**AUDIT COMMITTEE CHARACTERISTICS AND FINANCIAL REPORTING QUALITY IN NIGERIA**

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**CERTIFICATION**

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**DEDICATION**

This thesis is dedicated to God my creator, the giver of life and fountain of knowledge.

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**Abstract**

This study examined audit committee characteristics on the quality of financial reporting of selected quoted non – financial companies in Nigeria while specifically it looked into the trend of audit committee characteristics; challenges confronting audit committee effectiveness; effect of audit committee characteristics on the financial reporting quality and contributions of the management and internal audit to audit committee’s effectiveness in performing its oversight functions.

The study relied on primary and secondary data. The primary data were sourced through the administration of 300 structured pre-tested questionnaire, which were purposively administered equally on audit committee chairmen, audit committee members, chief financial officers, internal auditors, external auditors and financial analysts. Secondary data were also sourced from audited financial reports of the 54 sampled companies on variables such as financial reporting quality, audit committee members accounting expertise, director member of audit committee, audit committee meetings, board accounting expertise, board independence, board meeting, board size and audit market. The data were analysed using descriptive statistics such as mean, percentages, graphs and inferential statistics such as correlation and regression analysis.

The study found that in absolute terms the trend of audit committee characteristics in Nigeria has been on the upward trend over the sampled period, it was also found that lack of expertise, exclusion of chairperson from independent members, attitude of audit committee members, resources at the disposal of audit committees are the challenges confronting audit committee effectiveness. It was found that audit committee accounting expertise with (t= 2.22251, p-value < 0.05), audit committee director member (t= 25.84755, p-value < 0.05), and board meeting (t= 7.301439 at p-value < 0.05) were positively significant except board independence, which was negatively significant at (t= -2.320087, p-value < 0.05)

The study concluded that the characteristics of audit committee members with right proportion of independent and financial expertise in membership coupled with regular attendance at meetings play significant roles in ensuring quality financial reporting in the Nigerian companies.

**CHAPTER ONE**

# **INTRODUCTION**

# **1.1. Background to the Study**

It is a well-known fact in business that companies that are well governed and are operated in a responsible and sustainable ways are more likely to be in good health and as such maintain good value for the shareholders. As a result of the increasing level of globalisation, the deregulation and integration of capital markets, as well as the series of recent financial scandals around the world, various corporate collapses which took place in Europe, the United State of America and Nigeria inclusive, have caused regulators to find ways to reduce the conflict of interest between shareholders and managers and draw an efficient corporate governance system that will encourage sustainable economic growth.To avoid the scandals, attempts are made by various countries to enforce corporate governance, this is because credibility and transparency of financial reporting depend on the monitoring mechanism of any organisation (Othman, Ishak, Arif & Aris 2014). United Kingdom has Cadbury report; Sarbanes Oxley (2002) in United State of America; 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). Nigeria is the only known nation with sectoral crporate governance code. Up to 2016, the following are the existing sectoral codes of corporate governance; Code of corporate governance in Nigeria 2003; Code of corporate governance for banks in Nigeria, post – consolidation 2006; Code of corporate governance for licensed pensions operator 2008; Code of corporate governance for insurance industry in Nigeria 2009; Code of corporate governance in Nigeria 2011 and Exposure draft of the revised code of corporate governance for banks in Nigeria 2012. Good financial report will go a long way in influencing investors and other stakeholders in making investment decisions, credit and other similar resources allocation decisions for enhancing overall market efficiency (International Accounting Standard Board, 2008).

Financial reporting, can be said to be the periodic process of providing information in financial statements (including the notes thereto) about the financial position and performance of a reporting entity to parties (users) external to that entity to assist them in making informed decisions about allocating scarce resources (Financial Reporting Council of Australian of 2013).

In 2013, the honourable Minister of Trade and Investment, Olusegun Olutoyin Aganga inaugurated a committee to harmonise and unify all the existing sectoral corporate governance codes in Nigeria. The attempt is as a result of the fact that there were not known nation that have adopted this multiplicity of governance codes. It should be noted that the sectorial codes were very confusing in that they made conflicting provision on the same subject matters.

According to the Organisation for Economic Cooperation and

Development (OECD) “*Corporate governance involves a set of*

*relationships between a company’s management, its board, its*

*shareholders and other stakeholders. Corporate governance also*

*provides the structure through which the objectives of the company*

*are set, and the means of attaining those objectives and monitoring*

*performance are determined.”* OECD, (2015:9).

It is the system by which businesses are directed and controlled (Bhasin, 2012). Uche (2004) and Akinsulire (2006) are of the opinion that corporate governance provides the structure through which the company’s objectives are set and the strategies, the tactics and the means of attaining those objectives and monitoring performance defined. (Modum, Ugwoke & Onyeanu 2013).

The interest of this work centered mainly on audit committee aspect of corporate governance, and specifically on how the effectiveness of the committee can enhance the quality of financial reporting. Audit committee effectiveness has been a focus of international corporate governance reform for many years. Wu (2012) in his work traced the genesis of audit committees as a part of corporate governance structure to the abuse of power by corporate management, which led to financial scandals, financial reporting defalcations, and unjustifiable manipulation of accounting policies.

The strength of audit committee lies in its ability to improve the quality and integrity of financial reporting by reviewing the financial statement on behalf of the board. (Cadbury, 1992). Canadian Institute of Chartered Accountants (1992:20) defined audit committee as:

*A committee of directors of an organisation whose specific responsibility*

*is to review the annual financial statements before submission to the board*

*of directors. The committee generally acts as liaison between the auditor and*

*the board of directors and its activities may include the review of nomination*

*of the external auditor, overall scope of the audit, results of the audit, internal*

*financial controls, and financial information for publication.*

Companies and Allied Matters Act (CAMA , 2004), Cap C20 law of the federation of Nigeria 2004, consider 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. The inclusion of this committee in the corporate governance mechanism raises the expectations of shareholders and the general public for enhanced corporate governance and by extension increased performance of companies. This is predicated on perceived checkmating role of the audit committees in ensuring that the board of directors lives up to expectation in fulfilling the globally accepted pillars of corporate governance, to wit, accountability, fairness, responsibility and transparency (Modum, *et al.* 2013).

The effectiveness of audit committee as an oversight committee on the financial reporting matters a lot, if the committee is to make any impact in ensuring that the financial reporting is of high quality (Chen & Zhou, 2007). So many research have been carried in out in this area to prove and to ensure the reliability and quality of financial reports, audit committee must be effective and be seen to be effective. Chambers (2005); Sharma (2004); Bedard, Chtourou and Courteau (2004); DeZoort and Salterio (2001); Carcello and Neal (2000) and McMullen (1996) in their works were of the opinion that an effective audit committee prevents misstatement of financial reports. It was agreed that if an audit committee functions well, it will lead to the improvement of financial reports. Bryan, Liv and Tiras (2004) on their own concluded that there is an association between the audit committee effectiveness and firms earnings. Effective audit committee helps to boost investors’ confidence in the financial reports, it also, helps in improving the trust in financial reporting processes, as well as lending credence to the credibility to the audited financial statements (Rezaee, Olibe & Minmier 2003).

If audit committee is effective, the internal control system will be well established and function effectively and efficiently, which in turn will bring to the barest minimum the case of fraudulent practices as well as irregularities ( O'Connor, 2006).

# **1.2. Statement of the Problem**

The rampant corporate failures throw strong doubt on the effectiveness of audit committees in Nigeria, although so many factors may have contributed to their misfortune, much blame is on absence of strong commitment to the tenets of corporate governance of which audit committee is a critical element. In Nigeria audit committees still have a very long way to go, world bank report on the state of corporate governance in Nigeria observed that audit committees in Nigeria were weak (Okere, Mustafa, Linde, & Rahman, 2004). The Institute of Chartered Accountants of Nigeria (ICAN) also voiced its doubts about the effectiveness of audit committees in Nigeria (Kolafe, 2012). Audit committees in Nigeria give false impression that the financial report presented by the management are in order, whereas it may be far from the truth, as such the investing public should be wary of such reports (Jimoh & Metu, 2013).

A good example of such failures can be found in the following organisation; Cadbury Plc., Nigerian Railway Corporation (NRC), National Electric Power Authority (NEPA), Kaduna Textile Industry, Asaba Textile Industry, Nigerian Telecommunications Limited (NITEL) Benue Cement Company Gboko, Niger Cement Company Nkalagu, Nigerian Coal Corporation (NCC), Nigerian General Insurance Plc. (NGI Plc.), Calabar Cement Company Limited, et ceteraand several banks for which strong questions have been raised on the failure of Corporate Governance (Modum *et al*.).

Corporate world often considers audit committee as solution to the problems of false financial reporting and other control related problems, however, audit committee of most companies do not live up to the expectations, as many well-known corporate scandals and business failures that occurred, happens where audit committees existed and fraudulent financial reporting, audit failures, internal control breakdowns and other irregularities still take place.

O’Connor (2006) found that one of the most vexing problem in the financial world today, is the emphasis placed on ensuring the independence of external auditors. For so many years companies present financial statements that are quite different from the true position of things. In most cases the annual reports are window dressed by the management. This has led to collapse of many companies. But one surprising thing is the fact that many of these companies before the scandals, present clean health and unqualified audit report. The oversight function of the audit committee is therefore placed under scrutiny when a business whose financial statement once showed no indication of going out of business suddenly goes under. Because of this happenings there is the problem of determining the effectiveness of audit committees on the quality of financial report.

Generally, there has been limited research that specifically focuses on audit committee effectiveness and financial reporting quality in Nigeria, although audit committee has been widely discussed and recognised as a very effective mechanism for ensuring good governance in corporate affairs. In most cases, studies on audit committee effectiveness have been conducted in the context of developed countries including, the U.S.A., the U.K., Canada, and Australia (Bedard & Gendron, 2010). Literatures on audit committee effectiveness in emerging economies is still under-researched. For example, Tsamenyi, Enninful-Abu, and Onumah (2007), highlighted that, in contrast to the numerous studies on corporate governance in developed countries, minimal research has been conducted in developing countries.

The research problem come from the fact that despite the regulations that has been put in place to oversee effectiveness of audit committees in Nigeria there are still cases of falsification of financial report. This work will attempt to analyse the effective functioning of the audit committee in some selected non – financial listed companies in Nigeria.

This work seeks to look into the problem of audit committee effectiveness by analysing the characteristics of audit committee and the quality of financial reporting in Nigeria, since the findings of previous studies have not directly linked audit committee characteristics with quality of financial reporting. Similarly, other studies are on financial institutions that may not necessarily be used to generalise on all institution due to the difference in codes that applied to them. The specific focus of the work is to look into the trend of audit committee characteristics, challenges confronting audit committee effectiveness, effect of audit committee characteristics on the quality of financial reporting as well as issues that bothers on the contributions of management and internal audit to audit committee in overseeing the corporate governance in Nigeria. In other word the work seek to bridge knowledge and gap by analysing the audit committee characteristics and quality of financial reporting and also look into how the effectiveness of audit committee can enhance the quality of financial reporting in Nigeria. Thus, the study will contribute to the understanding of actual scenario of audit committee effectiveness and financial reporting quality in developing economies.

# **1.3. Research Questions**

In line with the objectives of the study, the work give answer to the following research questions:

1. what are the trend of audit committee characteristics on the quality of financial reporting in Nigeria?
2. what are the challenges confronting audit committee effectiveness in Nigeria?
3. what effect do the audit committee characteristics have on the quality of financial reporting in Nigeria?
4. what are the contributions of the management; internal auditors and external auditors to audit committee, in performing its oversight functions in Nigeria?

# **1.4. Objective of the Study**

The broad objective of the study is to investigate audit committee effectiveness on the quality of financial reporting of selected quoted non – financial companies in Nigeria, while the specific objectives are to:

1. examine the trend of audit committee characteristics in Nigeria;
2. assess the challenges confronting audit committee effectiveness in Nigeria;
3. examine the effect of audit committee characteristics on the quality of financial reporting in Nigeria; and
4. evaluate the contributions of the management, internal auditor and external auditor to audit committee effectiveness in performing its oversight functions in Nigeria.

# **1.5. Hypotheses of the Study**

This section discussed the development of the hypotheses investigated in the study.

**H1:**  Audit committees’ characteristics do not significantly influence the quality of financial reporting in Nigeria.

**H2:** Management, internal auditor and external auditor do not significantly contribute

to the effectiveness of audit committee in performing its oversight function.

# **1.6. Justifications of the study**

There are several justifications for the need to investigate into the issue of audit committee effectiveness and financial reporting in Nigeria. First, the cases of high profile corporate collapses almost everywhere and Nigeria are of great concern among investors, users of financial report and regulators on the quality of financial reports produced by companies, most especially where there are audit committee.

To put an end to this ugly situation and thereby protect investors and the investments from financial scandals and to as well restore trust in corporate reporting in Nigeria, the Securities and Exchange Commission provided the corporate governance codes that set out the principles of good corporate governance and best practice recommendations. Therefore, the need for audit committees and financial reporting quality in Nigeria.

Secondly, even though there are several research on the subject matter in Nigeria (Okoye &Cletus, 2010; Owolabi & Ogbechia, 2010). There are paucity of work on the effectiveness of audit committee on financial reporting on non-financial quoted companies in Nigeria.

Thirdly, most of the works used single source of data collection to sources for information, but this work make use of triangulation method to source for information used in this work. By triangulation we mean the process of verification that increases validity by incorporating several viewpoints and methods. It refer to the combination of two or more theories, data sources, methods or investigations in one study of a single phenomenon to converge on a single construct, and can be employed in both quantitative (validation) and qualitative (inquiry) studies. (Yeasmin & Rahman 2012).

Fourthly, financial regulators such as Securities and Exchange Commission, Financial Reporting Council of Nigeria that are vested with the responsibilities of ensuring that financial reports produced by companies are of high quality will find it useful, as well as other researchers will find it a useful tool, thereby contributing to the body of knowledge.

