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Corporate Governance and Audit Quality of Quoted Non-Financial Firms in Nigeria

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ABSTRACT
The main objective of this study is to examine corporate governance and audit quality of quoted non- financial firms in Nigeria. Specifically, to surveys the effect of board diligence, ownership concentration, board independence and managerial ownership on audit quality. The ex-post facto research design was adopted in the methodology of this study. The population consists of all quoted non- financial firms on the Nigerian Stock Exchange. A sample of 25 firms was examined between 2011-2016 financial years. Secondary data from financial statements of the sampled firms were used for the study. The data analysis technique used for this study was regression analysis using the pooled ordinary least squares and the panel Estimated Generalized Least Squares (EGLS) with fixed effects. The study revealed that board diligence enhances audit quality with significant effect while board independence, managerial ownership were not significant in determining audit qualities. Also, the ownership concentration does not determine audit quality but it was insignificant in this direction. Based on these findings, the study therefore recommends that the corporate governance code of best practices of 2010 should be re-evaluated and assured corporate governance indicator such as board diligence increased statutorily.
Keywords: Corporate Governance, Audit Quality, Ownership Structure and Quoted Firms

INTRODUCTION

The collapse of quoted firms both in financial and non-financial sectors shortly after the audit report has continued to raise the concern of professionals and members of the General public in Nigeria and the world at large. It has brought the need to enforce and strengthened the corporate governance structure of quoted firms with a view to enhancing audit quality in the financial reporting process. Basically, audit quality is enhanced through the effectiveness, objectivity and independence of the statutory auditors appointed by the corporate board of directors to audit the annual report prepared based on particular accounting standards and legal frameworks.

Good corporate governance by Board of Directors is recognized to influence the quality of financial reporting which in turn has an important impact on investors' confidence (Levitt, 2000). The quality of financial reporting is a function of audit quality which has the capacity to influence the investors' confidence. Adeyemi and Adeyemi and Fagbemi (2010), posits to search for mechanisms and ensure reliable high quality financial reporting has largely focused on the structure of audit quality. They noted that the auditing profession has been proactive in attempting to improve audit quality by issuing standards that focus on discovery and independence. There is no doubt that user of financial statements perception of audit quality is linked to an effective audit quality. This is premised on the fact that investors' assessment and confidence on the annual financial statements remains thwarted if thorough auditing is not done to provide the needed assurance geared towards encouraging investments. Against this back drop, this work examines corporate governance and audit quality of quoted non-financial firms in Nigeria.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Owing to the separation of ownership and control (and the resulting agency problems) in the modern business world, a system of corporate governance is necessary, through which management is overseen and supervised to reduce the agency costs and align the interests of management with those of the investors. While there is no generally accepted definition, corporate governance may be defined as a system 'consisting of all the people, processes and activities to help ensure stewardship over an entity's assets' (Messier, Glover and Prawitt, 2008).

Cadbury (1992) define corporate governance as a whole system of control financial and otherwise, which ensure that a firm is directed in the right way and towards the right direction. The Cadbury Committee's definition focused on the ways in which organizations are controlled and managed so as to achieve their main objectives. It also suggested that Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals.

The aim of corporate governance therefore, aligns nearly as possible the interests of individuals, corporations and society (Corporate Governance Forum, 2005). This definition stands out, as it states unequivocally the various roles of businesses. That is to say, organizations should not just be seen as an instrument of satisfying shareholders alone, rather, seen as an integral part of the community having its own share of duties and responsibilities. Management therefore, has a duty of care to the society as well to their shareholders.

Monks and Minow (1995) defined Corporate Governance in terms of interactions between various players in the corporate environment and the processes used in achieving consensus in the allocation of corporate resources and in the determination of corporate direction to ensure improved performance. This definition can be said to link Corporate Governance with the strategic position of organizations and perhaps sees Corporate Governance as the exclusive preserve of strategic level management.

Yadong (2004) addressed the concerns of stakeholders. It sees Corporate Governance "as the relationship between the corporation and the stakeholders that determines and controls the strategic direction and performance of the corporation. It is also the system by which corporations are directed and controlled". He further suggested that "this structure specifies the distribution of rights and responsibilities among various corporate participants including board members, executives, shareholders and other stakeholders; it spells out the rules and procedures for making decisions on corporate affairs". It also provides the structure through which the company sets objectives, the strategy for attaining those objectives and the guidelines for monitoring performance. This definition has important implications not just for the nature of interaction between corporate structures but also for interactions between the individuals within the structures. And a possible criticism of this definition is in its inability to specify the potential roles of stakeholders in the governance system. Although it mentioned the setting of rules and procedures for making decisions on corporate affairs, it is not explicit on the involvement of the stakeholders in governance and modalities for the allocation of corporate resources.

