AUDIT COMMITTEE SHAREHOLDING AND AUDIT QUALITY OF LISTED INDUSTRIAL GOODS FIRMS IN NIGERIA

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Abstract

The study examined the effect of audit committee block-shareholding on audit quality of listed industrial goods firms in Nigeria, using panel data. The population of the study is the twenty two (22) listed industrial goods firms in Nigeria from January 1st 2008 to 31st December 2018. The sample companies is nine (9), after filtering thirteen (13) companies as a result of delisting from the capital markets. Others were filtered out because the companies were not having sufficient data set for the period under review. Data for the study were obtained from audited financial reports and accounts of the sampled industrial goods companies for ten years period of the study. Binary logistic regression was used to analyze the data using STATA 14.0. The study shows that audit committee block-shareholding has a positive significant effect on the audit quality of listed industrial goods firms in Nigeria. The study recommends that, regulatory authorities like Securities and Exchange Commission (SEC) and Nigerian Stock Exchange (NSE) should encourage the industrial goods companies to have constituted audit committee with majority of block-shareholders and one among them to chair the committee.

Keywords:Audit Committee, Shareholding, Audit Quality Industrial Goods Firms

INTRODUCTION

Audit committee is one of the corporate governance mechanisms that have long been recognized as important for aligning the interest of stakeholders of firms. Audit committee is charged with oversight responsibilities of quality financial reporting process. Other responsibilities includes keeping under review the scope and results of external audit, as well as independence and objectivity of the auditors and faithful communication among others. Audit committee block-shareholder membership refers to the members of the audit committee with the percentage of equity owned directly or indirectly by the members, that is up to 5% of share outstanding or more. The large block-shareholders ownership means that the shares are controlled by a small group of people, hence ownership is concentrated. Concentrated ownership structure serves; as an efficient monitoring mechanism; to prevent managers from expropriating resources for private benefits (Juhmani, 2013).

Block-shareholders have potentials, beliefs, skills or preferences to influence firms through different channels and can compel the management of the company to maintain firm stock for a long-term in order to make gain or interest for themselves (Abu, Nyor & Okpanachi, 2018). Block-shareholders are believed to suffer a great loss of investments in the event of collapse or failure due to mismanagement of their huge investments by corporate managers. Block-shareholders are also interested in producing more benefits from their shareholding, and as such they decrease the likelihood of hiring qualified auditors or are less likely to hire a big audit firms or high quality auditor (Abu, Nyor & Okpanachi, 2018). Thus, the presence or membership of block-shareholders in audit committee might affect the activities of the audit committee either positively or negatively through their diligent activities to safeguard the going concerns of a firm or by undue influences on management decisions.

Audit quality is an outcome of the performance of the audit team. Salawu, Okpanachi, Yahaya and Nyor (2018) consider audit quality as the assessment of whether audits have served both the shareholders and other stakeholders' interests through increasing the accountability of managements and reinforcing trust and confidence in financial reporting. Auditors are charged with the responsibility of producing qualitative audit report and to be sure audit quality is consistently maintained.

The Industrial Goods (IG) firms are one of the vital industries in the world, largely because of their contributions and roles in every nation's economy. IG sector of Nigerian economy faces the same problem of corporate governance as a result of corporate irregularities by some firms to extent that the Nigerian Stock Exchange (NSE) has delisted many companies such as Adswitch PLC in 2016, IPWA PLC in 2016, Nigerian Ropes PLC in 2016, West Africa Glass Industry Plc in 2016, Ashaka Cement PLC in 2017, AVON Crown Caps & Containers PLC in 2017, African Paints PLC in 2018, Paints and Coatings Manufacturers PLC in 2018 and so on and so forth.