# **1.7. Scope of the Study**

The scope of this work is limited to two main issues. First, the population from which the sample was drawn is all non-financial institutions listed on the Nigerian Stock Exchange in 2016. Non – financial institutions were selected because most of the earlier research in Nigeria on audit committee were on financial institutions. Second, only those companies listed on the stock exchange were considered. This is because Nigerian Stock Exchange listing rules require only listed companies to disclose whether they have an audit committee or not. Consequently, the results may not be generalisable to companies that are not listed on the Nigerian Stock Exchange.

# **1.8****. Operational definition of terms**

**Audit committee**: is a selected number of members of a company's board of directors whose responsibilities include helping auditors remain independent of management. Most audit committees are made up of three to five or sometimes as many as seven directors who are not part of company management.

**Financial reporting**: is the process of producing statements that disclose an Organisation’s financial status to management, investors and the government.

**Code of corporate governance**:  is the system of rules, practices and processes by which a company is directed and controlled. Itessentially involves balancing the interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government and the community.

**Internal audit**: is an objective assurance and consulting activity designed to add value and improve an organization's operations

**External audit**: A thorough review of [ledgers](http://www.investorwords.com/2754/ledger.html) and other [accounting records](http://www.investorwords.com/15745/accounting_records.html) of a [company](http://www.investorwords.com/992/company.html) by [accounting](http://www.investorwords.com/48/accounting.html) professionals not employed by that company, in [order](http://www.investorwords.com/3495/order.html) to verify that the accounting records are accurate and [complete](http://www.investorwords.com/9256/complete.html).

**Audit committee independence**: Gray directors that are directors that are not in actual fact an insider but have close ties to the management

**Quality financial reporting**: This is the precision with which financial reporting conveys information about the firm’s operation in such a way that the report provides information that is useful to investors in making correct decisions. Quality financial reporting is the reporting of financial statement that is devoid of material misstatements.

**Audit committee financial expert**: This is a person that has sufficient industry experience/expertise; sufficient understanding of the industry risks and complexities arising from the industry; accounting/finance professional qualification; sufficient understanding of international financial reporting standards knowledge; and attendance in at least continuous professional development in a year.

**Board of directors**: The governing body of a corporation elected by the shareholders to establish and carry out corporate policy, select the corporation’s officers, make certain major decisions concerning the corporation’s business and finances, and to oversee the corporation’s operations.

**Grey directors**:They are not in actual fact insider but have close ties to the management

**CHAPTER TWO**

# **LITERATURE REVIEW**

The purpose of this section is to review existing research studies on audit committee, with a view to building a foundation that will help us identify any gap in the existing body of knowledge on audit committee effectiveness. The chapter covers conceptual literature review, theoretical and empirical studies as well as the conceptual frameworks. The rationale is to critically use the evidence from the studies to establish the gaps in the literature and also to serve as a basis for validation of the findings of the research work.

# **2.1. Conceptual Review**

# **2.1.1. Audit Committees**

Audit committee is 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. (CAMA 2004). Thus, audit committee is one of the mechanisms which help the Board of Directors to adopt better corporate governance practices. (Bhasin, 2016). The need for auditing arise as a result of the necessity for transparency and accountability in corporate organisations. Without audit, no accountability; without accountability, no control; and if there is no control, where is the seat of power? (Normanton, 1966). The idea in Normanton quotation is that, the audit is a necessary independent attestation of the accountability to the stakeholders by the stewards of the enterprise; that is, by the Board of Directors. However, where the organization is an owner-managed firm there is less need for the audit (Chambers, 2005). The development of audit committees have been driven by concerns about the credibility of financial reporting. Cadbury Committee (1992) in its report provided an outline of audit committee structure and membership, terms of reference, and a range of duties for the audit committee, but without an explicit statement as to the purpose of audit committee. According to Cadbury committee the audit committee appear to represent the means by which the conformance role of the board might be more effectively achieved.

Audit committee was established to focus on issues of control and accountability on the corporate affairs. This view of the audit committee role is confirmed by commentators such as Demb and Neubauer (1992), who described an audit committee as “the personification of the board’s stewardship responsibility”.Cobb (1993), identified four main purposes of establishing audit committees, namely:

(i). reduction of board liability;

(ii). establishing a link between the external auditor and the board;

(iii). the reduction of illegal activity; and

(iv). the prevention of fraudulent financial reporting.

The primary purpose of the audit committee is to oversee the financial reporting process of the company. Audit committees are established mainly to increase the credibility of financial statements. Pomeranz (1997) noted: “Audit committees and their perceived roles can be seen as vaguely unsuccessful, yet meritorious, endeavours to create a more level playing field for external and internal auditors”. Eichenseher and Shields (1985) linked the incidence of audit committee formation in the U.S.A. to the appointment of leading (`Big-Eight') auditing firms, suggesting that this was a response to increased directors’ liability. However, their study did not identify this as an explicitly articulated reason for audit committee formation, but instead inferred it from company behaviour. Collier (1996) in his work gave a detailed analysis of the genesis of audit committees in the U.K., in examining the literature on audit committee effectiveness, he concluded that evidence of their effectiveness was very limited and that it is not sufficient to support their rapid increase in popularity.

# **2.1.2. Audit Committee Composition**

For audit committee to be effective its composition matters a lot. The committee’s ability to monitor well depend on the way it is composed. The composition here is in term of independence, experience and financial literacy. Vafeas (2001) in his work examined audit committee composition in terms of independence and experience (expertise) and tried to identify the determinants of audit committee appointments. The results indicate that while the likelihood of audit committee appointment increases with the degree of outside directors’ independence, such likelihood decreases with compensation committee membership, other committee membership and the length of board tenure. However, audit committee appointments were not related to equity holdings and the number of other directorships. He highlighted the need to examine the influence of audit committee composition not only in terms of independence and expertise, but also in terms of financial literacy, on audit committee performance and the quality of the financial reports.

# **2.1.3. Audit Committee Independence**

This is another key characteristic of audit committee, it is one of the key factors that is considered in measuring the effectiveness of audit committee in monitoring financial reporting quality. Many studies have been done in this area. Abbott and Parker (2000); Archambeault and DeZoort (2001); Raghunandan, Read, and Rama, (2001); and Chen, Moroney, and Houghton, (2005) focused on the impact of independent audit committees on the audit function. It is assumed that independent directors within the audit committee are better at monitoring than their insider counterparts (DeFond & Francis, 2005)

Abbott and Parker (2000), found that firms with independent audit committee were more likely to select industry-specialist external auditors. This may reflect the desire of such audit committees to reduce their members’ reputational losses, which, in turn, will enhance audit quality. While Chen; Moroney and Houghton (2005) found that the Australian Stock Exchange Top 500 companies with high percentages of non-executive directors on their audit committees were more likely to hire a specialist (high quality) auditor compared to those with low percentages of non-executive directors on their audit committees. On their own, Archambeault and DeZoort (2001) found that companies with a suspicious audit change had a smaller percentage of independent directors on the audit committee compared to those with non-suspicious auditor change. Moreover, Raghunandan; Read and Rama (2001) study indicated that independent audit committees were more likely to have stronger relationships with internal auditors compared to dependent audit committees.

Other studies highlight the impact of audit committee independence on the quality of financial reporting and earnings management. Klein (2002) found that audit committee independence was negatively associated with abnormal accruals and that reductions in audit committee independence were associated with large increases in abnormal accruals. Also, Bedard; Chtourou and Courteau (2004) work shows that aggressive earnings management is negatively associated with the presence of an independent audit committee.

There are other studies that relate audit committee independence to governance and company variables. Beasley and Salterio (2001) concluded that voluntary increases in the number of outside audit committee members were associated with board size, board independence, and the separation of the Chief Executive Officer and board chair roles. Also, Klein (2002) found that audit committee independence was positively associated with board size and board independence and negatively associated with growth opportunities and firms with accounting losses.

There are other works that consider grey directors (grey directors are not in actual fact an insider but have close ties to the management), such as Carcello and Neal (2000) who examined the association between audit committee independence and the likelihood of receiving a going concern opinion using a sample of financially distressed companies. They found that companies with a high percentage of grey directors on the audit committee were less likely to receive a going concern opinion compared to those with a low percentage of grey directors on the audit committee. In addition, Vafeas (2001) used a relatively broad approach to defining grey directors in his study of audit committee appointments. Using an independence measure that screened directors who were consultants, bank officers, lawyers, relatives of management, or otherwise had any economic link to the company, he found that new audit committee appointees were more independent than a control group of non-audit committee directors.

If we sum the various country’s codes it would be seen that the Independence of audit committee is a subject of increasing interest. The combines Code of (2008), recommends while SOX Act (2002) requires all listed companies to establish and maintain a fully independent audit committee. While Nigerian code of corporate governance 2016 mandated that audit committee shall compose of independent non – executive directors.

# **2.1.4. Audit Committee Member Expertise**

There are many research work on audit committee expertise among such work is the work of the following; DeZoort, (1997); Lee and Stone, (1997); Raghunandan *et al*. (2001); Beasley and Salterio (2001); Bedard *et al*. (2004); DeFond *et al*. (2005) etc. While DeZoort (1997) and others found that audit committee members believed that all audit committee members should have sufficient expertise in oversight areas related to accounting, auditing and the law. Other studies like Raghunandan *et al*. (2001) surveyed chief internal auditors and found that audit committees with at least one member possessing an accounting or finance background were more likely to have longer meetings with their chief internal auditor, to provide private access to him or her and to review internal audit proposals and results. Bedard *et al*. (2004) found that aggressive earnings management is negatively associated with the financial and governance expertise of audit committee members. Lee and Stone (1997) studied 100 US multinational companies and described a mismatch between audit committees’ stated responsibilities and the levels of instrumental experience (defined as skills related to accounting, auditing and control issues) among members.

DeFond *et al*. (2005) investigated the market reaction to the appointment of directors with financial expertise to the audit committee. They found a positive market reaction to the appointment of directors with financial expertise to the audit committee. Furthermore, Beasley and Salterio (2001) studied Canadian boards and found that voluntary increases in audit committee members’ collective financial reporting and audit committee knowledge and experience were related to board size, proportion of outsiders on the board, and separation of board chair and Chief executive officer/president.

McDaniel and Maines (2002) conducted an experiment using audit firm managers and executive MBA graduates to examine the influence of expertise on the assessment of financial reporting quality. They found that experts made better assessment of financial reporting quality compared to non-experts. They concluded that efforts to enhance audit committee financial expertise might influence audit committees’ assessments of financial reporting quality.

# **2.1.5. Audit Committee Member Financial Literacy**

According to Vafeas (2001) little research has been done in this area unlike what happens in the case of independence and expertise. From the review of literature, it is easy to conclude that less attention is given to financial literacy as a character that mostly influence audit committee effectiveness.

Song and Windram (2000) found that UK companies with an audit committee with a higher level of financial literacy are less likely to have financial reporting problems. While, McDaniel, *et.al* (2002) in their work using audit firm managers and executive MBA graduates to assess differences in the way financial experts and financial literates evaluate financial reporting quality. It was reported that experts tended to focus more on common, less-important issues, while literates focused more on less rare, significant issues.

# **2.1.6 Audit Committee Authority**

Audit committee authority has to do with the duties of the committee, this duties and responsibilities vary from place to place. The authority of audit committee comes mainly from either the statute, Securities and Exchange Commission listing requirement or from the board of directors (DeZoort, Hermanson, Archambeault & Reed 2002). Audit committee has a wide variation of responsibility that could be performed. Each organisation has its own audit committee charter that spell out the duties and responsibilities of the committee. It is from this that members of the committee have understanding of the specific duties they are to perform.

In 1995 Coopers and Lybrand investigated the scope of audit committee responsibilities and found that audit committee has experienced a wide growth, because they perform a lot of duties (Coopers & Lybrand (1995). Bedard *et.al* (2004) stated that aggressive earning management is negatively associated with the presence of clear mandate defining the responsibilities of the audit committee. DeZoort (1997) conducted a survey to determine the most important oversight responsibilities of the audit committee. The results of this study indicate that audit committee members ranked financial statement review, internal auditor assessment and external auditor evaluation as the most important oversight responsibilities.

In summary, audit committee responsibilities are diverse and appear to be expanding, which makes it very hard for audit committee members to understand all these responsibilities especially in the absence of an audit committee charter. In addition, the oversight on the financial reporting, auditing and controls were the most important audit committee oversight responsibilities.

# **2.1.7 Audit Committee Resources**

For audit committee to be effective they should be given full access to all the necessary resources and information that could be of help in the effective performance of its responsibilities. Many of the literature on audit committee resources focused on the role that both internal and external auditors could play to support audit committees and on the size of the audit committee as an important determinant of audit committee effectiveness (DeZoort *et al.* 2002).

In their studies Cohen and Hanno (2000); Knapp (1991) and (1987); Schroeder; Solomon and Vickery (1986), highlighted the important role that external auditors could play in enhancing the audit committee effectiveness. For example, Knapp (1987) conducted a study to identify the factors that could influence the likelihood that audit committees will support auditors in their disputes with management. The results of this study indicate that firms with an audit committee were more likely to support the auditor in auditor-management disputes.

More recently, Cohen and Hanno (2000) found that external auditors made less favourable audit planning judgments in cases where the corporate governance structure included an audit committee that lacked technical experience and regular access to internal and external auditors without top management present. In the case of DeZoort; Friedberg and Reisch (2000) it was concluded that internal audit directors believed structured communications programs between internal auditors and audit committees could improve the quality of corporate governance.

Few studies have examined the impact of audit committee size on the audit committee effectiveness in different contexts. Archambeault and DeZoort (2001) investigated the impact of audit committee size on suspicious auditor switching. They found a negative association between audit committee size and suspicious auditor switching. Felo; Krishnamurthy and Solieri (2003) found a positive association between audit committee size and financial reporting quality. These studies provided support for the use of audit committee size as a proxy for the available audit committee resources.

From the various research work, many of the literatures on audit committee resources are on the impact of external and internal auditors to audit committee on audit committee effectiveness.