Audit quality adds a significant value to investors in capital markets because they often use audited financial statements by auditors as the main basis for investment decisions (Sudsomboon and Vssahawanitchakit, 2009). Bradshaw, Richardson and Sloan (2001) defined audit quality as the willingness to report any material manipulation or misstatements that will increase the material uncertainties and/or going concern problems. De Angelo (1981) view audit quality as the market assessed joint probability that auditor discovers an amorally in the financial statements, and reveals it. The ability of the auditor to reveal the amorally discovered in the financial statements is subject to how objective and independent the auditor is in the course of auditing exercise. One of the important attributes of auditing is related to audit quality in a way that audit-firms lower the information risk by providing the firm-specific financial reports integrity and improving its quality. Audit quality is positively associated to the integrity of firms' financial reports and negatively associated with the firm-specific information risk and its cost of equity capital. The quality of the firms' disclosed information is enhanced by the quality of audit, which in turn lowers the information asymmetry along with the detection and avoidance of accounting errors and misstatements (Chang, Gygax, Oon, and Zhang, 2008). Audit quality is normally related to the ability of the auditors to identify material misstatements in the financial statements and their willingness to issue an appropriate and unbiased audit report based on the audit results (Enofe, Mgbame, Aderin, and Ehi-Oshio, 2013).

Based on the Composition of Audit Committee, the internal audit contribute to the good corporate governance by bringing the best practice ideas about internal controls and risk management processes to the audit committee; providing information about any fraudulent activities or irregularities; conducting annual audits and reporting the results to the audit committee; encouraging audit committee to conduct periodic reviews of its activities and practices compared with current best practices to ensure that its activities are constituent with leading practices. From the other hand, an effective audit committee strengthens the position of the internal audit function by providing an independent and supportive environment and reviews the effectiveness of the internal audit function (Adams, 2003). The code provided for an audit committee that is expected to be effective and efficient. As such the composition of the audit committee is a dichotomous variable, assigned if there are at least three non – executive directors on the audit committee, otherwise.

The board of directors assumes an important role in corporate governance. Owing to the separation of corporate management and ownership, boards exist to protect the interests of shareholders and the board of directors is charged with monitoring and disciplining senior management, and therefore assuring the quality of financial reporting. Several studies provide evidence regarding the importance of the role of the board of directors in monitoring financial reporting, and therefore mitigating the manipulation of accounting information.

The relationship between external shareholders and managers is marked by moral hazard and opportunism, which result from information asymmetry. It is assumed that institutional investors have more influence than other individual investors. With the high portion of ownership, institutional ownership has importance on monitoring role in the process of auditing. It is rational that institutional investors demand high quality information from the firm. It was observed that the greater the level of institutional ownership, the more likely it is that a firm purchases audit services from large audit firm in order to ensure high audit quality. It also found that diffused institutional ownership was significantly and positively related to audit fees. It is expected that the portion of institutional ownership will have impact on audit quality of the firm. Also, believes that the growth of institutional ownership will increase demands for audit services with higher quality.

Drawing from the literature, the hypotheses to be tested in this study are stated below in their null forms:

H_1: There is no significant relationship between board diligence and audit quality of Nigerian quoted non-financial firms

H_2: There is no significant relationship between ownership concentration and audit quality of Nigerian quoted non-financial firms.

H_3: There is no significant relationship between managerial ownership and audit quality of Nigerian quoted non-financial firms

H_4: Board independence does not enhance audit quality of Nigerian quoted non-financial firms.

METHODOLOGY

Theoretically, there are various types of research designs. However, the study seeks to employ the ex-post facto method of research design. This is because the data generated were already in place in their respective secondary source; that is the annual reports of the selected firms in the Nigerian Stock Exchange library. The data analysis shall be done using descriptive statistics such as the mean, maximum, minimum, skewness, kurtosis and the jargue-bera statistics at a given significant or probability value (P-value). The correlation research design shall be used such that the direction of the association among the variables, whether positive, negative and the significance of the association as well could be assessed. The last component of the research design to be adopted in this study is the experimental type. The experimental research design shall also be employed in this study simply because the researcher seeks to evaluate the impact of some group of exogenous variables (corporate governance variables) on an endogenous variable (audit quality), thus establishing the impact. Panel data shall be used in this study. The quoted companies used in this study cut across all quoted non-firms in Nigeria.

