 2004 and 2011 studies highlighted that various regulations and poor application and participation with professional auditors to report fake results are influencing factors against compliance and misrepresentation of the financial reports in Nigeria.

These problems in audit reporting practices contributed immensely to the Nigerian financial crisis and cost them to lost confidence in both local and international potential investors (3) Thus, the crisis had led to the massive crash of the Nigerian stock market and falling in the value of the Nigerian currency (4). Examples of this are the accounting scandals by Cadbury Nigeria PLC and African Petroleum PLC. That has brought about doubt in the minds of the shareholders on the credibility and reliability of financial reports in Nigeria. Literature justified the relationship between the study variable see fore ample, (5) who examined the influence of audit quality about corporate governance. More so, (6–11). Also, (12) study the relationship between internal governance mechanisms and audit service and non-audit service fees.

The objective of this study is to investigate the effect of corporate governance attributes on the audit quality of the Nigerian listed companies. The organisation of this paper is divided into five sections. Section one is the introduction of the study and explanation of the related issues. In section two, there is a literature review of the previous studies. Section three is research methodology. Section four is the discussion of the result from the study model. In section four, there is a conclusion and recommendations for further research.

## II. LITERATURE REVIEW

Hence, corporate governance mechanisms aid stakeholders in aligning the interests of managers with the interests of investors, and by improving the dependability of the financial information and the truthfulness of the financial reporting process (13). As such, some of the key actors of the corporate governance mechanisms are the board of directors, audit committee and external auditors.

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Thus, the agency theory posits that the critical function of the board and audit committee is to ensure that an agent is performing in the best interest of the shareholders. Furthermore, they are also expected to assist in ensuring the vest audit services by external auditors in reasonable audit fees and mitigate the likelihood of financial fraud and illegal reporting practice in the organisation (14) Thus, it is expected that the corporate governance mechanisms increase audit quality, which will, in turn, enhance financial reporting. Below is the summary of the empirical studies on corporate governance mechanisms and audit quality.

(15) examined the influence of board independence over audit fees. The findings show that board independence has a significant positive influence over audit fees. Similarly, explored the determinant (16) of audit fees; the study reveals a significant positive association between independence and audit fees. Contrary to that (17,18) examined the influence of corporate governance over audit fees. The study shows a significant negative relationship between board independence effectiveness and audit fees.

More recently, (19,20) they examined the influence of female audit committee members on the audit fees. The study reveals a significant positive association between female audit committee members and audit fees. That suggests that female representation on the audit committee increases audit fees in demanding for more audit efforts. In the studies of (21,22) they examined the effect of board gender diversity on audit fees. The studies reveal that female audit committee chairs are associated with lower audit fees. They argued from a preview of the demand perspective that female audit committee chairs decrease the desire for the assurance delivered by external auditors.

Accordingly, the study of (21,23) confirms that an audit committee meeting is associated with higher audit quality. It is affirmed by (22) who examined the influence audit committee meeting on audit quality. He found that meetings and financial experts are positively related to audit fees. More so, (6) studied the influence of the audit committee meetings on audit fees effectiveness over the audit quality. Their finding supports that there is a negative relationship between audit committee meeting and the audit fees. Therefore, from the studies above, the following hypothesis is proposed.

*H<sub>1</sub>: There is a significant positive relationship between board independence and audit quality of the listed companies in Nigeria.*

*H<sub>2</sub>: There is a significant positive relationship between audit committee meetings and audit quality of the listed companies in Nigeria.*

*H<sub>3</sub>: There is a significant positive relationship between audit committee gender and audit quality of the listed companies in Nigeria.*

### III. METHODOLOGY

The data was collected from the annual reports and accounts of the sampled companies. The study utilised the population of the total public listed companies on the flow of Nigerian Stock Exchange (NSE) from 2012-2017 financial years of the companies. Ten sectors with one hundred and thirteen companies were selected as a sample from the eleven total sectors, which has an aggregate number of one hundred and sixty-nine listed firms. The financial sector has fifty-six companies that were excluded from the sample of this study

due to the different rules and regulations governing the sector. However, out of the one-hundred and thirteen companies, NSE delisted twenty-one from the sample years, and twenty-nine companies failed to provide available data needed by this study. Therefore, in the end, sixty-three companies with three hundred and seventy-eight firm years' observations were used as a final sample of the study.

### A. Model Specification and Variable Measurement

The proxies of the dependent and independent variables are being highlighted in table 1 below.