# **2.1.8 Audit Committee Diligence**

Audit committee diligence means the willingness of audit committee members to discharge their responsibilities and duties. Kalbers and Fogarty (1993) argued that audit committee diligence is the most important determinant of audit committee effectiveness. It should be noted that actual audit committee diligence cannot be measured direc tly, many literatures used number of audit committee meetings per year as a proxy for its diligence to investigate the impact of such diligence on the audit committee effectiveness (DeZoort *et al*. 2002), ssand others used voluntary audit committee disclosures. A number of researchers has focused on financial reporting quality. Song and Windram (2000) found that companies with reporting problems had less frequent audit committee meetings. Beasley; Carcello; Hermanson and Lapides (2000) examined the association between the number of audit committee meetings and the likelihood of having fraud financial reports. The results of their study indicate that there was a negative relationship between the number of meetings and the likelihood of fraud. Their study indicated that while companies with fraud cases generally held one meeting per year, companies without fraud cases met two or three times per year. Abbott *et al.* (2000) indicated that firms with audit committees that met at least twice per year were less likely to be sanctioned by the Securities and Exchange Commission for financial reporting problems.

Furthermore, Archambeault *et al.* (2001) concluded that companies with an audit committee that met more frequently were less likely to commit a suspicious auditor switch compared to companies with an audit committee that met less frequently. However, Abbott; Parker; Peter and Raghunandan. (2003) investigated the association between active audit committees (meet at least 4 times a year) and the non-audit services purchases. They found that companies with audit committees that met at least four times a year were more likely to have a lower non-audit services ratio compared to these with audit committees that met less than four times a year. In other words, companies with an active audit committee were more likely to limit non- audit services purchases compared to those with inactive audit committee.

# **2.1.9 Advantages and disadvantages of audit committees**

**Advantages**

The advantages of audit committee can be summarised as stated below:

1. Improves the quality of financial reporting, by reviewing the financial statements on behalf of the board of directors;
2. Creates a climate of discipline and control which will reduce the opportunity for fraud;
3. Enables the non-executive directors to contribute an independent judgment and play- a positive role;
4. Strengthens the position of the external auditor by providing a channel of communication and forum for issues of concern to be raised;
5. Provides a framework within which the external auditor can assert his independence in the event of a dispute with management;
6. Strengthens the position of the internal audit function by providing a greater degree of independence from management; and,
7. Increases public confidence in the credibility and objectivity of financial statements.

From the above, two things emerges, firstly, audit committees help the independence of non-executive directors, as well as that of the internal and external auditors. Secondly, audit committees improve the quality of financial reporting within the host organisation. An audit committee is also effective in minimising opportunistic accounting choice behaviour since its functions include a review of the firm's accounting methods and changes in accounting methods. The significance of audit committees in detecting errors, irregularities and fraudulent practices in the firm is of great importance. Since an audit committee restricts management’s choice of accounting methods that are not representational and faithful, extra protection is afforded to debt holders as well as shareholders. By monitoring the financial reporting and auditing processes, audit committees also reduce information asymmetries between a company’s internal and external agents, and consequently mitigate agency costs. Audit committee is as a delegate body of the board of directors which is charged with safeguarding and advancing the interests of shareholders. An audit committee is thus viewed as a monitoring mechanism intended to reduce information asymmetries between insider and outsider (i.e. management and non-management) board members (Pincus, Rusbarsky & Wong, 1989; cited in Pucheta-Martinez, & Fuentes, 2007). The significance of audit committees in strengthening internal control has been noted in many studies; for example, Archambeault and DeZoort (2001); Osman and Noguer (2007); Sori, and Karbhari (2006); Chen, Moroney and Houghton (2005); and Sarens, Beelde and Everaert (2009). All of these studies have addressed the importance and implication of audit committee’s role, and its credibility and reliability in case of firm‘s control mechanism, as well as investors’ decision-making process.

**Disadvantages**

Audit committee is not without its own disadvantages, in Nigeria as well as other countries it has been observed that many of this committee are not up to the task, as some times management make sure that members of the committee are always those that are well favoureable with them and a times the independent directors do collude with the managers. The audit committees and their roles have been criticised by some researchers; for example, Rainsbury, Bradbury and Cahan (2008) noted that the audit committees sometimes limits the growth opportunity of a firm. McMullen (1996) claimed that audit committees are considered as: “The creatures of the company's management rather than the watchdogs over shareholders’ interests”.Critics also argue that many audit committees hesitate to stop management misdeeds because they do not want to rock the boat. The theoretical arguments against audit committees were pointed out by many writers among which are: Barker (2002); and, Rainsbury et al. (2008).

Below are some of the points against audit committee:

1. The audit committee sometimes may cause encroachment on the functions of the

executive and dilution of executive authority, or may pre-empt management

responsibility;

1. The audit committee may cause the diversion of non-executive directors from their strategic and other roles into the routine matters of audit and financial reporting;
2. The audit committee might reduce contact between the auditors and the board;
3. Sometimes, the audit committee is used only as a rubber stamp to confirm management decisions; and,
4. Audit committee’s meetings sometimes simply become a waste of members’ time and company’s resources.

The disadvantage notwithstanding, it should be noted that having audit committee is more effective than not have one at all. Therefore, the drawbacks of audit committees that have been pointed out are not always caused by the audit committee itself but because of its weak practice in the company. In fact, establishing an effective audit committee can minimise (if not eliminate) these short comings and contribute to ensure better governance of corporate affairs.

# **2.1.10. Roles of Audit Committees in Corporate Governance**

Audit committee plays great role as board mechanism, in fact it has been said that audit committee is an important element in corporate governance. It should be noted that the reason for audit committee from country to country remain to improve the credibility of financial reporting. The committee provide a focus and fuller review and analysis of the matters relating to internal controls, auditing, and financial reporting.

In Nigeria the role of audit committee is as contained in both national code of corporate governance 2016 and Companies and Allied Matters Act 2004.

As earlier mentioned audit committee is one of the most important subcommittees which is formed by the board (Mallin, 2010). Many studies have researched into the roles of the audit committee in strengthening overall corporate governance (Gendron & Bedard, 2006; Turley & Zaman, 2007; Sori, Hamid, Saad & Evans 2007; Chen, Duh & Shiue 2008 and Beasley, Carcello, Hermanson & Neal 2009). Corporate governance has a positive impact on corporate auditing processes, and vice versa (Lin & Liu, 2009; Turley & Zaman, 2001). The true effectiveness of auditing is subject to the actuality and the development of the corporate governance environment, including audit committee practice (Holm & Laursen, 2007). Lin and Liu (2009) further noted that corporate governance plays an important role in enhancing the effectiveness of the audit function. In the effort to devise ways of bringing about good governance in companies, one of the issues that has taken an increasing importance is how best to harness the oversight process in such a way that it will achieve more fully the goal of high quality corporate financial reporting. It is the attempt to have quality financial reporting that brought about the idea of audit committee, which is at the core of the corporate financial reporting process (Blue Ribbon Committee, 1999).

According to the code of corporate governance (2016) audit committee is a board committee that has to work in tandem with the entire board. Today's corporate environment, concepts such as board accountability and audit committee effectiveness are increasingly important topics of discussion, and they are also increasingly becoming subject of corporate governance studies and surveys. Jennings (2002) argued that the goal in the creation of independent audit committees is to provide shareholders with the assurance that someone from outside the company is watching over the activities, practices, and behaviours of managers and the company’s employees. In fact, audit committee is a useful device that can provide an additional safeguard in corporate governance. Smith (2003) claimed that audit committees would be beneficial, not only in increasing the level of assurance against catastrophic failure and gross malfeasance but it would also offer improvements on a wider front, raising the overall standard of corporate governance for all companies that establish audit committees.

To fulfilling the oversight responsibilities of governing boards with regard to an organisation’s financial reporting, internal controls, and external audit process audit committee is of critical importance. Datta (2000) pointed out that a system of global corporate governance promotes a relationship of accountability between the principal actors of sound financial reporting, that is: the board, the management and the auditor. The idea now is that management is accountable to the board, and the board accountable to the shareholders. The role of an audit committee flows directly from the board oversight function. It also acts as a catalyst for effective financial reporting. The Board of Directors has primary responsibility for the financial statements which are prepared by the accounting department. The Board of Directors delegates the responsibility for overview of the financial reporting process and the external and internal audit functions to an audit committee, in which case there should be close communication between the audit committee and the internal and external auditors (Rainsbury *et al.*, 2008). Datta, (2000) discussed that a proper and well-functioning corporate governance system exists when the three main groups (i.e. the board, the management, and including the internal and the external auditor) responsible for financial reporting form the three legged stool that supports responsible financial disclosure and active oversight.

As sub-committee of the full board and as a monitor’s process, audit committee has an important role to play in the process. Among the different committees that can be created to monitor the actions of the board of directors, previous research assigns the audit committee a very important role within the governance structure (Osman *et.al* 2007).

# **2.1.11. Audit Committee Formation**

According to National code of corporate governance, audit committee formation comprises of:

i. The chairman of the audit committee must be an independent non-executive director. In the case of the statutory audit committee, its chairman should be either an independent non-executive director or an independent shareholder.

ii.The board audit committee shall meet at least once every quarter. The agenda for the meetings of the committee shall be developed by the chairman of the committee in consultation with other members of the committee.

iii.The number, timing and duration of board audit committee meetings should be appropriate to ensure that the committee achieves its objectives.

iv.At least once in a year, the board audit committee shall meet the head of internal audit and other members of the internal audit function without the chief financial officer and the external auditors being present.

# **2.1.12. Audit Committee Effectiveness**

With the various high calibers of corporate scandals that we witness in the past few years, one can conclude that having an audit committee in place does not guarantee its effectiveness neither does it mean that financial report so produces by organisations that has audit committee will be of good quality. (Mendez & Garcia 2007). The existence of an audit committee alone does not provide sufficient control, nor does it ensure that the company will maintain a high standard of financial reporting integrity (Rittenberg & Nair, 1994; Mendez & Garcia, 2007). This is as a result of the high-profile financial fraud cases mentioned earlier, academic and other stakeholders seek for effective audit committee in order to provide sound monitoring (Chan & Li, 2008). Without an effective audit committee, the financial reports of companies will lack any credibility. Audit committee needs to perform effectively, to achieve this care must be taken to structure, staff, and support the audit committee to ensure its effectiveness. Some questions remain about the effectiveness of these regulations (Romano, 2005). The audit committee is one of the key mechanisms of corporate governance (Chen *et al,* 2008) and its effectiveness is crucial for sound corporate governance practices in the organisation.

It should however, be noted that the determinant of this effectiveness depend on the constituency or constituencies to which the report goes. Dezoort, Hermanson Archambeault and Reed (2002) reported that an effective audit committee must have qualified members with the authority and resources to protect shareholders’ interest by ensuring that reliable financial reporting, internal control and risk management are in place.

The real meaning of effectiveness in academic research is unclear, this is because different researchers have explained the concept differently. Raghunandan *et al.,* (2001); Smith (2003) focused on audit committee effectiveness have used the word effectiveness’ to mean the carrying out or fulfilling its specific oversight responsibilities or duties ‘. Various studies (for example: Turley & Zaman, 2002; Watts, 2002; Zain & Subramaniam, 2007) have used discharging their oversight responsibilities for the definition of audit committee effectiveness. DeZoort, (1998) defined effectiveness as: "a committee's collective ability to meet its oversight objectives".The definition of an effective audit committee given by DeZoort *et al*. (2002) included its comprehensive roles and responsibilities, that is: “An effective audit committee has qualified members with the authority and resources to protect shareholders‟ interests by ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight efforts”. Woodlock and Claypool, (2001) found that once the audit committee is made aware of its current practices, a comparison needs to be made between current practices and those that constitute best practices so that the audit committee, the Chief Executive Officer, the Chief Financial Officer, and the external auditor are better able to assess where to commit resources to close the gap between current and best practices. A strong internal control function is a necessary criterion for an effective audit committee (Zain & Subramaniam, 2007) because the audit committee members especially rely on the work of the internal auditor in order to develop their own appreciation of the controls’ effectiveness (Spira, 1999a).

A well-functioning audit committee should have a greater likelihood of detecting problems than an inactive one (Choi, Jeon & Park 2004). Audit committee related disclosure and report in the annual report is a necessary element for assessing the effectiveness of audit committee function (ICAEW, 2001; Ng & Tan, 2003; Lee, Mandle & Ortman 2004). Relevant disclosures include a written charter or terms of reference specifying the audit committee responsibilities that have been endorsed or approved by Board of Directors, they also include audit committee reports demonstrating how an audit committee has fulfilled the described responsibilities during the year. The effectiveness of audit committee depends, to a large extent, upon their diligence or activities; such as, the frequency, duration, and content of audit committee meetings (Beasley & Salterio, 2001; Ng & Tan, 2003; Abbott, Parker & Peter, 2004). In addition, some studies (Beattie, Fearnley & Brandt 2000; Goodwin & Yeo, 2001; Braiotta, 2003; as well as Song & Windram, 2004) contended that an effective audit committee should hold meetings with the management, and the internal and external auditors separately in order to exercise an effective oversight or monitoring role over the financial reporting and auditing processes.