A total of twenty five (25) listed firms operating both in the service and manufacturing industries in the Nigerian Stock Exchange were selected as sample size using purposive sampling technique. To achieve the objective of the study, secondary data sources shall be employed from annual reports of the firms that made the sample for the period between 2011-2016. This choice is subject to availability and accessibility of the annual reports.

Model Specification and Data Analysis Methods

Gana and Lajmi (2011) documented the relationship between the board characteristics and external audit quality; and had to use two models stated below:

$$FAUD_{it} = \beta_0 + \beta_1 INDE_{it} + \beta_2 DUAL_{it} + \beta_3 SIZE_{it} + \beta_4 DILI_{it} + \beta_5 AGE_{it} + \beta_6 SEN_{it} + \beta_7 LTDTA_{it} + \beta_8 PROF_{it} + e_{it} \ldots\ldots\ldots\ldots\ldots\ldots. 3.1$$

$$RAUD_{it} = \beta_0 + \beta_1 INDE_{it} + \beta_2 DUAL_{it} + \beta_3 SIZE_{it} + \beta_4 DILI_{it} + \beta_5 AGE_{it} + \beta_6 SEN_{it} + \beta_7 LTDTA_{it} + \beta_8 PROF_{it} + e_{it} \ldots\ldots\ldots\ldots\ldots\ldots. 3.2$$

The variables are defined as follows:

FAUD: audit fees which are equal to the natural logarithm of audit fees.

RAUD: auditor reputation is a binary variable equal to 1 if the audit firm belongs to the "Big four" and to 0 otherwise.

INDE: independence of the board of directors is measured by the proportion of non-executive outsider directors relative to the total number of directors.

DUAL: duality of the board is a dummy variable that takes the value of 1 if the same person holds both positions and 0 otherwise.

SIZE: the size of the board of directors is measured by the total number of directors.

DILI: the diligence of the board is measured by the number of meetings conducted annually by the board.

AGE: the age of the CFO.

SEN: the seniority of CFO in the firm measured by the natural logarithm of the number of months worked in the firm.

LTDTA: the financial leverage of audited firm measured as the long term debt to total assets ratio.

PROF: economy profitability of the firm which is equal to the ratio of profit before tax and interest on total assets.

β_1- β_8 are the coefficients to estimate.

E and e' represent error term.

The index i corresponds to the company and the index t to the period.

The above models of the prior researchers are adopted in this study with a modification below:

$FAUD = \beta_0 + \beta_1 Bdi_{it} + \beta_2 OC_{it} + \beta_3 MGO_{it} + \beta_4 Bind_{it} + u_t$………….. 3.3

The above model used in this study indicates that audit quality is proxy using external auditors' reputation and audit fees.

Where:

FAUD	=	audit fees paid to the external auditors
$\beta_1 - \beta_4$	=	Coefficient of the independent variable.
Bdi	=	Board diligence, independent variable.
OC	=	Ownership concentration
Mgo	=	Managerial ownership
Bind	=	Board independence
t	=	time period, 2011 – 2016
β_0	=	The intercept
ut	=	Error term

These models used are actually inspired from the works of Simunic (1980) tested in the U.S.A. market which was subsequently modified by Salleh *et al.,* (2006) in the Malaysian market and was further adopted by Gana and Lajmi (2011) in Belgian. Given the two different measures of audit quality within the Nigeria context, it is expected that empirical substantiation would be made with a view to contributing to knowledge. Employing the econometric package of E-views version 7.0, the pooled and panel data estimates of the multiple regression models shall be obtained after some preliminary statistical analysis such as descriptive statistics and correlation matrix as earlier stated. The first model is a linear regression model whose dependent variable is metric while the second model is a logistic model where the dependent variable is binary. Several other tests shall also be performed after the regression analysis which include variance inflation tests (VIFs), Breusch-Godfrey serial correlation LM test, Heteroskedasticity test (ARCH test) and Ramsey specification test. The two models were analyzed using the fixed effect and random effect generalized least square regressions. The apriori signs are $\beta_1 - \beta_4 > 0$. The above apriori signs connote that the explanatory variables were expected to significantly and positively influence the audit quality of the selected firms in the period under consideration.

