EFFECT OF AUDIT COMMITTEE CHARACTERISTICS ON PERFORMANCE OF QUOTED MANUFACTURING COMPANIES IN NIGERIA

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Abstract

The study examined the effect of audit committee characteristics on performance of quoted manufacturing companies in Nigeria. Data were collected from audited annual reports of the firms for a period of 5 years 2014 to 2018. A total of 16 companies were selected which the data collected are analyzed by E-View. The results of this study indicates, Audit Size has no significant impact on Return on Asset (ROA). Audit Meeting has no significant influence on Return on Asset (ROA). Firm Size has no significant influence on Return on Asset (ROA). Management Efficiency has a significant influence on Return on Asset (ROA). Audit fee has a significant influence on Return on Asset (ROA). The results of this study demonstrated that return on asset, audit size, audit meeting, firm size, management efficiency and audit fee influence manufacturing companies. The study suggests that future researchers can consider other audit committee characteristics, different from the ones examined in this study. It was recommended that more non-executive directors should be added to the audit committee so as to improve the committee effectiveness and companies should mandate audit committee to meet at least six times in accounting period.

Keywords: Audit Size, Audit Meetings, Audit committee, Performance

Introduction

Audit committee characteristics is one of the main elements of the performance in helping to control management practices (Afify, 2009) The audit committee characteristics play an important role in supervising and monitoring the management of the company in order to protect the interest of the owners (Kallamu&Saat, 2015). It is recognized that the effectiveness of an audit committee characteristics can be gauged from the company performance and its competitiveness, especially in the changing of business environment, which is outside the control of the company (Herdjiono& Sari, 2017).The financial performance has implications to organizations health and ultimately its survival. Evidence has shown that audit committee characteristics are critically important to profitability (abbot &Raghundan, 2013). The concept of financial performance implies measuring the results of concerns the determinant of financial performance.The relationship between audit committee characteristics and financial performance has being examined by various authors according to Puni (2015), there is a positive relationship between performance and audit committee

characteristics existence. Ghafran and O'Sullivan (2013) reviewed studies on the various role of audit committee characteristics in governance.

Literature Review

The role of the audit committee is important to stakeholders as better quality disclosed financial reporting might improve market performance. Over time, the role of the audit committee has evolved and has progressively been re-defined from a voluntary monitoring mechanism employed in high agency cost situations to improve the quality of information flows to shareholders. It is now a key component of the oversight function and the focus of increased public and regulatory interest. The implied expectation is that a suitably qualified and committed independent audit committee acts as a reliable guardian of public interest (Abbott, Parker & Peter, 2002).

Theoretical review

Agency Theory assumes that the interest of the principal and agent varies and that the principal can control or reduce this by giving incentives to the agent and incurring expenses from activities designed to monitor and limit the self-interest activities of the agent (Jensen &Meckling, 1976). According to Bonazzi and Islam (2006), the principal will ensure that the agent acts in the interest of the principal by giving him the incentives and by monitoring his activities.Stewardship Theory according to Ntim (2009) argued that profitability will be enhanced if the executives have more powers and are trusted to run the firm. The theory suggests that having majority executive directors on a committee will increase effectiveness and produce superior result than majority independent directors on a committee (Al Mamun, Yasser and Rahman, 2013). This could be because of the technical knowledge of the executive directors about the understanding, appreciate and conscientiously apply the propositions of stakeholder's theory. Akingunola and Adekunle (2013) suggested that,the key to achieving the stakeholder model of corporate governance is to enhance the voice of and provide ownership -like incentives to those participants in the firms who control critical activities provide specialized inputs and to align the interests to these critical stakeholders with the interest of outside,passive shareholder.

Empirical Review

Aanu, Odianonsen, and Foyeke (2014) examined the effect on profitability by using four audit committee characteristics including audit committee independence, financial expertise, size, and meetings. There were 25 manufacturing firms being selected from the year 2004-2011. The result of Pearson Moment Correlation revealed that independence of the audit committee is positively related to ROA as it claimed that company with independent audit committee will be relatively more reliable to invest in, and this will boost up the performance of a company. Azim (2012) has determined the consequences of corporate governance mechanisms on performance of a company whereby audit committee characteristics size was one of the mechanisms. The sample size were 1500 companies which are selected from the 500 top companies listed under ASX in year 2004 -2006. This study has used multi linear regression analysis with and variance analysis as their measurement. The result showed the audit committee's size has a negatively affected performance of firm due to inefficient governance.