It is clear from the above discussion that previous studies have discussed two different frameworks of audit committee effectiveness. DeZoort *et al*. (2002) on their own reviewed 37 empirical studies published between 1987 and 2002, and provided a framework with four fundamental determinants of audit committee effectiveness, namely: composition, authority, resources, and diligence. On the other hand, instead of focusing on the determinants of audit committee effectiveness, Turley and Zaman (2004) and Kalbers and Fogarty (1993) analysed the effectiveness of audit committees using a framework which focused on successfully performing audit committee’s roles. However, while having the right people’ as audit committee members and providing them with concrete responsibilities and resources are important inputs to audit committee effectiveness, they are not sufficient to ensure effectiveness (Bedard & Gendron, 2010). Instead the process by which audit committee members assess information and oversee activities is important in this respect. In fact, process is a very important mechanism of an audit committee that explains how characteristics are translated into organisational outcomes. Gendron, Bedard and Gosselin (2004) noted that the audit committee process is an important factor in developing a better understanding of audit committee effectiveness. Bedard and Gendron (2010) explained that the dimensions of an audit committee process include: audit committee meeting, meeting agenda, questioning and leadership. However, performing audit committee roles successfully depends on the input factors (i.e. composition, authority, resource and diligence) and the processes by which an audit committee functions (e.g. meeting process) Therefore, it would be more comprehensive and accepted if audit committee effectiveness is evaluated on composition; Independence; Member expertise; Member Financial Literacy; Authority; Resources; and Diligence. This study aims to investigate audit committee effectiveness in Nigeria considering all of these dimensions as audit committee effectiveness criteria.

**Significance of Audit Committee Effectiveness**

Effective audit committee is fundamental to its oversight responsibility on the financial reporting process and in ensuring high quality financial reporting (Chen & Zhou, 2007). Various studies have proved that the existence of effective audit committee is positively associated with the quality of financial reporting. McMullen (1996) in his work found that the presence of audit committee is negatively associated with financial restatements and sanctions by the U.S. SEC. Chambers (2005) noted that poor standards of corporate governance (for instance, ineffective or non-existent audit committees) facilitate abuses (such as, fraudulent financial reporting). The significance of audit committee effectiveness in preventing misstatement in financial reporting has been highlighted in many studies. An effective audit committee is now treated as a principal player in ensuring global corporate governance and rebuilding public confidence in the financial reporting of a firm. A well-functioning audit committee leads to the improvement of corporate financial reporting and the decrease of earnings management or financial frauds, as well as the increase of unqualified auditor reports (Carcello & Neal, 2000; DeZoort & Salterio, 2001; Klein, 2002b; Sharma, 2004; Bedard *et al*. 2004). In their study, Bryan *et al*. (2004) found positive association between the audit committee effectiveness and firm‘s earning. An effective audit committee serves as important corporate governance mechanism to boost investors’ confidence in global corporate governance, to improve the trust in financial reporting processes, and it lends more credibility to the audited financial statements (Spira, 1999; Rezaee *et al*., 2003). The significance of an effective audit committee is visible in enhancing the quality of statutory auditing, which ultimately leads to better financial reporting. Garcia-Meca and Sanchez-Ballesta (2009) noted that the existence of audit committee reduces errors and irregularities in financial statements, and enhances the credibility of financial reporting; this result was consistent with the view of McMullen (1996).

In contrast, there are a number of studies which have found opposite results; for example, Beasley (1996) found that there was no significant relationship between presence of audit committee and the likelihood of fraud or error. Furthermore, Pucheta-Martinez and Fuentes (2007) revealed that presence of audit committee has little or no impact on quality of financial reporting. However, it is widely accepted that audit committee plays an important role in assuring the quality of financial reporting and corporate accountability. As a liaison between the external auditor and the board, the audit committee minimises information asymmetry between them, facilitates the monitoring process and enhances the independence of the auditor (Sori, Hamid, Saad, & Evans, 2007). An effective audit committee also significantly contributes to the establishment of a rigorous internal control function in the company, which ultimately reduces irregularities and fraudulent activities in the company’s affairs. Zain & Subramaniam (2007) highlighted the leadership role of audit committee in supporting and guiding internal auditors. They also argued that an audit committee is perceived to hold an authoritative position which helps it to question the decisions made by management. As already discussed, independence is a pre-requisite for an effective audit committee. Klein (2002) examined whether the magnitude of abnormal accruals has any relationship with audit committee independence and found a negative relation between audit committee independence and abnormal accruals, the impact of which is more pronounced when independent members in the audit committee are not a majority. Klein‘s (2002) study concluded that independent audit committees can monitor firms’ earning processes more objectively. Xie, Xie & Xu (2003) and Laux & Laux (2009) explained the role of audit committee in preventing earnings management. An independent audit committee is considered to be an effective mechanism in limiting earnings management (Garcia-Meca & Sanchez-Ballesta, 2009). Furthermore, Lin & Liu (2009) added that an effective auditing function can detect and disclose earnings management and other types of misconduct by business managers or controlling shareholders. Klein (2002b) and Bedard, Chtourou & Courteau, (2004) found that audit committee‘s independence and financial expertise are negatively associated with earnings management, as measured by discretionary accruals. Chen, Duh & Shiue (2008) noted that an effective audit committee can play a significant role in resolving an agency problem (i.e. owner-management problem) in the company. The study also found the influence of an effective audit committee in the higher earnings and returns of the company. It is clear from the above that an effective audit committee contributes significantly in ensuring fair and sound practice of financial reporting, establishing rigorous internal control, and thus safeguarding stakeholder’s interest.

# **2.1.13. Development of Audit Committee**

As it has been mentioned previously, Audit Committee is an important arm of the board of Directors, it is an essential aspect that help in strengthening the credibility of Financial Reports. According to Al- Lehaidan (2006) audit Committee is a sub –committee of the main board of directors of a company, usually formed from non-executive directors, and charged with matters relating to financial reporting, internal control system and audit and to act as a link between the board of directors, internal and external auditor. In a similar word Dilworth (1989) as sighted in Al- Lehaidan (2006) stated that audit committee are one mechanism through which auditors are held accountable for the scope, nature and quality of their work. Audit committee can thus exert a powerful influence on auditors through their role in conducting a specific inquiry into the scope nature and quality of the audit work done.

Review of the development of audit committees in the following countries would be carried out: the US, UK, Canada and Nigeria. It is believed that such will highlight the importance of audit committee and its attempt to ensure reliable, high quality financial reporting.

**Development of Audit Committee in United State of America**

The development of audit committee in the United State of America date back to the late 1930s when the Securities and Exchange Commission as well as the New York Stock Exchange after the McKesson – Robbin encourage companies to have audit committee. But the idea of audit committee was unpopular until around 1967, when the America Institute of Certified Public Accountants recommended that public owned corporations should appoint audit committee composing of independent directors to protect the interest of shareholders and to protect the integrity of the financial statements as well as Capital market. The New York Stock Exchange recommended that a special Committee comprising of independent directors be appointed to select the external auditors (Maassen, 2004).

In the 1970s, Moss Committee (a Congregational sub-committee) as well as Metcalf Committee (a Senate committee) recommended that audit committee should be one of the requirement for listing. This recommendation came to effect on 30 June 1978.

In 1987, Treadway Commission was formed with aim of identifying what may lead to fraudulent financial reporting and the steps to curb its occurrence. According to the Committee all public companies should be required by Securities and Exchange Commission to regulate the establishment of audit committee that would composed of independent directors. The reason behind this is to reduce the possibility of financial reporting fraud.

Again in 1994, the Kirk panel (the Public Oversight Board (POB) Advisory Panel on Auditor Independence) in its attempt to strengthen the professionalism of Independent auditor, recommended that there is need for a strong relationship between audit committee and the independent auditor in order to improve the integrity of financial reporting process. The New York Stock Exchange and National Association for Securities Dealers (NASD) form the Blue Robin Committee (BRC) in 1998 that worked on ways to improving the effectiveness of audit committee. The committee was mandated to evaluate the financial reporting process of USA (Luecke, 2001). As a result of financial scandal that rock the boat of Enron Corporation, regulators, professional bodies and other stakeholders rekindled the debate on corporate accountability and raised fear that the corporate system in the USA is rotting at its core (Sridhar, 2002). At this point, the Sarbanes – Oxley Act (2002) came with many requirements that includes the composition and duties of audit committee. (PriceWaterhouse Coopers 2002). The Act was passed into law to protect the investors by improving on the reporting accuracy of financial disclosure, it required companies to make new disclosures on internal controls, ethics codes and composition of audit committee on annual reports.

**Development of Audit Committee in United Kingdom.**

The development of audit committee was slower in the United Kingdom, because it did not start until around 1973. The initiative in respect of Public Sector audit committee was from early 1973. The internal audit report on civil service noted the advantages of having an audit committee, the report included discussions on audit plans and results of one of its roles (Dafinone, 2001).

In 1986, the Institute of Chartered Accountants of England and Wales recommended that audit committees should be responsible for external auditors as well as the approval of audit plan and the review of management reports issued by external auditors.

Vanasco (1994) in his work reported that in1987, Bank of England in its paper titled “the Role of audit committee in Banks” required all banks to establish an audit committee. In like manner the London Stock Exchange recommended that all quoted companies should have audit committee that comprises of non –executive directors.

The Cadbury committee was set up in 1991 by Financial Reporting Council, the London Stock Exchange and the Accountancy profession bodies to look into the financial aspect of Corporate Governance. The committee came up with the report that all companies listed on the Stock Exchange should disclose as a continuing listing obligation, a statement of compliance. Auditors are made to review the statement of compliance and to also state if the company had indeed complied with the code.

**Development of Audit Committee in Canada**

The bankruptcy of Atlantic Corporation Limited of 1965 was one of the major reasons that brought about the issue of audit committee in Canada. The bankruptcy was a major financial scandal in Canada that led to the issuance of Canadian Royal Commission. The Commission in its report recommended that all public companies should establish audit committee (Collier 1996).

In 1967, commission on companies’ law called Lawrence commission recommended that establishment of audit committee be made compulsory for all public companies (Canadian Institute of Chartered Accountants 1981). Audit committee is seen as an important link between the auditor and the board of directors. Vanasco (1994) in his work reported that the Companies Act of 1970 known as the Ontario Business Committee Corporation Act legislated and make audit committee a mandatory committee for all public limited companies. The Act was amended in 1975 requiring all public companies to have audit committee whose duty is to approve the financial statement before it is submitted to the board of directors for approval. Further to this is the Adams report that made recommendation that has to do with the responsibilities of the audit committee.

The release of a Notice on audit committee in 1990 by the Canadian Securities Administrators is another significant contribution to audit committee development (Hansell 2002). The notice dealt with the mandate of the audit committee in considerable detail, it recommended that the audit committee review non-audit engagements between the corporation and the external auditor and consider the impact of those engagements on the auditor's independence.

The Bank Act, the Trust and Loan Companies Act and the Insurance Companies Act were all amended in 1992 to ensure that the audit committee be composed of at least three non-executive directors of whom none should be officers or employees of the company or its subsidiaries.

**Development of Audit Committee in Nigeria**

Nigeria like United Kingdom did not introduce Audit committee as early as United State, as it was not introduced until 1990 when the Companies and Allied Matters Decree was promulgated. Section 359(3) of the CAMA (2004) as amended provides for the establishment of Audit Committees in public Companies in Nigeria thus: “The auditor shall in the case of a Public Company also make a report to an Audit Committee which shall be established by the Public Company.” Section 359(4) further provides that the membership of the committee shall be composed of equal number of directors and shareholders’ representatives so that the maximum number of members of the committee shall not exceed six. The provision on the establishment of Audit Committees in Public Companies in Nigeria was further boosted in 2003 by the Code of Best Practices of Corporate Governance in Nigeria, issued by the Securities and Exchange Commission, which was applicable to all public companies in Nigeria. According to (Nat, 2013) the 2003 SEC Code enjoined companies to have Audit Committees and further indicated directors’ representatives in the Audit Committee. The 2003 SEC Code was replaced by the Code of Corporate Governance in Nigeria 2011 issued by the Securities and Exchange Commission and which became effective on 1st April 2011. Perhaps, taking a clue from the provisions of the 2003 SEC Code, the Code of Corporate Governance for Banks in Nigeria Post-Consolidation, issued by the Central Bank of Nigeria and mandatory for all banks operating in Nigeria also made provision for the establishment of audit committees in all banks operating in Nigeria. Furthermore, the Code of Corporate Governance for Insurance Companies in Nigeria issued by the regulator of the Insurance Industry in Nigeria, National Insurance Commission (NAICOM), similarly provided for the establishment of Audit Committees in Insurance and Re-insurance companies operating in Nigeria. However, in the Code of Corporate Governance for Licensed Pension Operators issued by the National Pension Commission (PENCOM), the Audit Committee only received a mere mention in two provisions; the first provision, recognizes the Audit Committee as one of the Committees the Board of Directors of a relevant company can establish to facilitate its work and the second provision stipulates that the Corporate Governance report to be prepared by a relevant company for submission to PENCOM should contain the composition of the Audit Committee of the company and the details of the Committee’s activities. (Nat, 2013)

It should be noted that Nigeria is the only known nation with sectorial corporate governance code.

In 2013, the Honourable Minister of Trade and Investment Olusegun Olutoyin Agagu inaugurated a committee chaired by Mr. Vincent Odiase to harmonise and unify all the existing sectorial corporate governance code in Nigeria. The attempt is as a result of the fact that there were not known nation that have adopted this sectorial multiplicity of governance codes. It should be noted that the sectorial codes were very confusing in that they make conflicting provision on the same subject matters. The Code became effective on the 17th October, 2016. The Financial Reporting Council of Nigeria issued three of these codes namely:

(i). National code of Corporate Governance for Private Sector in Nigeria 2016 (“Private Sector Code”);

(ii). Public Sector Code in Nigeria 2016 (“Public Sector Code”); and

(iii). Not – For – Profit Organisation Governance Code 2016 (“Not – For – Profit Code”). While the Public-Sector Code await directive from the Federal Government on its effective date. It should be noted that the three codes are under suspension on the directive of the federal Government of Nigeria. However the code has been suspended by Federal Government, but not repealed.

# **2.1.14. Financial Reporting Quality**

The financial reporting quality matters in this thesis as it is one of the basis of nominating audit committee in the first place. This section discusses different perspectives of financial reporting quality, the different methods used in prior studies for measuring financial reporting quality are also outlined.

