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AUDIT COMMITTEE CHARACTERISTICS AND AUDIT QUALITY OF QUOTED DEPOSIT MONEY BANKS IN NIGERIA

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Abstract

This study examined the effect of audit committee characteristics on audit quality of quoted deposit money banks (DMBs) in Nigeria. Specifically, the study examined effects of audit committee size and audit committee financial expertise on audit quality. The study adopted ex-post facto research design. The population of this study comprised all the 13 Deposit money banks (DMBs) quoted on the Nigerian Exchange Group as at 31st December, 2023. Because the population is small and as such all of the population were used as sample size of the study. The data were collected from the annual reports of the sampled deposit money banks for a period of ten (10) years (2014 to 2023). This study measured audit quality using discretionary accruals and controlled for exogenous factors using firm size and leverage. Descriptive statistics and multiple regression were employed for analysis. According to the result audit committee financial expertise has significant and positive effect on audit quality while audit committee size has insignificant and negative effect on audit quality of quoted deposit money banks in Nigeria. The study recommends that audit committee characteristics have significant positive associations on audit quality. The study finally recommended that the Nigerian corporate governance code should consider members of the committee with financial expertise because this will contribute to improving audit quality and consequently reduce information asymmetry, which not only clarifies the conflicts of interests between shareholders and management but also makes management more accountable.

Keywords: Audit Committee, On Audit Quality, Deposit Money Banks, Financial Expertise And Nigeria.

1. Introduction

Deposit money banks are the most important institutions for savings mobilization and financial resource allocation. Consequently, these roles make them occupy important positions in economic growth and development. In performing this role, it must be realized that banks have the potential, scope and prospects for mobilizing financial resources and allocating them to productive investments. Therefore, no matter the sources of the generation of income or the economic policies of the country, deposit money banks would be interested in giving out loans and advances to their numerous customers bearing in mind

the three principles guiding their operations which are, profitability, liquidity and solvency. Most businesses in Nigeria have no access to banks' credit due to poor accounting records, poor managerial skills, lack of credit worthiness and their inability to generate enough income to ensure loan repayment which is guaranteed at maturity date, so as to sustain a viable intermediation process.

The quality of financial reports is key to confident and informed markets and investors. The purpose of the independent audit is to provide confidence in the quality of financial reports. Improving audit quality and the consistency of audit execution is essential to

maintaining confidence in the independent assurance they provide.

If a company fails but its financial report did not properly show its declining financial position and results or going concern issues, it is reasonable for questions to be asked about the role played by the company directors and the auditor. Questions may also be asked if investment decisions are made using financial reports that do not reflect a company's true financial position and performance.

Audit committees and external audits play an important role in enhancing the quality of financial statements and the firm financial performance by mitigating financial distress, such results are supported by many researchers. For example, Salloum, Azzi, Gebrayel (2014) found that the financial distress of banks has a significant negative relation with the meeting frequency of the audit committee. Geiger and Rama (2006) asserted that the big audit firms provide a high-quality report in terms of producing lower errors compared with the non-big audit firms.

However, most of these studies centered on how quality financial reporting could be stimulated. However, there are few studies on audit committee characteristics and audit quality in Nigeria such as Ilaboya and Ohiokha (2014), Akhidime (2015) and Asiriwa et al. (2018). Using a similar method of analysis, logistic regression, and these studies reported mixed findings. While Asiriwa et al. (2018) reported a mixed effect of audit committee characteristics on audit quality, Akhidime (2015) reported a positive effect and the findings reported by Ilaboya and Ohiokha (2014) are mixed. The disaggregated findings render this study inconclusive and therefore constitute one of the motivations for this present study.

Consequently, the period covered by previous studies leaves a gap to be filled. For instance, the study of Ilaboya and Ohiokha (2014) covered 2007 to 2012, Akhidime (2015) covered 2005-2009 and Asiriwa et al. (2018) covered 2012-2014. It is not only that the periods covered by these studies are too short, findings

reported might not be relied upon given the intermittent change of the government policies. In the same vein, none of the available studies in this context has attempted to resolve it in Deposit money banks in Nigeria.