Matari, Swidi, Fadzil and Matari(2012) between audit committee characteristics and performance of the public listed companies in Saudi Arabia. Sample data for 135 companies in year 2010 has been collected from Saudi Stock Market. Audit committee characteristics size was one of the independent variable for the research with measurement for the total directors on the audit characteristics. Findings of Pearson and the Multiple Linear Regression analysis has proved that size of audit committee characteristics and profitability are significantly related as they may have wider knowledge based and more authority.

Methodology

This study comprises of eighteen (16) quoted manufacturing companiesin the consumer goods sector (Cadbury Nig.plc, International Breweries plc, Nestle Nig.plc, Honeywell flour plc, Guinness Nig.plc, Nigerian Enamelware plc, Unilever Nig.plc, Vitafoam Nig. plc, Champions breweries plc, Dangote Sugar Refinery plc, Mcnicholsplc, Nigerian breweries plc, PZ CussonNig.plc, Northern Nig.plc and Nascon Allied Industries plc). The study cover a period of 5years (2014 to 2018).

Model Specification

$ROA_{it}=\beta o+\beta_1 AS_{it}+\beta_2 AM_{it}+ \beta_3 AF_{it}+\beta_4 MEFF_{it}+\beta_5 FS_{it}$

Where:

ROA= Return on Assets

AS= Audit Size

AM= Audit Meetings

AF= Audit Fee

FS=firm Size

MEFF= Management Efficiency

DATA PRESENTATION AND INTERPRETATION

Table 1 Correlation Matrix Table

	ROA	**AS**	**FS**	**AM**	**MEFF**	**AF**
ROA	1.000000					
AS	0.013607	1.000000				
FS	0.411386	0.207177	1.000000			
AM	0.110266	0.327769	0.315797	1.000000		
MEFF	-0.675383	0.019347	-0.462669	-0.187802	1.000000	
AF	0.152932	-0.046312	0.698066	0.218624	-0.118143	1.000000

Source: Authors' computation 2020

Table 1shows the correlation between Return on Asset (ROA), Audit Size (AS), Audit Meeting (AM), Firm Size (FS), Management Efficiency (MEFF) and Audit Fee (AF). It shows that ROA is positively correlated to FS, AM and AF, it is negatively (weak) correlated to MEFF. It shows that AS is positively correlated to FS, AM and MEFF, it is negatively (weak) correlated to AF.FS is positively correlated to AM and AF and it is negatively (weak) correlated to MEFF. AM is negatively (weak) to MEFF and positively correlated to AF. MEFF is negatively (weak) correlated to AF.

Regression Result
Fixed and Random effect result
Table 2

	Dependent Variable: ROA					
	Fixed Effect			Random Effect		
Variable	Coefficient	Std. Error	T-Statistic	Coefficient	Std. Error	T-Statistic
C	-1.427229	1.543850	-0.924461	-0.409028	0.554288	-0.737934
AS	0.003740	0.020928	0.178692	0.002821	0.019155	0.147244
AM	0.008748	0.015601	0.560737	0.000459	0.013614	0.033714
FS	0.102451	0.101092	1.013444	0.057130	0.065040	0.878381
MEFF	-0.000840	0.000154	-5.451254***	-0.000838	0.000137	-6.093015
AF	0.054504	0.233130	0.233795	-0.12503	0.097084	-0.128789
R-Squared	0.675947			0.470104		
Adj.R^2	0.566099			0.434300		
F-Statistic	6.153457			13.13001		

Table 3 Hausman Test Result
Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	2.020664	5	0.8463

Source: Author's computation, 2020.
In panel data analysis, the Hausman test can help you to choose between fixed effects model and a random effects model.If the p-value for Hausman test is less than 5% level of significance, we reject random effect result and accept fixed effect specification, but if the p-value is greater than 5% level of significance, we do not reject random effect of our regression. Here, our p-value is 0.08463 which is greater than 0.05. This research work is accepting the random effect specification.