Audit quality has drawn worldwide attention when the big companies such as Enron and WorldCom collapsed in 2001 and 2002 respectively. The high profile scandals and investor dissatisfaction with governance practices have shifted away from 'soft law' such as comply - or- explain requirements and created more stringent standards for financial disclosure, committee, and board nominations, and audit policies (Shill, Hoque & Akter, 2015). With regards to this matter, countries around the world have tried to set the best practices as a guideline for enhancing corporate governance. Clear example among are Cadbury Report that was introduced in United Kingdom, Sarbanes Oxley in United States, the Dey Report in Canada, the Vienot Report in France, the Olivencia Report in Spain, the King's Report in South Africa, Principles and Guidelines on Corporate Governance in New Zealand and the Cromme Code in Germany (Bhagat & Bolton, 2009) as cited in Shil, Hoque and Akter (2015). The goals of most of these regulations were to improve firm's corporate governance environments in which audit committee is considered as a major player. Nigeria also witnessed reforms under corporate governance mechanism to enhance the oversight function of the board of directors and restore public confidence and the integrity of auditor and financial reports. For example, Nigerian Code of Corporate Governance 2003 which was later revised in 2011 and 2016 by Security and Exchange Commission Act and Companies and Allied Matter Act (CAMA, 2004). But still Nigeria witnesses several accounting scandals and corporate failures that were blamed on earnings management practices of firms, which audit reports were unable to detect and report truthfully.

Studies have been conducted on this area both in Nigeria and abroad but mostly examine audit committee with financial or firm performance such as Al-Matari (2012),Wakaba (2014), Cheah, Chew, Kuan, Low and Poon (2016), Glover-Akpey and Azembila (2016), Shehu (2017) and so on. While some other researchers examine audit committee with financial reporting quality such as Eyemebo, Mohammed and Ali (2017), Kibiya, Ahmad and

Amran (2016), Moses, Ofurum and Egbe (2016), Onyabe, Okpanachi, Nyor, Yahaya and Ahmed (2018), Ormin, Tuta and Shadrach (2015), Umaru (2014). While some investigated audit committee and earnings quality like Bala and Gugong (2015), Lin, Li and Yang (2006). Few studies are conducted on audit committee and audit quality like Asiriuwa, Osariemen, Uwuigbe and Uwuigbe (2018), Miko and Kamardin (2015), Salawu, Okpanachi, Yahaya and Nyor (2018). The domain used by other studies also motivated this work as to the best of knowledge of the researchers no study have been done on audit committee and audit quality for industrial goods sector of the Nigerian economy. More so, to the best of knowledge of the researchers, the variable used in this research is not used in area of audit committee in Nigeria rather the variables are commonly used in area of finance excepts in the work of Glover-Akpey and Azembila (2016) in Ghana.

This study therefore, examines the effect of audit committee block-shareholding and audit quality of listed industrial goods firms in Nigeria and hypothesized that:

H_o: audit committee block-shareholding has no significant effect on audit quality of listed industrial goods firms in Nigeria.

The study covers only listed industrial good firm in Nigeria. The study covers a period of ten years (2009 to 2018). The period is adequate to determine the effect of audit committee block-shareholding and audit quality of listed industrial goods firms in Nigeria and is consistent with the duration used in earlier studies like Samaila and Bello (2017) and Isa and Uba (2017).

Findings from this study will assist auditors in their duties and responsibilities with regards to the quality of audit activities, as to the factors that are of eminent importance in achieving high audit quality and high financial reporting quality. The study also offers important input to serve as a strong base for the regulators and professional accounting bodies to establish policies relating to type of `audit committee characteristics, members supposed to be in audit committee etc.

Literature Review

Audit committee concept in literature can be traced back to the American Institute of Certified Public Accountants (AICPA), who in 1967 recommended the establishment of audit committee boards in order to assist with reporting process (Asiriuwa, Aronmwan, Uwuigbe & Uwuigbe, 2018). More so, bodies such as the Tread Way Commission, Blue Ribbon committees, US Security and Exchange Commission contributed greatly in the development of audit committees (Blue Ribbon Committee 1999, Treadway Commission 1987). Audit committee in Nigeria started from the initial efforts that led the legislations to support the corporate governance and the audit committee in particular. These legislations are Companies and Allied Matter Act (CAMA, 2004) as amended and the Stock Exchange Law of 2003 and modified in 2011 and 2016. The Code of Best Practices on Corporate Governance in Nigeria (SEC Code, 2003) issued by the Securities and Exchange Commission in 2003 has greatly impacted the corporate governance scene in Nigeria (Okolie, 2014). Thus, audit committee in Nigeria has enactments with similar requirements as in many developed countries where it is required that all listed companies should establish an audit committee (section 359 (3), CAMA, 2004).