Table 1: The proxies of the study variables

Variable	Acronym	Measurement
Audit Quality	AQLT	Natural logarithm of audit fees for the year (24).
Board Independent	BIDEP	Proportion of nonexecutive/independent board member (25).
AC Meetings	ACMT	A number of meetings held by the audit committee during the year(26).
AC Gender	ACGEN	Percentage of women directors on the audit committee (27).

Using the proxies in table 1 above, the main regression analysis of the study is highlighted in the following model. It explained the relationship between the dependant and the independent variables.

$$AQLT_{it} = \beta_0 + \beta_1 BIDEP_{it} + \beta_2 ACMT_{it} + \beta_3 ACGEN_{it} + \beta_4 LEV_{it} + \beta_5 FAGE_{it} + \beta_6 FSIZ_{it} + \beta_7 FGROW_{it} + \beta_8 ROA_{it} + \epsilon_{it}$$

Where: AQLT = audit quality, BIDEP = board independent, ACMT = audit committee meetings, ACGEN = audit committee gender, LEV = leverage, FAGE = firm age, FSIZ = firm size, FGROW = firm's growth, ROA = return on assets,  $\epsilon_{it}$  = error term.

## IV. RESULT AND DISCUSSION

### A. Descriptive Statistic

Table 2 below revealed the average descriptive values of the dependent variable audit fees as 16.503million Naira (equivalent to 47,229 USD), this is the average amount of the audit fees paid by the Nigerian companies. Hence, the table agreed that the minimum amount of the audit fee is 13.710 million Naira as (equivalent to 39,171 USD) and maximum of 19.536 million Naira (equivalent to 55,817 USD) for the listed firms in Nigeria. However, for the independent variables, the board of directors have a minimum of 11% representation of the independent directors and a maximum of 92% approximately.



Thus the average value of the independent director’s representation is 64%. It implies that independent directors dominate the board of Nigerian companies. The audit committee meetings held on average 4 times per year and a maximum number of 9 times as well as a minimum of 1 time respectably. Similarly, for the proportion of audit committee gender, the minimum proportion of female member is 0% while the maximum proportion is 20%, and the average proportion is 16%. Therefore, it is indicating that the engagement of women in the audit committee is low compared to their counterpart in the Nigerian listed companies.

Table 2: Descriptive Statistics

Variable	Mean	Min	Max	Sd
AQLT	16.503	13.710	19.536	1.013
BIDEP	0.640	0.111	0.917	0.161
ACMT	3.992	1.000	9.000	0.924
ACGEN	0.158	0.000	0.200	0.144
LEV	0.373	0.007	1.000	0.226
FAGE	23.534	2.000	69.000	14.321
FSIZ	16.774	12.557	21.215	1.799

FGROW	0.711	-1.000	35.211	3.751
ROA	0.018	-1.196	0.641	0.183

Note: AQLT = audit quality, BIDEP = board independence, ACMT = audit committee meetings, ACGEN = audit committee gender, LEV = leverage, FAGE = firm age, FSIZ = firm size, FGROW = firm growth, ROA = return on asset.

**B. Correlation Matrix**

Use either from table 3 of the correlation matrix below, the result indicated that only audit committee meeting among the independent variables is correlated to the audit quality, it correlated at 10% significant level. That signifies the relationships of the variable in the regression model. The control variable of firm size is also correlated at 10% significant level with the audit quality. However, all other related variables are not correlated to the audit quality of the Nigerian listed firms.

Table.3 Correlation Matrix

Variable	AQLT	BIDEP	ACMT	ACGEN	LEV	FAGE	FSIZ	FGROW	ROA
AQLT	1.000								
BIDEP	-0.066	1.000							
ACMT	0.241***	-0.057	1.000						
ACGEN	-0.036	-0.005	0.033	1.000					
LEV	-0.026	-0.044	0.095	0.095	1.000				
FAGE	-0.000	-0.048	-0.134	0.060	0.045	1.000			
FSIZ	0.645***	0.066	0.103*	-0.068	-0.141**	0.095	1.000		
FGROW	-0.090	0.085	0.075	-0.004	0.088	-0.060	-0.179**	1.000	
ROA	-0.077	-0.036	-0.152	-0.095	-0.115	0.036	0.226***	-0.036	1.000

Note: AQLT = audit quality, BIDEP = board independence, ACMT = audit committee meetings, ACGEN = audit committee gender, LEV = leverage, FAGE = firm age, FSIZ = firm size, FGROW = firm growth, ROA = return on asset, \* p<0.01, \*\* p<0.05, \*\*\* p<0.0 = significant at 1%, 5% and 10% respectively.