# **2.1.15. Perspectives of Financial Reporting Quality**

Jonas and Blanchet (2000) described the two general perspectives widely used in assessing the quality of financial reporting. The first perspective is based on the needs of users. Here, financial reporting quality is determined relative to the usefulness of the financial information to the users of the information. In the second place financial reporting quality focused on the notion of shareholder/investor protection. This perspective defines quality financial reporting as "…full and transparent financial information that is not designed to make more difficult or mislead users" (Jonas & Blanchet 2000). Arthur Levitt, former chairman of the Securities and Exchange Commission in the United States, stressed the importance of transparent, timely and reliable financial statements to the protection of investors (Levitt 1998).

There is a fundamental distinction between these two perspectives of financial reporting quality. The user needs perspective is mainly concerned with providing relevant information to users for making decisions, whereas the shareholder/investor protection perspective aims to ensure the information provided to users is sufficient for their needs, transparent and competent (Jonas & Blanchet 2000).

# **2.1.16. Methods of Measuring Financial Reporting Quality**

A number of methods have been used in the research literature to empirically measure financial reporting quality. One broad method has been to use a variety of approaches to measure the quality of the earnings numbers reported in firms' financial reports. Under this method, the higher the quality of earnings, the higher is the overall financial reporting quality. Schipper and Vincent (2003) reported that there is neither a widely agreed meaning given to the term "earnings quality", nor a generally accepted approach to measuring this concept.

This research will use two empirical models to measure earnings quality. These models are explained in more detail in Chapter 3. The first model to be used is a modified version of the Jones (1991) model of discretionary accruals. This model has been widely used in the literature to capture earnings management, which is viewed as an inverse measure of earnings quality (Bartov, Gul & Tsui 2001; Chung, Firth & Kim 2002; Frankel, Johnson & Nelson 2002; Balsam, Krishnan & Yang 2003; Chung & Kallapur 2003; Gul, Chen & Tsui 2003; Koh 2003; Krishnan 2003; Dowdell & Krishnan 2004; Chen, Lin & Zhou 2005).

Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying performance of the company or to influence contractual outcomes that depend on reported accounting numbers. Schipper (1989) defined earnings management as "…a purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain." These definitions take an opportunistic view of earnings management, whereby the intent of management is to obtain some private gain by misleading stakeholders or influencing contractual outcomes. Therefore, under this perspective, earnings management negatively impacts on the quality of earnings, i.e., the greater the earnings management, the lower the earnings quality and vice versa. If earnings were managed opportunistically, the reported earnings number and the overall financial reports would be of a lower quality. This relates to both perspectives of financial reporting quality from Jonas and Blanchet (2000), as opportunistic earnings management both decreases the usefulness of the financial information for users (the user needs perspective) and misleads users (the shareholder/investor protection perspective). An alternative view is that earnings are managed to allow managers to reveal more private information to users about the financial reports (Schipper 1989; Healy &Wahlen 1999).

The second model used to measure earnings quality was the Dechow and Dichev (2002) model. This model argues that estimation errors in accruals and subsequent corrections of these errors, decreases the quality of accruals and earnings. However, unlike the Jones (1991) type models of discretionary accruals that "…focus on the opportunistic use of accruals to window-dress and mislead users of financial statements", no attempt is made to separate the intentional from the unintentional accrual estimation errors (Dechow & Dichev 2002). This is because both types of errors imply low quality accruals and, therefore, earnings. Therefore, while the Jones (1991) model assumes that accruals and earnings quality is only affected by management intent to manipulate, the Dechow and Dichev (2002) measure of earnings quality incorporates both intentional and unintentional estimation errors in accruals. Intentional errors arise from incentives to manage earnings and would be similar to opportunistic earnings management proxied by the Jones (1991) model. Unintentional errors arise from management lapses and environmental uncertainty (Francis, *et.al* 2005a).

Several recent papers have used the Dechow & Dichev (2002) model as part of their empirical tests. First, Xie, Xie & Xu (2003) examined the association between earnings quality and audit committee monitoring service, which was proxied by the frequency of annual audit committee meetings. Second, Dhaliwal, Naiker & Navissi (2006) investigated the association between three types of audit committee financial expertise and accruals quality. Other recent papers that have used the Dechow & Dichev (2002) model include: Francis *et.al* (2005) who investigated the pricing of accruals quality by investors; Francis; LaFond; Olsson & Schipper (2004) who examined the association between the cost of equity capital and seven earnings attributes, which included accruals quality and Aboody, Hughes & Liu (2005) who examined the association between earnings quality, insider trading and the cost of capital.

A number of other approaches have been used in prior studies to measure the quality of earnings. Wild (1994) measured earnings quality as the informativeness of earnings reports before and after audit committee formation. Informativeness was measured by the extent of market reaction to the release of the earnings reports. Earnings quality was measured by Vafeas (2005) using the existence of small earnings increases and the avoidance of negative earnings surprises.

Apart from earnings quality, several other methods have been used in the literature to measure overall financial reporting quality. A number of studies have surveyed different groups of stakeholders such as investors (Hodge 2003) and auditors (Cohen Krishnamoorthy, & Wright 2002) to gather their perceptions of the quality of earnings and financial reporting. Felo, Krishnamurthy & Solieri (2003) used analysts’ ratings from the Association for Investment Management and Research to measure financial reporting quality. These ratings are based on evaluations by sub-committees of analysts of the quality of annual published information, quarterly and other published information and information provided through the investor relations program. A similar approach was used in studies by Lang & Lundholm (1993 and 1996).

# **2.1.17. Audit Committees and the Internal Audit Function**

Corporate governance role in the internal audit function goes as far back as 1940 (Gramling, Maletta, Schneider & Church (2004), however the renewed and expanded focus on the internal audit function in recent regulatory reports (Smith, 2003; SOX, 2002) has further increased the importance of the role it plays in ensuring the quality of corporate governance. As audit committees are responsible for the monitoring and overseeing of the effectiveness of the internal audit function in the overall financial reporting process, much of the extant research are focused on the interaction between audit committees and the internal audit function, specifically investigating a variety of audit committee characteristics and the quality of internal auditing. Cohen, Krishnamoorthy & Wright(2004) argue that a close relationship between the audit committee and the internal audit function improves the governance capabilities of both parties. The stream of research looking at this important relationship has focused on the interaction of these two governance mechanisms from a number of different perspectives; expectations and contributions of each other’s role in the corporate governance mosaic (Sarens & Beelde, 2006; Zain Subramaniam & Stewart, 2006; Sarens, Beelde & Everaert 2009); audit committee involvement in process issues (Goodwin, 2003; Gendron *et al.*, 2004); the role of audit committees in negotiating resources for the internal audit function (Carcello, Hermanson & Raghunandan, (2005); Abbott *et al.*, (2010); Barua, Rama & Sharma, (2010) ); and the association between audit committee characteristics and the disclosure and remediation of internal control weaknesses (Krishnan, 2005; Zhang, Zhou & Zhou, 2007; Goh, 2009; Hoitrash, Hoitash & Bedard 2009).

Audit committees perceive internal control evaluations as one of their most important responsibilities in the oversight process (Dezoort, 1997; Cohen *et al.*, 2004), however, the measurement of such perception is not a trivial task.

The results of a questionnaire survey of chief internal auditors, conducted by Zain *et al.* (2006), showed that audit committees which are independent and have accounting and auditing experience are positively associated with the internal auditors’ assessment of their contribution towards external audit. These findings suggest that organisations with appropriately constituted audit committees have the potential to benefit from the contributions made by the internal audit function in terms of financial statement audit. Audit committees always seek the support of the internal audit function in areas such as internal audit control procedures. This is especially the case when companies lack formal risk management systems. The embedded position of internal auditors within a company and their familiarity with the risk management system puts them in a unique position. This places an expectation on them from the audit committees to perform a helpful role in the financial reporting process. Findings from a Belgian case study show that the internal audit function more or less meets the internal control expectations of audit committees (Sarens & Beelde, 2006). Furthermore, the advising, supportive and facilitative role of internal auditors provides a great help and comfort to audit committees in their monitoring and improving internal control and risk management aspects of companies (Sarens, Beelde & Everaert, 2009).

The bulk of empirical research seeking to investigate the impact of audit committee characteristics on the internal audit process focused on issues of independence and financial expertise of audit committee members. Moreover, surveys seem to be the methodology of choice in this line of enquiry. Scarbrough, Rama & Raghunandan (1998) surveyed Canadian firms and reported that audit committees composed solely of outside directors meet the chief internal auditor and review the work of the internal auditor more frequently compared to audit committees with employee directors. In a similar vein, Goodwin and Yero (2001) surveying Singapore firms, found evidence that audit committees composed solely of independent directors met more frequently and privately with chief internal auditors as compared to their counterparts. Similar findings have also been documented in studies of US firms (Raghunandan Read & Rama, 2001) and Australian/New Zealand firms (Goodwin, 2003), where the audit committee had at least one member with accounting or finance experience. These studies are thus suggestive of a positive link between audit committee independence and the frequency and privacy of meetings with the internal auditor. The privacy of these meetings enhances and protects the independence of internal auditors, as these internal auditors tend to discuss sensitive issues with audit committee members more freely in the absence of management (Scarbrough *et al.*, 1998; Braiotta, 1999). Moreover, the chances of these meetings being private, increases if audit committee members are equipped with accounting expertise. In addition, the accounting expertise of the audit committee is also strongly associated with periodic reviews of the internal auditors work. Hence, this validates the importance of accounting and finance knowledge by audit committee members in the assessment of work carried out by the firm’s internal audit function.

The most discussed procedural issue in the internal audit literature is of meetings between audit committees and internal auditors. On answering ‘what goes into these meetings’ Gendron, Bedard & Gosselin,(2004) suggests that both parties tend to discuss the effectiveness of internal controls, the use of wording and the accuracy of financial statements, and the quality of external audit. Although the overwhelming evidence points to the importance of interaction between these functions, a point of caution must be observed. All these surveys focus only on the views of the internal auditors. It would be interesting to see the perceptions of effectiveness and reliance audit committees and external auditors place on the internal audit function. Prior UK research has pointed to the lack of confidence shown by audit committees in seeking to challenge and question the findings of the internal audit function (Turley & Zaman 2007). This study acknowledged the limited impact audit committees had on the work plan of the internal audit function and on matters such as internal control and audit. The members of the internal audit function remark that this limited role of audit committees is due to the lack of experience and detailed knowledge. However, the establishment of an informal link between the head of internal audit and the chair of audit committee is shown to be of significant importance as this improves the overall motivation of the head of internal audit function in carrying out its duties in proving their credibility to the audit committee chair as a valuable unit of the firm.

Being an organ of the firm, the credibility or usefulness of the internal audit function is inevitably linked with its objectivity and independence from management. The role of audit committees is also of much importance in strengthening the independence of the internal audit function. Goodwin *et al.* (2001) argue that audit committees provide an independent forum for internal auditors to discuss matters relating to their independence. Issues such as; the functional reporting lines for internal auditors; the use of internal audit function as a training ground for management; and, most importantly, the hiring and firing of the chief internal auditor; have been the subject of prior research. The Institute of Internal Auditors (IIA, 2004) argue that reporting lines are the ultimate source of internal audit independence and are crucial for good corporate governance. They therefore encourage chief audit executives to report directly to audit committees. A survey carried out in US suggests that lenders perceive that those internal audit departments that report directly to the audit committee are more able to deter and report financial statement fraud than internal audit departments reporting directly to company management (James, 2003). Moreover, no difference in users’ perceptions of financial statement and fraud prevention was recorded between in-house and outsourced internal audit functions (James, 2003). However, the use of the internal audit function to train future management personnel was found to be widespread, thus posing a threat to the objectivity of the internal auditor (Goodwin *et al.*, 2001).

# **2.1.18. Audit Committees and the External Audit Function**

From the earliest days, audit committees were viewed as an important mechanism in seeking to improve the statutory audit process. Cadbury Committee in its report on the benefits of audit committees stated that they "...offer added assurance to the shareholders that the auditors, who act on their behalf, are in a position to safeguard their interests". The Cadbury committee also noted that "...the annual audit is one of the cornerstones of corporate governance. The audit provides an external check on the way the financial statements have been prepared and presented and it is an essential part of the checks and balances required." (Cadbury report, 1992).

There are many studies on the subject of involvement of audit committee in dealing with external auditor (Lennox & Park, 2007; Beasley *et al*., 2009; Bedard & Gendron, 2010). In fact audit committee is a valuable instrument for initiating direct contact with the independent (external) auditor, participating in the selection of the external auditor, and promoting effective communication between the independent auditor and corporate directors ( Beasley *et al*. 2009).

Many of the research on the relationship between audit committees and audit quality has sought to examine this from a number of different perspectives such as: to understand how audit committees themselves perceive audit quality (Schroeder *et al.*, 1986; Knapp, 1991); investigating audit committee behaviour in the event of auditor-manager conflict (Dezoort *et al.*, 2003; Bierstaker, Cohen, DeZoort & Hermanson 2012); the interaction between audit committees and external auditor behaviour ( Abbott *et al.* 2003a; Zaman, Hudaib & Haniffa 2011; Chan, Liu & Sun 2012); and the role of audit committees on the choice of external auditor (Chen *et al.*, 2005; Chen & Zhou, 2007).

The other roles of the audit committee with respect to the external auditors include:

i. Consideration of the selection, reappointment, and dismissal of the external auditor, the audit committee should share the selection responsibility with management. (Lennox & Park 2007; Bedard & Gendron 2010).

ii. Reviewing the independence of the external auditor, it is important that the audit committee protect and enhance the independence of the external auditor. The committee should therefore consider if there are any factors that might impair the independence of the external auditors.

The ultimate objective of the audit process is to arrive at an opinion on the truth and fairness of the financial statements and therefore convey to the users of the financial statements an independent opinion as to whether the financial statements as a whole represent a true and fair view of the company's statement of comprehensive income and its state of affairs at statement of financial position date.

It is therefore important that the audit committee review the criteria required for external auditor independence.