CAMA (2004) defines the audit committee as a committee of shareholders and non-executive directors charged with the responsibility of liaising between the external auditors and the board of directors on one hand, and between management and the external auditors on the other hand. Al-Thuneibat (2006) defines audit committee as a committee that is composed of non-executive directors in organization. The major goal behind forming the audit committee is to increase auditing quality and reduce questioning of board of directors when the external auditors are performing their duties. Audit committee is expected to be effective in discharging the responsibilities. Kalbers and Fogarty (1993), as cited in Samaila and Bello (2017) define audit committee effectiveness as the competency with which the audit committee carries out its specified oversight responsibilities. According to Dezoort and Salteerio (2001), an effective audit committee is the one that has qualified members with the authority and resources to protect stakeholders' interest by ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight efforts.

The most well-known definition of audit quality, which has been widely accepted by many scholars, is the one documented by DeAngelo (1981) which states that audit quality is a market-assessed joint probability that a given auditor will both discover a breach in the client's accounting system and report the breach.

The relevant theory considered in this research is stakeholders' theory which is defined in the work of Zabojnikova (2016) as ensuring the conditions of the responsibilities to the various stakeholders to create value and co-ordinate the management levels among various stakeholders including stockholders, employees, customers, creditors, suppliers, regulators, tax agencies, competitors, even the whole society. This theory proposes that the essence of corporate governance activities is not only to benefit the shareholders but also the other relevant stakeholders. A business would not be able to maximize shareholders value if any stakeholder is ignored or mistreated.

Auditors are expected to offer a reasonable assurance based on their professional judgments on whether the accounts show true and fair view from the business of the client. But many reported cases of scandals took place and auditors were failed to report that have led the even creation of audit committee with the main responsibility of recommending the appointment of external auditor and to maintain his independence. This study opines that the creation of that audit committee is part of the recognition and usage of the stakeholders' theory as other members are directly involved in audit matters of the firms and not left the audit issues between internal auditor and external auditors only even though they are the most responsible stakeholders on matters. Therefore, all stakeholders have to be given due considerations and fairly involved and treated. Stakeholders' theory is very important in the context of corporate governance and for the control mechanisms to be adopted by the companies, such as audit committees that we are examining in this paper, in order to enhance the audit quality of the firms.

Corporate governance literatures confirm that audit quality and financial reporting quality is highly effective when firms have effective constituted audit committees. Same on other hand, corporate finance literatures reveal that institutional and block-holder ownership structure affects audit quality either positively or negatively (Abu, Nyor & Okpanachi, 2018). Recent studies confirmed that firms have few shareholders that control the activities of the firms and some are in audit committee as either chairman or floor members in the committee. La Porta, Lopez-De-Silanes and Shleifer (1998) conducted study on non-financial firms in 49 countries and find that on average; the largest three shareholders own almost 50% of their company. Thus, such few shareholders that almost owns the company if become members in audit committee that might affect the success or otherwise of the committee through either diligence monitoring oversight activities or by injecting undue influences within the committee. Habbash (2013) opined that firms with a low level of block ownership, if compared with high-block-holder firms face less agency problems due to the separation of ownership and management, but more severely face agency problems between controlling (block-holders) and non-controlling shareholders (minority shareholders).Therefore, present or membership of such shareholders, especially, the controlling shareholders or block-shareholders in some committees affects the quality and results on the activities of the committee.