Random Effect Results
From the regression result (See Table 2), only MEFF is seen to be statistically significant (according to the p-value of the regression) at 5% level of significance. Since MEFF is the only variable lesser than 5% level of significance, we can say it is highly statistically significant.From the regression result for the co-efficient, the constant (α) in the model is -0.409028. This means that holding other variables (AS, AM, FS, MEFF and AF) constant, ROA is equal to -0.409028. From the equation, β1co-efficient is 0.002821 which shows that a positive and insignificant relationship exists. β2co-efficient is 0.000459 which shows that a positive and insignificant relationship exists. β3 co-efficient is 0.057130 which shows that a positiveand insignificant relationship exists.β4 co-efficient is -0.000838 which shows that a negative and significant relationship exist. β5 co-efficient is -0.012503 which shows that a negative and insignificant relationship exists. Under the T-stat, to know if the variables are

statistically significant, for each variables, we need to find t (α/2, n-k) and we tend to reject the null hypothesis if only t-stat >t (α/2, n-k). To calculate t (α/2, n-k), this would be equal to t (0.05/2, 80-6); t (0.025, 74) = 1.980. The F-stat is used to test for joint hypothesis. Under the F-Stat, H0 is rejected if F-stat >Fcal (Fα (k-1, n-k)) but if not, we do not reject the null hypothesis. In our regression, F-statistics is 13.13001 and F-cal is F0.05 (6-1, 80-6) when α=5 %(0.05), k=6 (number of parameters) and n=80 (number of observation); this gives F0.05 (5.74) which equal to 2.2899.

Using the probability value for F-stat (p-value(F-stat)) to test for joint hypothesis which states that null hypothesis should be rejected if p-value (F-Stat) is < level of significance. In our regression result, the value for the p-value(F-stat) is 0.000000 which is lesser than the level of significance (0.000000>0.05), we reject null hypothesis. The R-squared is a goodness of fit measure for linear regression model. It measures the strength of the relationship between the model and dependent variable on a scale of 0-100%. An R-squared of 1 indicates that regression is perfect. In our regression result, R-squared is 0.470104 which shows that about 47.01% of variation in dependent variable is explained by the explanatory variable. This indicates a weak fit since 52.99% (100-47.01) % of the variables are attributable to the error term and the closer the R-squared to 1 the better the regression model. Adjusted R-squared is simply the modification of R-squared and it adjusts the explanatory variable in term of the model which tends to increase only if variables improve the model more than expected. The Adjusted R-squared is 0.434300 (43.43%) as shown in the regression result table.

Discussion of Findings

From the random effect result: It indicates the performance which is measured by ROA is positively related to Audit Size (AS). The result shows a performance of 0.8833 which is > 5% level of significance, this indicates that audit size has no significant impact on ROA. ROA is positively related to Audit Meeting (AM). The result shows a performance of 0.9732 which is > 5% level of significance, this indicates that audit meeting has no significant influence on ROA.ROA is positively related to Firm Size (FS). The result shows a performance of 0.3826 which is > 5% level of significance, this indicates that firm size has no significant influence on ROA.

ROA is negatively related to Management Efficiency (MEFF). The result shows a performance of 0.0000 which is < 5% level of significance, this indicates that management efficiency has a significant influence on ROA.ROA is negatively related to Audit Fee (AF). The result shows a performance of 0.8979 which is > 5% level of significance, this indicates that audit fee has no significant influence on ROA.The main objective of this study is to examine the effect of audit committee characteristics on profitability of quoted manufacturing companies in Nigeria. Sixteen (16) manufacturing firms were selected based on availability and accessibility of annual reports and existence within the period of this research work (2014-2018) on the Nigerian Stock Exchange (NSE). Data was collected from financial statement and analyzed using the panel data regression analysis.

Conclusion and Recommendations

After the exhibition of this study, the conclusions are as follows; there is no significant relationship between (AS, AM, FS and AF) and firms' performance (ROA). Managers should be aware of MEFF and AF because it has a negative relationship with ROA which represents performance.In line with the critical evaluation of the findings, the following

recommendations were made. Firms should employ less executive directors and have more non-executive directors for proper decision making and compliance in the board. Also, firms should ensure that they impose the use of the three main audit characteristics to avoid corporate governance failure.

Firms should also be consistent with the number of executive directors and non-executive directors for proper decision making and for a reliable source of data (for research purpose).

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