Moreover, most of the previous studies either look at some variables of audit committee characteristics such as committee independence, size, meeting or expertise unlike this current study that look at the combined effect of committee expertise and audit committee size on audit quality. Based on the identified gaps, this present study examines audit committee characteristics and audit quality in Nigeria, particularly in quoted Deposit money banks (DMBs)

2. Literature Review

2.1 Conceptual Definitions

2.1.1 Audit committee size

Companies and Allied Matters Act (CAMA 2004) provides that audit committee size should not exceed six. Audit committee size is important because it signals the significance attached to the committee. An audit committee with large membership is blessed with different viewpoints in deliberating on financial reporting issues. It also enables the committee to handle several financial reporting issues simultaneously thereby leading to timely completion of external audit.

The number of audit committees is the number of audit committee members owned by a company. (Al-Musali *et al.*, 2019) suggest that the control and monitoring function will increase with a larger number of audit committees because the broader view and expertise offered by the larger committee will enable audit committees to perform their monitoring roles better. The number of audit committees is measured by the number of audit committee members in the company. Following the legal requirements of Nigeria, section 359 (6) of the Companies and Allied Matters Acts CAMA (1990), laws of the federation of Nigeria, the functions of audit committee are to review the audited

and unaudited financial statements as well as other special investigation of the company in accordance with the legal requirement and agreed ethical practices and to ensure that the company maintains an effective system of accounting and internal control as well as to review the scope and results of external auditors thereby reaffirming their objectivity.

Most of the regulations including that of Nigeria require the provision of an equal number of shareholders and directors to run the audit committee (Hussaini & Adam, 2014).

As highlighted earlier, section 359(6) of the Companies and Allied Matters Act CAMA requires every public company to have an audit committee which shall have a maximum of six members of equal representation by three shareholders and three directors (Bala, 2014).

As stated by Temple *et al* (2016), the magnitude of the committee is the sum of memberships of the group chosen by the governing bodies. Where a large audit committee member exists, possible challenges emanating from financial reporting tasks likely have the likelihood of being exposed and settled. This depends on the situation where a considerable number of the size of the committee raises the available means to the committee and enhances the superiority of control, as previous studies have shown that audit committee size affects corporate disclosure (Majiyebo *et al.*, 2018).

2.1.2 Audit committee financial expertise

Hasan *et al.* (2020) advocate that the resource dependence theory clarifies that the AC's role is to afford resources in the form of expertise and experience in order for corporations to gain a competitive advantage in FRQ. These specialists are projected to mitigate the agency problem to manipulate earnings reports which stand up to the ability of managers. The presence of a financial expert in AC has been considered as strength. It is a factor

that lowers earnings management and helps high-quality earnings reporting

Financial expertise refers to the extent to which members of the audit committee have financial experience (or education). Due to the aim of monitoring the financial reporting process of an organization, it is important for audit committee members to comprise directors who are competent and experienced in financial aspects.

2.1.3 Audit Quality

Audit quality broadly refers to the services performed by the auditors engaged by the client firms. Firms demanded higher quality audits because of the standard and the experience they have acquired. Hiring audit quality would attract more investors and picture the performance of the organization. Hence, stakeholders and investors will have confidence and trust in the company that engaged in higher audit quality because of the reputation and experiences that accounting firms with audit quality provided (Fama, 1980; Fama and Jensen, 1983).

2.2 Empirical Review

Although previous studies tackled the size of an audit committee, so the numbers of the person who join up the committee are unfixed. However, (Asiriwa *et al.*, 2018; Suryanto *et al.*, 2017; Khudhair *et al.*, 2019) in a related study revealed that audit committee size had a positive correlation toward audit quality. On the other hand, the Security Exchange and Board of India (SEBI's) Clause 49, "A qualified and independent AC shall be set up. Section 359(3) of the CAMA (2004) stated that audit committee members in public companies in Nigeria shall not exceed five in number. Two-thirds of the members of AC shall be independent directors." The audit committee is a component of corporate governance and enhances auditing quality.

Furthermore, (Hamdan *et al.*, 2013) at Amman Stock Exchange Market in the financial sector had examined the relationship between audit committee size on financial performance, operating performance and

stock performance, listed. It concluded that audit committee characteristics impacted financial and stock performance. It did not influence operating performance. On a sample of fifteen Deposit Money Banks and the annual reports and accounts of the banks for the period 2008-2015 in Nigeria, (Isa & Farouk, 2018) resulted audit committee size thereof has a significant effect on earnings management (Mardessi & Fourati, 2020). Besides, DeFond, Hann, and Hu (2005) claim that the presence of a financial expert is deemed essential to an AC's effectiveness because the committee needs to perform a wide range of duties that require a high level of financial sophistication.