Scholars documented mixed results concerning how block-shareholding affects audit quality. Some studies reports positive impacts while other reports no effect. For example, Abu, Nyor and Okpanachi (2018) documented that block-shareholding has positive effect on audit quality. This indicates that having block-shareholders in audit committee positively affect the audit quality a firm. Thus, block-shareholders in audit committee enhance the activities of the committee and by so doing, improves the audit quality of a concerned firm. Audit committees are not effective in firms where agency conflicts arise between controlling and non-controlling shareholders (Habbash, 2013).

Also Habbash (2013) found that audit committees tend to be effective in constraining earnings management only in non-block-holders controlled firms. Therefore, membership of such holders in audit committee cannot affect negatively the earnings management. Another study conducted on the effect of block-shareholders on earnings management: the case of tunisian listed firms by Halioui and Jerbi (2012) found that the presence of block-shareholders affects positively the discretionary accruals and their result also shows that those block-shareholders are not effective monitors of earnings management even if they are part of the audit committee. This speaks the low level of block shareholders' effectiveness in constraining earnings management within committees. The ultimate objective of the appointment of non-executive members in the audit committee is to ensure that there is no undue pressure on audit committee members from individuals with controlling interests (Jaggi & Leung, 2007). However, if there are block-shareholders with a controlling interest, non-executive members of the audit committee will realize that their personal relationships with these large shareholders may influence their reappointment and, as a consequence, they may not oppose the views of the block-shareholders. Thus, if non-executive members of an audit committee have to show loyalty to the controlling shareholders, their independence and, thus, their effectiveness are compromised and this will affect the activities of audit committee and the audit quality of the concerned firms.

Methodology

This study adopts panel data from secondary sources. The population of the study is the twenty two (22) listed industrial goods firms listed on the the Nigerian Stock Exchange. The criteria used for sample size were two: First, the company must have been listed on the NSE on or before 2008. Secondly, it must have been quoted without being delisted between 2009 and 2018. This criterion was established with view to ensuring that the industrial goods companies have their published financial statements for the period covered by this study (2009 to 2018). As a result of this filters, the sample size of this study reduced to nine (9). Thirteen (13) companies were removed as a result of been delisted from NSE and/or because of incomplete data. Descriptive statistics was used in describing the nature of the data. Simple regression run in order to make inferences from the result. Stata14 was used as a tool of data analysis. Diagonostic tests such as multicolinearity test, normality test, heteroscedasticity test, hausman specification test, langrange multiplier test were conducted. The model of the study is represented as follows:

$$AQ = \beta_0 + \beta_1 ACBS + \beta_2 FS_{i,t} + \beta_3 FL_{i,t} + u_{i,t} \ldots\ldots\ldots(1)$$

Whereas:

AQ = Audit Quality, measured by the Big 4 is equal to 1 and 0 if otherwise (Salawu et al., 2018). ACBS is Audit Committee Block-Shareholding and is measured by 1 if the audit committee has a block-shareholder as either a chairman or member and 0 if otherwise (Glover-Akpey & Azembila, 2016). FS is Firm Size and is measured by natural logarithm of total assets (Salawu et al., 2018). FL is Firm Leverage, measured by ratio of total liabilities divided by total assets (Klapper & Love, 2004). β_0 stands for intercept; $\beta_{1\text{-}3}$ represent coefficients of independent and control variables; u stands for error term; i represents companies (i=9) and t stands for years (t=10).

Results and Discussion

Table 1

Descriptive Statistics

Variables	Mean	Std. Dev.	Min.	Max.	Skewness	Kurtosis
AQ	0.63	0.48	0	1	-0.55	1.31
ACBS	0.34	0.48	0	1	0.65	1.43
Fsize	22.43	1.97	19.46	27.01	0.47	2.62
Flev	0.52	0.27	0.04	2.29	0.63	2.92

Source: STATA 14 Output based on study data.