# **2.2. Theoretical Review**

# **2.2.1 Agency Theory**

An agency relationship is a contract under which one-person (the principal) engages another person (the agent) to perform some services on his/her (the principal’s) behalf (Jenson & Meckling, 1976). Agency relationship is also defined as a contractual process whereby owners delegate some of their authorities and responsibilities to a team consisting of expert member(s), and they then expect this team to exercise their expertise in the best interests of the firm‘s operational success. Muth & Donaldson, (1998) described agency relationship as delegation of power by the owner to the management. Eisenhardt, (1989) discussed two main causes of agency problems, namely: conflict of interests, and different attitudes towards risk between owner and management. The theory is based on the notion of relationship in which the principal delegates responsibilities to the agent, risk is shared between the entities, and there is a potential conflict of interest (Eisenhardt, 1989).

In line with agency theory, the central problem of Corporate Governance is how the shareholders ensure that self-seeking executives act in the shareholders’ interest rather than their own (Hendry, 2005). Since human being are rational if the shareholders failed to monitor management properly, the company’s assets might be used for the welfare of management instead of maximising the company‘s wealth. Chrisman, Chua & Litz, (2004) noted that this conflict arises from information asymmetry between owners’ and managers, and so there exists a gap between the two. Agency problems of moral hazard and adverse selection, in particular, develop under information asymmetries between agents and principals. In this respect, Chrisman et al. (2004) concluded that one of the reasons behind principal and agent conflict is the information asymmetry between owners and managers, which emerges because of a knowledge gap about the company‘s internal operations. While the principals (owners) need quality information to monitor, control, and motivate the agents, the agents (management) have full control over the information flow. This sometimes leads to information asymmetry which, in turn, becomes the cause of the agency problem (Lazarides & Drimpetas, 2008). These problems occur when managers in possession of information make decisions that are self-serving, such as: engaging in executive perquisites, shirking behaviour (moral hazard), or misrepresenting their skills and abilities (adverse selection) in the hiring process (Eisenhardt, 1989; Rutherford & Buchholtz, 2007).

As a result of information asymmetries and self-interest, principals do not have reasons to trust their agents and will seek to resolve these concerns by putting in place mechanisms to make sure that the interests of agents are in line with that of the principals and what can be done to reduce the scope for information asymmetries and opportunistic tendencies of the agent.

The separation of ownership and control allows controlling shareholders to pursue private benefits (Albuquerue & Wang, 2008). Sometimes, shareholders may prioritise their own welfare at the cost of other stakeholders, and so they tend to influence management decision in order to maximise short term profit. Management prefers to maximise the wealth of the firm by earning sustainable long term profits. Consequently, conflicts of interests between owners and management emerge and can grow exponentially. Management decisions and activities need to be monitored for accountability purposes. Close monitoring is possible when owners themselves can actively participate in this monitoring process. However, because of the high cost of involvement, and in some cases due to the lack of expertise and knowledge, they cannot be actively involved in the process. Nevertheless, the board has to set monitoring mechanisms because of their oversight responsibilities to shareholders.

While the board usually hires an expert and knowledgeable body to oversee management activities on its behalf, the audit committee is a subcommittee under the Corporate Governance framework to which the board delegates some of its crucial oversight responsibilities. Chen, Duh & Shiue, (2008) studied non-U.S. companies trading shares in the U.S. market, and argued that effective audit committee can resolve agency problems of foreign companies no matter which Corporate Governance model is being followed in the company‘s home country. Dey (2008) found the level and intensity of agency problem is less in those firms where audit committee are more effective in terms of composition and functioning.

The audit committee alleviates the agency problem by facilitating the timely release of unbiased accounting information by managers to shareholders, creditors and so on; thereby, reducing the information asymmetry between insiders and outsiders (Klein, 1998b). Since managers usually do not have to interact frequently with shareholders, a distance in terms of trust might exist due to this communication gap. The audit committee can act as a bridge of such gap. Chen *et al*. (2008) found that the audit committee can help to maintain contact between a management and its shareholders. They also mentioned that the effectiveness of an audit committee in resolving agency problems is also applicable to foreign companies, even though their home countries adopt different Corporate Governance systems. Since an audit committee mainly performs the monitoring role, the effect of this committee on a firm‘s performance is better explained by agency theory than by the other theories (Bedard, Coulombe & Courteau, 2008).

# **2.2.2. Stewardship Theory**

Stewardship theory has its roots in psychology and sociology and was designed for researchers to examine situations in which executives as stewards are motivated to act in the best interests of their principals (Donaldson & Davis, 1991). Unlike agency theory, stewardship theory assumes that managers are stewards whose behaviors are aligned with the objectives of their principals. The theory argues and looks at a different form of motivation for managers drawn from organisational theory. Managers are viewed as loyal to the company and interested in achieving high performance. The dominant motive, which directs managers to accomplish their job, is their desire to perform excellently. Specifically, managers are conceived as being motivated by a need to achieve, to gain intrinsic satisfaction through successfully performing inherently challenging work, to exercise responsibility and authority, and thereby to gain recognition from peers and bosses. Therefore, there are non-financial motivators for managers.

Stewardship theory presumes that executive managers, far from being opportunistic, are honest and that they are good stewards of the corporate assets (Nicholson *et.al* 2007). Donaldson and Davis (1994) argued that the managers are good stewards of corporations who, being motivated by their own achievement and responsibility needs, work hard to increase shareholders' wealth. According to this theory, the economic performance of a firm is improved if power and authority are concentrated in the hand of Chief Executive Officer. Depth of knowledge, commitment, access to current operating information and technical expertise are vital to run a company efficiently, and Chief Executive Officers, who are deemed to possess these advantages, will be able to provide more effective leadership. The idea of trusteeship echoes the stewardship theory in many ways (Kay & Silberston, 1995) since it puts emphasis on the concept that managers have numerous motivations other than simply maximising their own benefits. Earlier, Etzioni (1975) argued that managers, when faced with a situation which brings no direct personal advantage, may still base their job on a sense of duty. Hawley & Williams (1996) claimed that this would lead to a situation where either the boards are mainly executive-dominated or there are no boards at all. Turnbull (1997) suggested that boards can be made redundant with the presence of a dominant active shareholder, particularly when the shareholder is a family or government. Tricker (1996) noted that company law imposes a fiduciary duty upon managers towards the shareholders and, therefore, managers can be easily trusted with the stewardship of the company assets. In short, the stewardship theory of Corporate Governance thrives on the concept of managers being self-motivated towards working for the best interest of the company and other related parties. Each stakeholder plays an important part in creating an environment where transparency and accountability are encouraged, enforced, and rewarded. Tricker (1984) described accountability in stewardship theory as the means by which those who manage and oversee the affairs of the company are held to account for their stewardship of corporate assets.

According to stewardship theory, the behavior of the steward is collective, because the steward seeks to attain the objectives of the organisation (e.g., sales growth or profitability). This behavior in turn will benefit principals such as outside owners (through positive effects of profits on dividends and share prices) and also principals who are managerial superordinate because their objectives are furthered by the steward. Stewardship theorists assume a strong relationship between the success of the organisation and the principal's satisfaction. A steward protects and maximises shareholders' wealth through firm performance, because, by so doing, the steward's utility functions are maximised.

Stewardship theorists argue that the performance of a steward is affected by whether the structural situation in which he or she is located facilitates effective action. If the executive's motivations fit the model of man underlying stewardship theory, empowering governance structures and mechanisms are appropriate. Thus, a steward's autonomy should be deliberately extended to maximise the benefits of a steward, because he or she can be trusted. In this case, the amount of resources that are necessary to guarantee pro-organisational behaviour from an individualistic agent (i.e., monitoring and incentive or bonding costs) are diminished, because a steward is motivated to behave in ways that are consistent with organisational objectives. Indeed, control can be potentially counterproductive, because it undermines the pro-organisational behavior of the steward, by lowering his or her motivation (Argyris 1964). The essential assumption underlying the prescriptions of stewardship theory is that the behaviors of the executive are aligned with the interests of the principals.

Given the advantage of stewardship to principals, the question is why is there not always a steward relationship, rather than an agency relationship? The answer lies in the risks that the principals are willing to assume. When the owners and the managers engage in the governance contract, owners must decide how much risk they are willing to assume with their wealth. Risk-averse owners will most likely perceive that executives are self- serving and will prefer agency governance prescriptions. Implementing stewardship governance mechanisms for an agent would be analogous to turning the hen house over to the fox. Agency prescriptions can be viewed as the necessary costs of insuring principal utility against the risks of executive opportunism. From this perspective, a better question might be why would an owner ever take the risks of stewardship governance prescriptions?

# **2.2.3 Stakeholder Theory**

Although stakeholder theory has evolved gradually since the 1970s (Solomon, 2007), one of the pioneering expositions of this theory was introduced by Freeman in 1984 when he defined a stakeholder as: ―*any individual or group who can be affect or is affected by achievement of the organisation’s objectives”*. Stakeholder theory takes account of a wider group of constituents rather than simply focusing only on shareholders (Mallin, 2010). Thus, stakeholders can include shareholders, employees, suppliers, customers, creditors, communities in the vicinity of the company‘s operations, and the general public. Some extreme proponents of this theory suggest that environment and future generation can also be included as stakeholders. One commonality characterising all definitions of stakeholders is to acknowledge their involvement in an exchange relationship (Freeman, 1984; Hill &Jones, 1992). Stakeholder theory highlights that the interests of different groups, and argues for the possibility of favouring one group‘s interest over that of another (Jones & Wicks, 1999). It also suggests that the company is a separate organisational entity, and that it is connected to different parties in achieving a wide range of purposes (Donaldson & Preston, 1995).

Proponents of the stakeholder theory emphasise that the corporation could not exist without the contributions of groups like customers, employees, and the community of which it is a part, and the environment; therefore, managers should consider how their decisions affect these other constituents (Stovall, Neill & Perkins, 2004). McAlister, Ferrell & Ferrell (2003) argued that this theory presumes a collaborative and relational approach to business and its constituents. Supporters of this theory argue that the Corporate Governance problem turns round the objective function of the corporation. The notion that the firm's goal is to maximise shareholders' welfare is regarded as being too narrow. Rather, they suggest that the goal of the firm should be extended to include the maximisation of the welfare of other stakeholders, such as: employees, creditors, suppliers, customers, the environment, and the community (Freeman, 1984). Solomon (2007) contended that a basis for stakeholder theory is that companies are so large, and their impact on the society is so pervasive, that they should discharge accountability to many more sectors of the society than solely their shareholders; they should include employees, suppliers, customers, creditors, communities in the vicinity of the company's operations, and the general public. Creditors have an interest in getting their loans repaid on schedule; suppliers have an interest in securing fair prices and dependable buyers; customers have a stake in getting value for money. Basically, this theory is used to help understand the groups and individuals that can affect, and are affected by, the achievement of an organisation's purpose, and those effects may be economic, regulatory, technological, social, political and managerial.

In support of stakeholder theory, Donaldson & Preston (1995) pointed out that managers are responsible to deploy their wise decisions and best efforts in obtaining benefits for all stakeholders. Similarly, Wang & Dudley (1992) noted that the Board of Directors cannot ignore its responsibilities in safeguarding a stakeholder‘s interests. Corporate governance ensures the conformance of corporations with the interests of investors and society by creating fairness, transparency and accountability in business activities among employees, management and the board (Oman, 2001). John, Litov & Yeung (2008) reported that corporate risk taking and growth of the firm are positively associated with the quality of stakeholder’s protection. However, sometimes excessive risk taking by the firm leads to the value of the firm being destroyed (Goel & Thakor, 2008), which is contradictory with stakeholder theory. Sternberg (1997) rejected stakeholder theory because she considered it to be incompatible with business or with Corporate Governance. In her view, the theory rules out the goal of business which is to maximise long-term owner value. Turnbull (1997) disagreed with Sternberg's arguments because she had inadequate empirical evidence to support her views, and this supported the theory. Previously, stakeholder theory was believed to be an opponent of agency theory because of many significant differences between these two theories. But in recent years, there is a growing perception among theorists and practitioners that these two paradigms may in fact be compatible and they can be combined within one single paradigm (Wheeler, Colbert & Freeman, 2002). Hill & Jones (1992) also argued that stakeholders theory and agency theory perspectives of organisational phenomena are no longer viewed as mutually exclusive interpretations, instead they may indeed be interpreted in one single model.

Therefore, it is clear that a growing body of literature and empirical evidence argues that by taking account of all stakeholders, instead of shareholders alone, the company is more likely to achieve the long term profit maximisation which is also conducive to sustainable wealth maximisation. Hillman, Keim & Luce (2001) found that the inclusion of stakeholders on the board merely improves their relation and performance. They emphasised the board effectiveness in this regard. A well-functioning Audit Committee ensures a better Corporate Governance practice in a firm, which ultimately leads to the overall welfare of many stakeholders. Deys (2008) conclusion is notable in this respect, he mentioned that an organization’s performance and stakeholder’s value are positively affected by various governance mechanisms, including Audit Committee. Stakeholders’ interest have been emphasized in the definition of effective Audit Committee given by DeZoort et al. (2002). They argued that the ultimate goal of the Audit Committee is to protect all stakeholders’ interests and welfare.

# **2.2.4 Power Theory**

Power is define as the ability to act successfully even against the resistance of others (Weber 1947). The definition indicates the situations in which one social actor prevails over others. Power often is described as an implicit element in the control of organisational action (Pfeffer 1982). Components of organisations, such as audit committees, must possess power to discharge their responsibilities.

French and Raven (1959) developed a typology of power that approaches the construct by classification and illustration. Five types of power were identified: reward, coercive, legitimate, and expert and referent. Mintzberg (1983) combined reward and coercive powers in one type of power called sanctionary. He described it as control over resources. Raven (1974) subsequently added information power to their list. There have been many attempts to define and classify types of power, which indicates the importance of the typology of power (Kalbers & Fogarty 1993). Although complete agreement does not exist, there is significant consensus that power represents control over resources (reward and coercive), control over information and its content (information), personal attributes (expert and referent) and formal mandates (legitimate).