**C. Regression Result**

The The result of the fixed effect regression was reported in Table 4 below. However, the fixed effect regression was carried out based on the suggestion of the significant P-value of 0.000 in the Housman test as documented in the table. From the regression result, board independent has an insignificant negative relationship with audit quality. It is signifying that a minimum proportion of the independent directors on the board may have a significant influence on the audit fees of the Nigerian companies.

Moreover, not all independent directors have a financial knowledge to review the audit fees professionally, but it may happen as a result of much experience and dedications as independent directors, they may act to the best interest of the shareholders. The finding is in line with agency and resource dependency theories that believe much engagement of the

independent professional members of the board will help in making rational decisions.

Therefore, the first hypothesis of this study was rejected. Thus, the result supported the studies conducted by and (28), who revealed that a larger proportion of the board independence was negative insignificantly related to the audit fees. Contrary to that, (19,29) documented an insignificant positive relationship.

The statistical result of audit committee meetings was found as a 5% level of a significant positive relationship with audit fees of the Nigerian listed firms, and a coefficient value of 11%. That is to say, every increase in one sitting for the audit committee may also increase 11% of the audit fees in the selected companies. Thus, the result supported the second proposed hypothesis of the study.

However, this result implies that more regular meetings may lead to fatigue and tiredness, and creating room for accommodating irrelevant discussions that are outside the scope and the overall objectives of the firms. Therefore, the finding agrees with the agency and resource dependency theories that presumed in no need for a regular meeting by the professional in making the decisions of the paramount interest of the shareholders. The finding is in line with the study of (30) who showed the committee meeting was positively related to higher audit fees. It is contradicted with the study of (30) that revealed a negative relationship to higher audit fees.

**Table 4: Relationship between corporate governance attributes and audit quality**

AQLT	Coef.	Std. Err.	t-val	p-val
BIDP	-0.320	0.249	-1.280	0.201
ACMT	0.112	0.045	2.510**	0.013
ACGEN	-0.499	0.291	-1.720***	0.087
LEV	0.143	0.180	0.790	0.428
FAGE	-0.005	0.003	-1.610	0.107
FSIZE	0.349	0.029	11.890***	0.000
FGROW	-0.007	0.011	-0.720	0.475
ROA	-1.139	0.224	-5.100***	0.000
Cons	10.562	0.541	19.51***	0.000
R <sup>2</sup>		0.376		
Hetttest (Chi2)		0.580		
P.value		0.444		
HM Test (Chi2)		40.800		
P.value		0.000		

Note: AQLT= audit quality, BIDEP = board independence, ACMT = audit committee meetings, ACGEN = audit committee gender, LEV = leverage, FAGE = firm age, FSIZ = firm size, FGROW = firm growth, ROA = return on asset, \* p<0.01, \*\* p<0.05, \*\*\* p<0.001. = significant at 1%, 5% and 10% respectively.

The audit committee gender diversity in the Nigerian listed companies was found as 10% negative significant level relationship with audit fees, the coefficient value if 49%. It implies that whenever there is an increase in 10% of the female members in the audit committee, there will be a likelihood for a decrease in audit fees by 49%. Therefore, the result rejected the third hypothesis of the study. The explanation for this could be that female member are more conservative for a better consultation than the men. That could make them purchase fewer audit services from the external auditors. The result supports the expectations of agency and resource dependency theories of audit quality, which suggests that greater internal control is attributed to lower audit processes and thus, to lower audit fees. Some literature supported this finding see, for example, the study of (31) who found a significant negative association between the committee gender and audit fees. Contrary to that, a study of (32) revealed the relationship positively.

## V. CONCLUSION

External auditors play a vital function in corporate governance, which serves as a complementary mechanism for

enhancing the legal protection of outside shareholders. It will, in turn, reduce the agency complicity between the company's insiders and outside shareholders. This study examined the effect of corporate governance attributes on the relationship between audit quality of the listed firms in Nigerian. The attributes used was a combination of board and audit committee characteristics.

The result highlighted an insignificant negative relationship in board independence and positive significant in an audit committee meeting, while a significant negative relationship was documented in audit committee gender and audit quality using audit fees in the Nigerian listed companies. It is concluded that a high number of female members in the audit committee attract low audit fees and force the audit team to decrease tests, which will positively affect audit quality. Consequently, it is the same as more independent members of the board promote shareholders' interests and strengthen the credibility of the audit quality.

However, a high number of meetings in the audit committee will demand higher audit fees in order to protect the corporate reputation. The finding will help the potential investors, policymakers and regulators about the effect of board and audit committee on audit fees in Nigerian listed companies. Therefore, this study is recommending for further research on this area to employ more measures of audit quality and also to apply the use of intervening variable or other corporate governance mechanisms in order to have more strength of the study

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