DISCUSSION OF FINDINGS

Evaluation of the regression result in the tables shows that board diligence has a positive slope coefficient and statistically significant at 5% (P=0.02) to determine audit quality; but displays a weak association (r=0.07) in the period under consideration of the sampled firms. With the fixed effects panel estimation given the result of the Hausman test, board diligence (BDI) appears to have a positive (3753.25) effect on audit quality which was however not statistically insignificant (P=0.122) at 5% level. Consequently, we accept the hypothesis (**H1**) of no significant relationship between board diligence and audit quality in Nigerian quoted non-financial firms. The empirical evidence regarding the effect of board diligence is still quite unclear due to inadequate focused attention on the relation. The statistical insignificance of the relation between the two variables has a lot of policy recommendation in this study. Similarly, the non-significance of the influence of the board diligence in relation to audit quality can be intuitively said to be as a result of the variations and reduction in the frequency of board meetings in the quoted non-financial firms used for this study in the various years. The study finding is quite different from Yatimi *et al.,* (2006) where they ascertained negative relationship between boards of directors' diligence. Similarly, Chukwunedo and Ogochukwu (2014) found that frequency of board meeting was not related to audit quality. However, the finding from the study is in tandem with DeZoort *et al.,* (2002) and Carcello (2002). It clearly suggests that the frequency of meeting by the board serves as a monitory process and has the propensity to enhance audit quality of quoted non-financial firms in Nigeria.

Evaluation of the panel least squares regression result in the tables indicates through ownership concentration has a positive but weak (r=0.09) relationship with audit quality, but has a negative and statistically insignificant impact on audit quality. With the fixed effect panel estimation, OWCONT has a negative (-99.47) effect on audit quality which is also insignificant at 5% (p=0.197). Consequently, we rejected the (**H**$_2$) which say no significant relationship between ownership concentration and audit quality in Nigeria. In line with the study finding, Chen, Yen, Fu and Chang (2007) point out that the audit service (quality) demand by firms with controlling shareholders could be different from that demanded by firms without controlling shareholders; they found that audit quality is indeed deteriorated and compromised when an auditor faces a business of family controlled clients. Similarly, the finding made is not somewhat varying from that of Ashbaugh and Warfield (2003) study in Germany where they found a positive relationship between ownership dispersion and audit quality.

The empirical result shows that board independence (BIND) has a positive association with audit quality. The result indicates that board independence has a positive impact on audit quality though statistically insignificant at 59 (P=0.679). The fixed effect panel estimation result of BIND has a positive (98.34) impact on audit quality, though is statistically insignificant at 5% (p=0.533). On this basis, we accept the hypothesis (**H**$_3$) of no significant relationship between board independence and audit quality of quoted non-financial firms in Nigeria. The result shows that managerial ownership has a positive relationship with audit quality and statistically significant at 5% (p=0.90). With the fixed effects panel estimation, MGO appears to have a positive (337.01) impact on audit quality though not statistically insignificant at 5% (p=0.09) level. Hence, we accept the hypothesis (**H**$_4$) of no significant relationship between managerial ownership and audit quality in Nigeria non-financial firms.

CONCLUSION AND RECOMMENDATION

An important body of research in empirical anterior has been the effect of corporate governance in relation to audit quality given the spate of corporate collapse shortly after the audited annual reports of quoted non-financial firms. This has continued to raise some level of curiosity about which corporate governance indicators can considerable determine audit quality. The aim of this study is to provide greater insight into how certain corporate governance mechanisms may positively determine the audit quality of quoted non-financial firms in Nigeria. In attempt to provide empirical evidence, we examine board diligence; ownership concentration, board independence and managerial ownership significantly determine audit quality. Our study found that board diligence proxy as frequency of board meeting has a positive association with audit quality; it positively determines audit quality and is statistically significant in the period considered. Board independence and managerial ownership positively determine audit quality but were not significant. However, ownership concentration negatively influence audit quality and is insignificant.

Based on our empirical findings, it is therefore recommends that;

i. The Security and Exchange Commission as well as the auditing profession make it mandatory for frequency of board meeting to be at least 10 to 15 times per annual. This will enable proper supervision and monitoring of the corporate organizations' affairs in pre and post-audit period.

ii. The percentage of ownership in quoted companies should be readily defined or specified in the corporate governance code of best practices since large ownership concentration have been empirically evaluated to display adverse effect on the audit of quoted non-financial firms.

iii. There should be "belt tightening" measure statutorily put in place by regulators of the capital market and other relevant bodies to ensure the percentage of external directors on the corporate board outweigh that of the executive board of directors so as to continually provide an oversight function to ensure audit quality is greatly improved; and the enhancement of shareholders' investment decision making in the corporate world.