In the context of Audit Committees, Kalbers and Fogarty (1993) identified six types of power that could affect the committee effectiveness. Legitimate power results from the fact that an audit committee is established through delegations of responsibility from the corporate board of directors. However, this board of directors is charged with ultimate accountability for corporate management. They investigated the contribution of the power of audit committees in 90 US firms. They proposed that audit committee effectiveness is perceived as a function of the types and extent of audit committee power. They classified the six types of power into two categories, namely, institutional powers (legitimate, sanctionary and information) and personal powers (expert, referent and will). They found that formal, written authority and observable support from management played the most important roles in audit committee effectiveness (institutional powers). In addition, their results revealed that the will power (diligence) has the most impact on audit committee effectiveness among the personal powers.

However this theory has been criticised by many due to the non-dominance interest for various groups or persons who can affect or is affected by the policy of the organization. It was argued that the proponents of the theory fail to specify how to make tradeoffs among competing interests and they leave managers with a dilemma in making management decisions.

# **2.2.5. Resource Dependency Theory**

Resource Dependency Theory proposes that actors lacking in essential resources will seek to establish relationship with (i.e. be dependent upon) others in order to obtain needed resources. In fact, Resource Dependency Theory claims that the mutual appointment of directors generates benefits to the firm in terms of higher performance. Cohen, Krishnamoorthy, & Wright (2007) in their work found some similarities between Resource Dependency Theory and agency theory. This claim was supported by the findings of a recent study by Jackling & Johl (2009). The study found that the larger the board size the higher the corporate performance. This notion was also argued by Hilman & Dalziel (2003); and Pearce & Zahra (1992). Resource Dependency Theory is useful in addressing the role of directors as boundary spanners between the organisation and the environment (Young & Thyll, 2008). Directors’ professional appointments enhance the organisational functioning by providing access to resources needed by the firm. Resource Dependency Theory suggests that the external parties’ ability to command those resources which are vital for an organisation, gives those parties power over it. This means that if a foreign partner brings a resource necessary for the company’s success, then the external partner will gain power relative to the local partner. It also implies that a partner’s control will be focused on those activities to which this partner brings resources. This theory, therefore, leads to the conclusion that the partners’ ability to govern a firm depends not only on the relative size of their equity holdings, but also on the significance of the essential tangible and intangible resources which they bring to the firm (Child, Yuan & Yan,1997).

Organisational success in Resource Dependency Theory is defined as organisations maximising their power (Pfeffer, 1981). Research on the bases of power within organisations began as early as Weber (1947), and has included much of the early work conducted by social exchange theorists and political scientists. A generalisation of power-based arguments from intra-organisational relations to relations between organisations began as early as Selznick (1949). Resource Dependency Theory characterises the links among organisations as a set of power relations based on exchange resources. Resource dependence asserts that the board’s primary role is to assist management with strategy and resource acquisition (Cohen *et al*. 2007b; Nicholson *et.al* 2007). Board‘s role is that of helper or partner, rather than a monitor of the management (Beasley *et.al* 2009). In emerging economies, it is likely that local partners and local markets are unable to provide the more sophisticated resources required by firms. This leads them to becoming highly dependent on their foreign partners for items such as technology, management systems, training, and professional support services. Most emerging economies suffer from the shortage of fund, expertise, and institutional channels to adequately finance their working capital requirements, or expansion investment; Nigeria is no exception in this regard. Resource Dependency Theory implies a reasonable reliance on the foreign partner in overcoming these lacks and shortages.

Having reviewed some of the theories on corporate governance, it is clear that quite a lot of investigations has been carried out on the role of the board in making sure that the interest of all stakeholders to the organization are cared for. That no single theory in isolation can provide a complete understanding of the board‘s role is not in doubt, there are a lot of evidences in this regard (Daily *et al.*, 2003; Nicholson & Kiel, 2004; 2007; Jackling *et.al* 2009). Tricker (2009) in his work pointed out that “*Corporate governance, as yet, does not have a single widely accepted theoretical base nor a commonly accepted paradigm... the subject lacks a conceptual framework that adequately reflects the reality of corporate governance”*. The attempt of all the theories despite the differences are that they all describe the same problems from a different perspective. However, the main theory that has affected the development of corporate governance, and that provides a theoretical framework within which it most naturally seems to rest, is agency theory (Mallin, 2010). She also noted that stakeholder theory is coming more into play as companies increasingly become aware that they cannot operate in isolation to a wider stakeholder constituency. Further, it is clear that agency theory is related to most of the theories discussed above, and it encompasses the basic idea of these theories. Audit committee is believed to be an effective mechanism in resolving an agency problem in an organisation (Bedard *et al.,* 2008; Chen *et al.,* 2008; Dey, 2008). Sarens *et al*. (2009) state the audit committee role in reducing agency gap thus: ‘*the audit committee attempts to protect the principals‟ interest by monitoring the agents‟ actions and thus reduces the information asymmetry that exists between the owners, management and other stakeholders.*

For this reasons agency theory is considered appropriate for this work. Current recommendations on corporate governance consider agency theory as justification for the various mechanisms to strengthen the board, the use of board committees, and the promotion of the roles of both internal and external auditors as a means of improving accountability and control.

# **2.3. Empirical Review**

# **2.3.1 Empirical Review in Developed countries**

Abbott, Parker, and Peters (2004) found that independent audit committee members are more objective and less likely to overlook possible deficiencies in the manipulation of financial reports. The results of this study suggest that financial reporting quality improved in the year after the formation of audit committees compared with the year before. The results also indicate that independence and expertise are positively associated with improved financial reporting quality.

Gendron and Be´dard (2005) adopted a social constructivist approach to better understand the process by which meanings regarding audit committee effectiveness are internally developed and sustained, within the small group of people who attend audit committee meetings. They conducted the investigation through interviews in three large Canadian public corporations listed on the Toronto Stock Exchange. Their analysis indicates that attendees\_ reflective acts upon processes and activities surrounding audit committee meetings play a key role in configuring meanings of effectiveness. Moreover, every attendees configuration of meaning consists of an amalgamation of a more or less heterogeneous set of emotions regarding the committees formal duties emotions that vary from confidence to hopefulness to anxiety. As such, the paper problematises several assumptions that underlie corporate governance literature.

Barua, Rama and Sharma (2010) provided the first empirical evidence of the association between audit committee characteristics and the investment in internal auditing. the analyses, from a sample of 181 SEC registrants, suggest that the investment in internal auditing (internal audit budget) is negatively related to the presence of auditing experts on the committee and the average tenure of audit committee members, but positively related to the number of audit committee meetings (a proxy for audit committee diligence). These observations suggest potential complementary and substitution effects between the audit committee and internal auditing, and thus raise important implications for future research.

Velte and Stiglbauer (2011) based their study on the findings from a study on the annual reports’ analysis of German corporations listed in the DAX30, TecDAX, MDAX and SDAX that investigated whether the implementation of audit committees and independent members with financial expertise leads to higher accounting quality (lower earnings management and accounting errors). The analysis of regressions conducted states a significant negative link between the independence and financial expertise of its members, earnings management and accounting errors. Significant results cannot be achieved if less than 50% of the audit committee members are independent financial experts.

Chapple, Jubb and Lee (2012) examined audit committee effectiveness in its association with regulatory compliance in a highly sanctioned environment. It uses the Australian continuous disclosure regime to investigate whether audit committee effectiveness is associated with a higher frequency of disclosures, thereby enhancing the efficiency of the capital market and creating more informed individual investors. The findings show that, as hypothesised, audit committee effectiveness measured as an index composed of sub-components involving audit committee size, meeting frequency, independence, member financial literacy and membership of other audit committees, is positively associated with disclosure frequency. Further tests show that it is the financial literacy sub component which is most implicated in this relationship. Company size, years of listing, the proportion of inventories and receivables to total assets, whether or not the company has been involved in a takeover offer or bid or in changes to its number of shares are significant control variables.

Szczepankowski (2012) investigated the relationship between corporate managers, directors and the providers of equity, people and institutions who save and invest their capital to earn the return. This study presents survey research results of audit committee activity in Polish public stock companies quoted on the Warsaw Stock Exchange (WSE). The purpose of the paper is to present the audit committee practice in Poland after 2009. The paper shows that the audit committee practice is still the most problematic issue of transitional Polish corporate governance rules. The survey has shown that the corporate needs and its implementation, and communication with listed companies leave a lot of room for improvement. The paper is based on the documents prepared in 2010 by PricewaterhouseCoopers, the Polish Association of Listed Companies and the Polish Institute of Directors.

Zaman (2013)seeks to investigate the conditions and processes affecting the operation and potential effectiveness of audit committees, with particular focus on the interaction between the audit committee, individuals from financial reporting and internal audit functions and the external auditors. A case study approach was employed, based on direct engagement with participants in audit committee activities, including the audit committee chair, external auditors, internal auditors, and senior management. It was found that informal networks between audit committee participants condition the impact of the audit committee and that the most significant effects of the audit committee on governance outcomes occur outside the formal structures and processes. An audit committee has pervasive behavioural effects within the organisation and may be used as a threat, an ally and an arbiter in bringing solutions to issues and conflicts. Audit committees are used in organisational politics, communication processes and power plays and also affect interpretations of events and cultural values.

Habbash, Sindezinguen and Salama (2013) examined the impact of audit committee characteristics on earnings management, of FTSE 350 companies, for the fiscal years 2006 and 2007. Characteristics such as number of members and meetings; independence; directors’ remuneration; outside directorships; various types of financial expertise; audit committee members’ ownership; regulated sector; and the listing on FTSE 100 are investigated. No significant association was found between absolute discretionary accruals and these characteristics, apart from in the regulated industry. The results for signed discretionary accruals show that some characteristics have an effect on either upward or downward earnings management. This reveals the importance of distinguishing between audit committee effectiveness on constraining upward and downward earnings management. The work explores some qualitative audit committee characteristics, which have not previously been examined. In addition, it is probably the first to examine the effect of several audit committee characteristics on earnings management in the UK context. The findings of this study provide useful insights for regulators in order to improve and reconsider the current regulations on audit committee mechanisms. The findings of generally ineffectual audit committees in the United Kingdom, along with many similar findings from other countries (see [Xie et al, 2003](https://link.springer.com/article/10.1057/jdg.2012.2#CR52) and [Baxter and Cotter, 2009](https://link.springer.com/article/10.1057/jdg.2012.2#CR5)), raise concerns about the current situation of the regulation and the composition of audit committees. External auditors are warned against relying on the form rather than substance of audit committees.

Rickling (2014) examined the association between audit committee directors’ tenure and number of other board memberships at firms that repeatedly meet or just beat analyst forecasts as compared to firms that repeatedly just miss such forecasts. The researcher used data from the period 2005 to 2007 and find that the proportions of audit committee directors with (a) long tenure and (b) more than three other board memberships are positively associated with the likelihood of a firm repeatedly meeting or just beating analyst forecasts. These results suggest that audit committee director tenure and the degree of director “busyness” can affect an audit committee member’s effectiveness in providing financial reporting oversight and provide empirical support for calls by governance advocates and others about limiting audit committee member tenure and busy-boarding.

Fontaine, Khemakhem and Herda (2015) examined audit committee members’ perspectives on mandatory audit firm rotation, mandatory audit partner rotation, ways in which audit committees monitor auditor independence and objectivity, and the costs associated with switching audit firms. In-person interviews with audit committee members in Canada were conducted to improve understanding of the reasons underlying audit committee members’ positions on mandatory audit partner rotation. All audit committee members interviewed in this study were adamantly opposed to mandatory audit partner rotation. Mandatory audit partner rotation was perceived as a threat to their shareholder-granted authority to make audit firm appointment decisions. Participants believe that their professional judgment and observations are the most effective means of ensuring auditor independence and view mandatory audit partner rotation as an unnecessary intervention. This was explained using self-determination theory. The findings were also used to develop a conceptual model of audit committee relationships with external auditors and financial management.

Güneş and Atılgan (2016) concluded that audit committee effectiveness has been researched for several times by academics in accounting and finance literature in terms of relationships with earnings management, corporate governance mechanism, power types and, audit fee etc. The study therefore laid emphasise on effective audit committees on bank performance via using some of the main bank performance indicators which are return on asset (ROA), return on equity (ROE) and net interest margin (NIM) in the Turkish and the UK banks during 2006-2010.

# **2.3.2 Empirical Review in Developing countries**

Al-Lehaidan (2006) empirically investigated whether there is an association between audit committee effectiveness and the selection of a high quality auditor for both Australian and Saudi listed companies using their local guidelines to enhance audit committee effectiveness as benchmarks. In addition, the association between audit committee effectiveness and non-audit services purchases was examined only for Australian listed company as providing such services by the incumbent auditors is not allowed for Saudi listed companies. The work further examined the relationships between six audit committee characteristics, namely, independence, size, activity, charter, expertise and literacy and the selection of a high quality auditor for both Australian and Saudi listed companies. Also the relationships between the six audit committee characteristics and non-audit services purchases are empirically tested only for Australian listed companies. While there was a positive (negative) association between audit committee effectiveness and the selection of a specialist auditor (the magnitude of non-audit services purchases) for the Australian Stock Exchange listed companies, there was no association between audit committee effectiveness and the selection of a specialist auditor for the Saudi Stock Market listed companies. Because both countries have very similar recommendations regarding enhancing audit committee effectiveness, the findings of this thesis indicated that there are other factors such as different audit committee framework, different market development and cultural factors that might affect audit committee effectiveness. In addition, the findings indicate that audit committee independence is the most important determinant of both audit quality and non-audit services purchases for the Australian Stock Exchange listed companies.