Table 1 presents the descriptive statistics (mean, standard deviation, minimum, maximum, skewness, and kurtosis) of the study variables (which are audit quality, audit committee block shareholding, firm size, and firm leverage) in this study. The result shows that audit quality (AQ) has a mean value of 0.63, a standard deviation of 0.48, minimum value of 0 (non-big four) and a maximum value of 1 (big four). This means on average 63% of listed industrial goods firms are audited by the Big 4 audit firms with wide dispersion of 48% from the mean. Regarding audit committee block shareholding (ACBS), the mean value is 0.34, standard deviation of 0.48, minimum of 0 (non-member) and a maximum of 1 (member). This indicates that 34% on average are block shareholders while the standard deviation value of 0.48 indicates wide dispersion from the mean. Moreover, Fsize (firm size) has a mean of 22.43, standard deviation of 1.97, minimum value of 19.46 and a maximum value of 27.01. This indicates the wide dispersion from the mean. For firm leverage (Flev), the mean value is 0.52, standard deviation is 0.27, minimum and maximum values are 0.04 and 2.29 respectively. This indicates the little dispersion from the mean. However, the skewness and kurtosis values for firm size and firm leverage are for normality test. According to West, Finch, and Curran (1995), skewness and kurtosis values should be less than 2 and less than 7 respectively. Hence, all the variables in this study are found to be normally distributed because the values of skewness ranges between-0.55 and 0.65, while kurtosis values ranges between1.31 to 2.92 as shown in Table 1.

In order to test the hypothesis developed in this study, logistic regression model is utilized as delineated in Table 2. Binary logistic regression is used because the dependent variable (Audit Quality) of this study is binary/dichotomous in nature, that is, '1' if the financial report of a firm in the sample is audited by a 'Big-Four' audit firm, and '0' if otherwise.

From the result of logistic regression in Table 2, the model explains 24.49% of the variation in Audit Quality, and the model is also significant (waldχ^2 =6.59, p<0.05). more so, the model is correctly specified as the Hosmer-Lemeshow test of goodness-of-fit has a p-value greater than 0.05 (chi2(8), p> χ^2 =0.082).

Table 2
Result of Logistic Regression

Variable	Expected Sign	Coefficients (β)	T-Stat.	P>t
Intercept	?	-6.6695	-2.22	0.026**
ACBS	+	0.2447	2.32	0.021**
Fsize	+	0.7490	0.79	0.430
Flev	+	0.0650	0.04	0.966
N		90		
Wald chi2(3)		6.59		
Prob>Chi2		0.0261**		
Pseudo R^2		0.2449		
Hosmer-Lemeshow chi2(8)		13.99		
Prob > chi2		0.0820		

Source: STATA 14 Output based on study data.

Specifically, the binary logistic regression result from Table 2 demonstrates that Audit Committee Block Shareholding (ACBS) has a significant positive effect on Audit Quality (β=0.2447, p<0.05), indicating that any increase in audit committee block shareholdingwill result in an increase in audit quality by 0.2447. This result does not support the hypothesis developed in this study which states that ‘audit committee block-sharehoiding has no significant effect on audit quality of listed industrial goods firms in Nigeria. In consideration to the control variables in this study (firm size and firm leverage), the result from Table 2 shows that firm size (Fsize) and firm leverage (Flev) have positive but insignificant effect on audit quality having ((β=0.749, p>0.10) and (β=0.065, p>0.10) respectively.

Conclusion and Recommendations

Based on the findings of the study, it concluded that audit committee block-shareholding has a significant positive effect on Audit Quality of listed industrial goods firms in Nigeria. This conclusion is consistent with the prior research of Glover-Akpey and Azembila (2016) which reports that audit committee blockholders has positive significant effect on reporting quality; and also consistent with the work of Abu, Nyor and Okpanachi (2018) which reports that block-holder ownership has positive and significant effect on audit quality. The finding contradicts the work of Habbash (2012). Thus, this study recommends that SEC, NSE and other regulatory authorities should encourage the industrial goods companies to have constituted audit committee with majority of block-shareholders. This adds the monitoring effectiveness on the committee and enhances the financial reporting quality of the firms listed under industrial goods sector of Nigeria.

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