Katmon and Al Farooque (2017) evince an insignificant relationship between AC financial expertise and discretionary accruals. According to Kusnadi, Leong, Suwardy, and Wang (2016), mixed expertise with accounting, finance, and/or supervisory is better than single expertise in the AC. They uncover that while FRQ is positively and significantly associated with the presence of an accounting expert in AC, it is not associated only with the presence of a financial or supervisory expert in AC.

On the other hand, Carrera, Sohail, and Carmona (2017) examine the relationship between AC and FRQ in the US and find that an increasing proportion of AC members with financial accounting expertise decrease the FRQ. Moreover, Ghafran and O'Sullivan (2017) highlight the potential value of AC expertise in smaller firms as opposed to larger listed firms, suggesting that the value of expertise to audit quality depends on the specific financial reporting challenges firms face.

Al-Shaer, Salama, and Toms (2017) also find that AC quality tends to increase quality rather than volume of environmental accounting disclosures, that an accounting expert causes improvement and that it applies to smaller firms. Consequently, having a financial expert in the AC evinces that the internal audit program and financial information might be monitored with good intentions, it is required for

monitors to have sophistication in financial matters to detect financial problems.

2.3 Theoretical framework

Agency theory is being derived from the financial economics literature and is part of the positivist group of theory of which the approach of study of society that focuses on specifically the scientific evidence, such as experiments and statistics (Adams, 1994). The assumption under the agency theory that everyone will always act in accordance with their own best interest. If the principal and the agent both always finding the opportunity to maximize their own self-interests in this relationship, this may end up that the agent might not always act in the best interests of the principal. As a result, this forces action to be taken against the agent by the principal in order to keep the agent in line with the interest of the principal (Jensen & Meckling, 1976). AC is one of the corporate governance mechanisms that are expected to provide an oversight role over the entire process of financial reporting to ensure the interests of the shareholders are being protected and prioritized.

3. Methodology

Research design is the conceptual framework around which research is conducted that reflects the blueprint for the collection, measurement and analysis of data (Aruwa & Wada, 2016). The present study adopts an analytical and ex-post facto research design. This design suggests that research is conducted after the event has taken place and requires data already in existence. The emphasis here is on studying a situation or a problem in order to explain the relationship between two or more variables. The study understands and analyzes the effects of audit committee characteristics on audit quality by using statistical tools.

3.2 Model Specification

This study modified the model used by Asiriwa, Aronmwan, Uwuigbe and Uwuigbe (2018) to examine

audit committee attributes and audit quality. This is given below:

$$AUDQ = f(ACSI, ACEXP) \quad (1)$$

Where:

AUDQ = Audit Quality

ACSI = Audit Committee Size

ACEXP = Audit Committee Expertise

FSZ = Firm Size

LEV = Leverage

f = functional relation

Table 1: Measurements of Variables

S/N	Variable	Type	Measurement	Source
1	Audit Committee Size	Independent	The number of audit committee members	Annual reports
2	Audit Committee financial Expertise	„	Measured as the number Members with financial knowledge	Annual reports
5	Audit Quality	Dependent	Discretionary Accruals	Sarawornrawanich (2011)
6	Firm's Size	Control	Total debt over total assets	Data Stream
7	Leverage	Control	The natural log of total assets	Data Stream

Source; Author's Computation 2024

$$AUDQ = \beta_0 + \beta_1 ACSI_{it} + \beta_3 ACEXP_{it} + \varepsilon_{it} \quad (2)$$

The model is modified by limiting the independent variables in the above model to just audit committee size and audit committee expertise. The adjustment was based on the intended objectives of this study. Hence, the model for this present study is stated thus:

β_1 - - - = Discretionary accruals

i = cross sectional variable from 1, 2

4. Results and Discussions

Table 2: Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
AUQ	130	.2429726	.2103182	.006346	.885584
ACEXP	130	.5980392	.4927153	0	1
ACSIZE	130	5.813725	.4389545	4	6
FSZ	130	4.894498	.5480376	3.5677	6.456777
LEV	130	.3501533	.1620502	.018924	.7676128

Source: Stata Output 2024

The outcomes in the table 2 indicates that the measure of Audit quality (AUQ), which is the inverse of absolute discretionary accruals of Deposit Money Banks (DMBs) firms has an average value of .2429726 with standard deviation of .2103182, and minimum and maximum values of .006346 and .885584 respectively. The extent of absolute value of discretionary accruals in the sample firms has a mean

of .24% with standard deviation of .21%. This indicates that the deviation between companies is quite very small. The firms tend to record a relatively higher Audit quality in some years than in others.