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Table 1: Descriptive Statistics

	FAUD	BDI	OWCONT	BIND	MGO
Mean	91396.46	5.133333	78.99933	53.04907	35.20644
Median	75000.00	5.000000	56.99000	55.60000	26.92500
Maximum	1401000.	8.000000	3565.000	100.0000	135.6400
Minimum	2500.000	2.000000	7.970000	11.11000	1.010000
Std. Dev.	177446.7	1.040564	287.3606	18.02084	31.85548
Skewness	5.991698	-0.411726	12.01966	-0.440265	1.038849
Kurtosis	40.74872	2.993750	146.3257	2.691802	3.438314
Jarque-Bera	9803.550	4.238209	132000.9	5.439501	28.18094
Probability	0.000000	0.120139	0.000000	0.065891	0.000001
Sum	13709469	770.0000	11849.90	7957.360	5280.966
Sum Sq. Dev.	4.69E+12	161.3333	12303844	48387.85	151201.0
Observations	150	150	150	150	150

Source: Author's Review 7.0 Output, 2017

Table 2: Correlation Tests

FAUD	BDI	OWCONT	BIND	MGO
1	-0.007	0.009	0.060	-0.042
-0.007	1	0.159	-0.254	-0.166
0.009	0.159	1	0.002	0.040
0.060	-0.254	0.002	1	0.182
-0.042	-0.166	0.040	0.182	1

Source: Author's Review 7.0 Output, 2017

Table 3: Panel Data Estimation Result

Dependent Variable: FAUD
Method: Panel Least Squares
Date: 06/19/17 Time: 16:42
Sample (adjusted): 2011 2016
Periods included: 3
Cross-sections included: 25
Total panel (balanced) observations: 75

Convergence not achieved after 500 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-52128.42	85433.67	-0.610162	0.5438
BDI	26301.64	11470.32	2.293017	0.0249
OWCONT	-747.1799	506.1070	-1.476328	0.1444
BIND	269.7458	644.5378	0.418510	0.6769
MGO	-40.72971	336.1894	-0.121151	0.9039
AR(3)	0.207878	0.023001	9.037697	0.0000

R-squared	0.613200	Mean dependent var	74245.28
Adjusted R-squared	0.585171	S.D. dependent var	138926.4
S.E. of regression	89478.63	Akaike info criterion	25.71801
Sum squared resid	5.52E+11	Schwarz criterion	25.90340
Log likelihood	-958.4252	Hannan-Quinn criter.	25.79203
F-statistic	21.87734	Durbin-Watson stat	1.673933
Prob(F-statistic)	0.000000		

Inverted AR Roots	.59	-.30+.51i	-.30-.51i

Source: Author's Review 7.0 Output, 2017

Table 4: Correlated Random Effects – Hansman Test

Equation: Untitled
Test period random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Period random	3.441199	4	0.4869

Period random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
BDI	-1400.225039	-158.461790	3230560.098279	0.4896
OWCONT	12.517049	7.369246	83.541619	0.5733
BIND	723.922083	691.761992	5225.689723	0.6564
MGO	-301.677064	-311.483304	987.865640	0.7550

Period random effects test equation:
Dependent Variable: FAUD
Method: Panel Least Squares
Date: 06/18/17 Time: 16:58
Sample: 2011 2016
Periods included: 6
Cross-sections included: 25
Total panel (balanced) observations: 150

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	69813.03	101405.4	0.688455	0.4923
BDI	-1400.225	15107.21	-0.092686	0.9263
OWCONT	12.51705	52.94253	0.236427	0.8134
BIND	723.9221	859.2289	0.842525	0.4009
MGO	-301.6771	476.7023	-0.632842	0.5279

Effects Specification
Period fixed (dummy variables)

R-squared	0.032618	Mean dependent var	91396.46
Adjusted R-squared	-0.029570	S.D. dependent var	177446.7
S.E. of regression	180051.2	Akaike info criterion	27.10421
Sum squared resid	4.54E+12	Schwarz criterion	27.30492
Log likelihood	-2022.816	Hannan-Quinn criter.	27.18575
F-statistic	0.524505	Durbin-Watson stat	1.506952
Prob(F-statistic)	0.854897		

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