The descriptive statistics shows that on average, the audit committee financial expertise (ACFEP) during the period of the study is 59%, from the mean value of .5980392 with standard deviation of 0 .4927153. This

shows that some firms did not comply with the international recommendation of having at least one audit committee member with financial expertise, even though the provision of CAMA (1990) and SEC code of corporate governance (2011) is that companies audit committee members should have at least one member with financial literacy not specifically financial expertise. The audit committee financial expertise shows a minimum of 0 and maximum of 1 respectively.

The descriptive statistics from the table also indicates the mean of the committee size is 5.813725 which signifies that on the average it can be said there are approximately six members in the audit committee of listed Deposit Money Banks (DMBs) firms in Nigeria. Therefore, it can be said that on the average there is a compliance of the requirement of CAMA 1999 and the SEC code of corporate governance (2011), with regards to the provision of equal representation of

three shareholders and three directors. The audit committee size shows a minimum and maximum of 4 and 6 respectively.

Table 2 also shows that the average firm size (FSIZ) of the sample Deposit Money Banks (DMBs) firms during the period of the study is 4.89% with standard deviation of .548%. This implies that the data deviate from the mean from both sides by 0.554%, the standard deviation suggests that the data is distributed around the mean. The minimum and maximum values of FSIZ are 3.56% and 6.45% respectively.

The Table also indicates that the sample Deposit Money Banks (DMBs) firms in Nigeria have an average leverage (FLEV) .35% during the period of the study, from the mean of .3501533 with standard deviation of .16%, and the minimum and maximum value of .018% and .76% respectively. The standard deviation suggests that the data is spread around the mean.

Table 3: Correlation Matrix

Variables	AUQ	ACIND	ACEXP	FSZ	LEV
AUQ	1.000				
ACEXP	0.1993	-0.1350	1.000		
ACSIZE	-0.0235	0.1066	0.1539		
FSZ	0.0453	-0.0038	-0.0625	1.000	
LEV	0.1380	-0.2645	-0.0713	-0.1314	1.000

Source: Output from STATA 2024

Table 3 shows the correlation between the dependent variable, AUQ and the independent variables, ACEXP and ACSIZE on one hand, and among the independent variables themselves on the other hand. Generally, high correlation is expected between dependent and independent variables while low correlation is expected among independent variables. According to Gujarati (2004), a correlation coefficient between two independent variables 0.80 is considered excessive and thus certain measures are required to correct that anomaly in the data. From the Table all the correlation coefficients among the independent variables are below 0.80. This points to the absence of possible Multicollinearity though the value inflation factor

(VIF) and tolerance value (TV) test is still required to confirm the assumption.

Table 3 reveals a positive correlation between the dependent variable of Audit quality and the explanatory variables of audit committee financial expertise mix with coefficients of 0.1993. This implies that the explanatory variable moves in the same direction with Audit quality. The table 3 also reveals that audit committee size exhibits negative correlations with Audit quality, with coefficients of -0.0235. This means that the explanatory variable and the outcome variable move in different directions. In addition, table 3 reveals that the control variable of firm size

and leverage moves in the same direction with Audit quality.

4.1 Regression Diagnostics

The following healthiness tests are carried out to find out whether data used for analysis is reliable.

Test for Multicollinearity

Non-existence of Multicollinearity is a key assumption of linear regression analysis. Multicollinearity occurs when the explanatory variables are not independent of each other. Multicollinearity is examined using tolerance and variance inflation factor (VIF) values. The result of the Multicollinearity test is shown in the table below.

Table 4: Tolerance and VIF values

Variable	VIF	1/VIF
ACEXP	1.11	0.900702
ACSIZE	1.25	0.801191

Table 5: Hausman specification test

Variables	Fixed effect	Random Effect	Differences
ACEXP	-.0634503	-.0659619	.0025116
ACSIZE	-.1224234	-.0587591	-.0636643
FSZ	.0242408	-.0037548	.0279956
LEV	.0048076	.1215908	-.1167832
chi2(3) =	9.15		
Prob>chi2 =	0.1651		

Source: output from STATA 2024

The Hausman specification test was conducted to choose between the fixed and random effect model. The result of the Hausman test revealed that the value of chi2 is 9.15 and the prob>chi 0.1651. The insignificant value as reported by the probability of chi2 indicates that the Hausman test is in favor of a random effect model. Further to this, the Breusch and Pagan lagrangian multiplier test for random effect was conducted to choose between the random effect result and OLS regression. The result revealed that the chi2 value is 2.20 with prob>chi2 = 0.0691. The result indicated that the best model to be interpreted is the OLS regression model.

FSZ	1.18	0.849967
LEV	1.21	0.827425
Mean VIF	1.21	

Source: STATA Output 2024

Based on the evidence presented in the Table it can be concluded that there is no Multicollinearity problem. This is because the VIF values for all the variables are less than 10 and the tolerance values for all the variables are greater than 0.10 (rule of thumb).

4.2 Test for Heteroscedasticity

Heteroscedasticity arises when the error terms along the regression are not equal. Heteroscedasticity was tested using Breusch Pagan's test. Based on the results, it can be concluded that there is no problem of heteroscedasticity as the chi square is 0.02, which is insignificant, implying that there is absence of heteroscedasticity.

Table 6: Regression result

AUQ	Coefficient	T	p-value
ACEXP	.5841493	3.25	0.002
ACSIZE	-.0177318	-0.36	0.720
FSZ	-.2385726	-2.11	0.038
LEV	.2178355	1.56	0.122
R-Square	0.7047		
Wald Test	53.23		
Prob. of chi2	0.000		

Source: output from STATA 2024

The R-square value shows the level at which the explanatory variables explain the dependent variable. Table 6 reveals that the R-square is 0.7047. This

means that the audit committee characteristics variables in the study explained the Audit quality (AUQ) to the tune of 70%. The value of F - statistic is 53.23 with probability of $\chi^2 = 0.000$. The probability of χ^2 is significant at 1%, indicating that the model is fit. This serves as substantial evidence to conclude that the audit committee characteristics variables selected for the study are suitable for the study effect of audit committee characteristics variables on Audit quality of Deposit Money Banks (DMBs) firms in Nigeria.

The table also shows that audit committee financial expertise has significant positive effect on the Audit quality of sampled Deposit Money Banks (DMBs) firms in Nigeria, from the coefficient of .5841493 with t-value of 3.25, which is statistically significant at 5% level of significance (p-value of 0.002). This result suggests that an increase in audit committee expertise increases the quality of financial reporting of firms. Based on this, the study rejects the null hypothesis two (H01).

The table also shows that audit committee size has a significant negative effect on the Audit quality of listed Deposit Money Banks (DMBs) firms in Nigeria, from the coefficient of -.0177318 with t-value of -0.36, which is statistically insignificant at all level of significance (p-value of 0.720). Based on this, the study fails to reject the null hypothesis two (H02).

The table also shows that firm size (FSIZ) has significant negative effect on the Audit quality of listed Deposit Money Banks (DMBs) firms in Nigeria, from the coefficient of -.2385726 with t-value of -2.11, which is statistically significant at 5% level of significance (p-value of 0.038). This result suggests that an increase in firm size reduces the quality of financial reporting of firms. Furthermore, the table indicates that firm leverage (FLEV) has an insignificant positive effect on the Audit quality of

sampled Deposit Money Banks (DMBs) firms in Nigeria, from the coefficient of .2178355 with t-value of -1.56, which is statistically insignificant at all level of significance (p-value of 0.122). This result suggests that the higher the level of debts in the capital structure of Deposit Money Banks (DMBs) the lower Audit quality.

5. Conclusion and Recommendations

The overall results of this study suggest that there is a significant positive association between audit committee characteristics and Audit quality. In particular

The study also concludes that audit committee financial expertise has a positive and significant effect on the Audit quality of Deposit Money Banks (DMBs) firms in Nigeria. Suggesting that audit committees with at least one financial expert are a necessary governance factor in reducing fraudulent financial reports.

The Regulatory bodies in Nigeria should ensure that the majority of audit committee members should have financial literacy and industrial expertise that will improve the quality of financial reports.

Although the evidence does not support the current corporate governance code of 2011 recommendation concerning audit committee size, this study recognizes the importance of having at least three members on an audit committee, because this contributes diverse skills, expertise and independence to the committee. The result for audit committee size, however, can provide some consolation to companies that are structurally or financially constrained from meeting the corporate governance recommendations.

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