Mohiuddin (2012)noted that for several decades, the audit committee has been a subject of substantial research interest in developed countries including the U.S.A. and the U.K. In his attempt to examine the scenario of audit committee practices from the perspective of an emerging economy like Bangladesh, the study investigates the state of audit committee practices in the companies listed on the Dhaka Stock Exchange, The result find out that the overall effectiveness of audit committees in Bangladesh is not at a satisfactory level. More specifically, the observations made in the study include: (i) the audit committee s are mostly dominated by executive directors; (ii) the expertise (in terms of qualification and experience) of audit committee members is not at a satisfactory level; (iii) the audit committee members do not devote much time to the committee‘s affairs; (iv) the independent members of the committee are not adequately remunerated for the time and effort devoted to the company; and, (v) although the audit committee s are playing an important role in some areas including financial reporting, external auditing and internal auditing, there is still plenty of scope where the audit committee s can play a more proactive role. The study also found that the opinions of three sample groups namely, the audit committee Chairperson, the Company Secretary and the Finance Head were similar in most of the aspects of audit committee practices while the External Auditor group differed from the other three groups in some areas.

Othman, Ishak, Arif, and Aris (2014) examined the influence of audit committee characteristics on voluntary ethics disclosures of the top 94 companies listed on Bursa Malaysia. The study employs content analysis of company's annual report and multiple linear regressions to look at the relationships between voluntary ethics disclosure and audit committee characteristics. The result from the study suggests that only two audit committee characteristics (tenure and multiple directorships) are associated with the voluntary ethics disclosure, whilst independence, expertise, meeting frequency and size were inconsistent. This study serves to assist the stakeholders in putting greater emphasis on audit committee in determining ethics disclosure of companies.

Hematfar and Azizifar (2014) examined the association between the quality of audit committees on financial reporting quality and external audit fees in an environment where the formation of audit committees was unregulated. The results show no significant association between the quality of an audit committee and the quality of financial reporting. They concluded that the benefits of ‘best practice’ audit committees may be less than anticipated by regulators and policymakers.

Odunga and Wasonga (2014) studied Audit Quality, Audit Committee Effectiveness and Audit Evaluation: A Critical Literature Review, seeking to review literature on audit quality to establish how audit quality is affected by audit committee effectiveness and audit evaluation. The study involves critical review of academic literature and research on audit quality, audit committee effectiveness and audit evaluation including related theories and empirical studies which investigates the relationship among audit quality, audit committee effectiveness, and audit evaluation. Review findings reveal that there is no agreeable audit quality framework, definition of audit quality and information on how audit committee effectiveness affects audit quality. Independence of the audit committee, qualification of members reflected on the knowledge and expertise possessed and size of the committee are believed to improve financial reporting quality resulting in high audit quality. audit committee’s frequency of meetings, contributions reflected in committee minutes, informal relationships between the committee and stakeholders such as internal and external auditors; and senior management improves audit quality in organizations*.*

Lee (2014) analysed the role of the audit committee in China by employing the following theoretical frameworks: managerial hegemony theory to examine whether audit committees in China serve as a mere “rubber stamp”; the origin of agency theory to determine whether audit committees are supported by the separation of ownership and control to act as overseers and supervisors; and to use resource dependence theory to assess whether audit committees provide added value by acting as consultants and trainers in China. Telephone interviews surveying 330 listed companies in China yielded 61 interviews, and the research results reveal that the audit committee’s role supports both the resource dependency and agency theories but conflicts with managerial hegemony theory.

Soliman and Ragab (2014) examined the association between the audit committee effectiveness, audit quality and earnings management practices of more active 50 Egyptian companies listed on the Egyptian Stock Exchange of the non - financial sector during the period 2007-2010. After controlling for size, leverage and cash flow from operation activities, the results of univariate and multivariate analyses indicated that audit committees independence; experience of audit committee members; audit committee meetings; and audit quality have significant negative association with discretionary accruals as a proxy for earnings management. On the other hand, no significant relationship is found between audit committees size and the level of discretionary accruals.

Leong, Wang, Suwardy And Kusnadi (2015) examined three characteristics (independence, expertise, and overlapping membership) of audit committees and their impact on the financial reporting quality for Singapore listed companies. The main finding is that financial reporting quality will be higher if audit committees have mixed expertise in accounting, finance and/or supervisory. In addition, they do not find evidence that incremental independence of audit committees enhance financial reporting quality because audit committees already consist of a majority of independent directors. Finally the study fail to find any impact of overlapping membership on audit and remuneration committees on financial reporting quality. Overall, the results have policy implications on improving corporate governance effectiveness in terms of financial reporting quality.

Yuanto, Kwong, Themin and Jiwei (2015) examined three characteristics (independence, expertise, and overlapping membership) of audit committees and their impact on the financial reporting quality for Singapore listed companies. The main finding is that financial reporting quality will be higher if audit committees have mixed expertise in accounting, finance and/or supervisory. They did not find evidence that incremental independence of audit committees enhance financial reporting quality because audit committees already consist of a majority of independent directors. Finally they did not also find any impact of overlapping membership on audit and remuneration committees on financial reporting quality. Overall, the results have policy implications on improving corporate governance effectiveness in terms of financial reporting quality.

Nasser (2015) examines whether specific audit committee characteristics, including independence, knowledge, experience and training, and interaction between audit committee members and the internal audit function are associated with effectiveness. It was concluded that audit effectiveness is higher when members are more independent affected mainly by their ability to express an opinion regarding doubt of continuity and having compensation within the acceptable limits, knowledge and experience affected mainly be the existence of at least one member who as strong accounting, financial and auditing expertise, and effective interaction with internal audit function measured mainly by audit committee reviews of the programs and procedures related to risk management process and audit committee determination of the internal audit annual budget. These findings are consistent with an increased demand for higher quality auditing by audit committees, and by firms that make greater use of internal audit.

Kituku and Ahmad (2016) investigated and evaluates the factors that influence the effectiveness of Malaysian audit committees in performing their roles. The factors that were considered are knowledge and expertise, independence, size and frequency of meetings. The study identified four independent variables which are knowledge and expertise, independence, size and frequency of meetings. These four independent variables were found to significantly influence the dependent variable which is the effectiveness of the audit committees in performing their roles. It was proved that for an audit committee to be effective, its members must have financial knowledge and expertise, which would then enable them to detect any material misstatements as well as any fraudulent accounting methods. In addition, the study stress that the audit committee should be independent. This would provide objectivity of judgments made by audit committees which helps to improve corporate governance in both public and private sectors.

Glover-Akpey and Azembila (2016) discussed the impact of audit committee on the performance of public traded stocks on the Ghana Stock exchange since this is crucial in protecting the interest of shareholders. The purpose of the paper is to examine the association between the characteristics of audit committees and performance of firms. Data were collected from a sample size of 36 trading stocks on the Ghana Stock Exchange for the financial year of 2015. The number of meetings and financial experts among other characteristics were the predictors of the performance of the traded stock on the Ghana Stock Exchange (GSE). To test the hypothesis for the study, Logit cross-sectional regression using SPSS 17.0 version was utilized. This study revealed a relationship between the characteristics of the audit committees and the performance of the firms. Meanwhile, the number of independent members on the audit committee had no influence on the performance of the firms. However, the number of independent members of the audit committee with finance or accounting degrees impacted negatively on the firm’s performance. The study made the recommendation that the corporate governance discussions should be re-focused from independence to more experienced and financial literate members on the Audit Committees and also a relatively longer tenure should be accorded the chairman of the Audit Committee of firms to enhance firm performance.

Al-Matari, Homaid and Alaaraj (2016) examined the effect of audit committee effectiveness characteristics, namely, the frequency of meeting between audit committee and internal auditors, audit committee reviews of the internal audit proposals and audit committee reviews of the internal audit results on the performance of the bank’s performance. The study utilised a survey questionnaire method targeting 20 banks operating in Yemen. The result of the study was based on 112 usable questionnaires. The findings showed that there is a significant relationship between the three audit committee effectiveness characteristics and the performance of banks.

Bhasin (2016) performed a ‘content’ analysis on the audit committee reports of the top 500 listed companies in India during 2010 to 2013 to determine the information content of these reports and the extent to which these reports conform to the Clause 49 requirements of the Securities and Exchange Board of India. Also, discussed are the various trends about an audit committee characteristics viz., size, composition, activity, as well as, the extent of non-audit services provided by auditors in the top 500 listed Indian companies. The 2013 Companies Act in India makes comprehensive reforms to virtually all areas affecting corporate governance. Thus, an effective audit committee can be a key feature of a strong corporate governance culture, bringing significant benefits to an organization. The effectiveness of the audit committees is based on the characteristics of independence, financial expertise and diligence.

Karajeh and Ibrahim (2017) in their study examined that Malaysia companies are always encouraged to improve the quality of financial reporting. However, some managers tend to manipulate earnings’ data to make it appear more attractive. Stakeholders rely on the audit committee to motivate managerial provision of accurate data for accounting processes. Hence, the study examines the impact of financial reporting quality on shareholder value and assesses impacts from the audit committee’s influence and its relationship to financial reporting. The study used modified Jones model to evaluate the financial reporting quality. Also, the study proposes ordinary least square for identifying the impact of (i) independent audit committee, (ii) financial and accounting expertise, and (iii) audit committee size as proxies to investigate the effect of the audit committee on the relationship between financial reporting quality and shareholder value.

El Haddad and Ez-Zarzari (2017) the work examined the effect of the presence of audit committees on earnings management within the Moroccan context, and most specifically in the companies listed in the Casablanca stock exchange. The researchers adopted previous research embedded in the Dechow, Sloan and Sweeny (1995) model of earnings management that requires a maximum of 6 companies by sector, a condition that limited our sample to 27 companies dispatched only on 4 industry sectors. Given that the companies manipulate the accruals to show the increasing results or to maintain the stock price, the role of the audit committee is to ensure that this manipulation is to be reduced in order to provide investors with accurate information. In the Moroccan context, this reduction started appearing in 2014. The years 2011, 2012 and 2013 were marked by a preparation of implementation tools of these committees mainly the integration of independent administrators within the administrative boards. However, due to lack of data, the work was limited given the fact that the year 2016, which represented a year where the listed companies should have created an audit committee, was not covered.

Jerubet, Chepng’eno, and Tenai (2017) established the effects of audit committee characteristics on quality of financial reporting among firms listed in Nairobi Securities Exchange, Kenya. The study was guided by the agency theory. Explanatory research design was used. A survey of all firms was done and only 46 firms were extracted because they were operating in NSE at the year 2014. The study utilised secondary data which was collected by use of a document analysis guide. Data was analysed using both descriptive and inferential statistical methods. The findings indicated that audit committee size has a positive and significant effect on the quality of financial reporting (β1= 0.417, ρ<0.05). However, findings showed that audit committee independence had a negative and significant effect on the quality of financial reporting (β2= -0.478, ρ<0.05). The findings indicated that increase in audit committee size increases quality of financial reporting. This implies that an increase in the audit committee size enables the members to distribute the workload and dedicate more time and resources in monitoring. These findings will also have policy implications as regulators around in Kenya continue to define and refine the desired characteristics and behavior of audit committees.

Juhmani (2017) examined the effectiveness of some audit committee characteristics to monitor management behavior with the respect to their incentives to manage earnings. Bahraini listed companies on Bahrain Bursa for the year 2012 to 2014 have been investigated to analyse the relationship between audit committee characteristics and earnings management. The audit committee characteristics examined are independence, size, meetings and financial experts. Multivariate regression model was used to examine the relationship between earnings management as dependent variable and audit committee characteristics as independent variables and other firm-specific attributes, as control variables. As a small developing market, Bahrain’s unique business environment and context offer a good opportunity and provides a useful setting for examining the effectiveness of audit committee characteristics in detecting and preventing earnings management practices. The results showed that discretionary accruals as a proxy for earnings management is negatively associated with audit committee size and audit committee financial experts, but positively associated audit firm size as control variable. However, the results do not show a significant relationship between audit committee independence, audit committee meetings, company size, leverage and earnings management. This study extends the literature on the monitoring function of the audit committee on earnings management, and contributes geographically to the financial reporting process and earnings management literatures by analyzing data from an emerging market and providing useful information for the corporations, accounting profession and the regulators on the effective practice of audit committees.

# **2.3.3 Empirical Review in Nigeria**

Dafinone (2001) in his study considers the extent to which the composition and structure of the audit committee is associated with the ability of the audit committee to fulfil its roles and objectives effectively in UK listed companies. The study therefore considers if the key governance mechanisms thought to impinge on audit committee effectiveness are present in companies in which the audit committee is considered to have failed in their financial reporting oversight role. The results, based on comparing the governance mechanisms in companies with no financial reporting problems ("CNFRP") to companies that have financial reporting problems (CFRP), indicate that "CNFRP's" have audit committees with significantly higher percentages of financially literate and technically competent members. This thesis provides insight into the effectiveness of governance mechanisms in UK audit committees during the period 1995-1999. This thesis contributes by updating our understanding of the factors that influence the effectiveness of the audit committee. It highlights that current recommendations in the United Kingdom, with their focus on audit committee composition and structure, should also consider the competency of audit committee members and determine a benchmark by which competency may be measured.

Gabriel (2012) investigated the impact of audit committees attributes on financial reporting quality of Banks in Nigeria. Modified Jones model (1991) was used as proxy for financial reporting quality. The audit committee attributes investigated were: independence, financial expertise, frequency of meetings, and multiple directorship. The population of the study was all the twenty-two (22) quoted banks on the Nigerian Stock Exchange as at 31st December, 2010 filtered to eleven (11) banks considering only banks declared healthy by the CBN and having the relevant data required for the study. Secondary data were used obtained from secondary sources, i.e., annual reports and returns filed with SEC. The research design used is correlation research design. The effectiveness of Audit committee attributes is one of the significant themes in corporate governance debates. He examining empirically whether audit committee attributes are associated with financial reporting quality in Nigerian banks. By using a measure of financial reporting quality, Jones (1991) model this study is one of the few studies that overcome the imprecision inherent in the abnormal accruals/earnings management. The result shows that the percentage of audit committee members having financial expertise is positively related to financial reporting quality. He also reported some evidence of a positive relationship between the independence, frequency of meeting and multiple directorship of the audit committee and financial reporting quality. He concluded that mandating greater expertise on audit committees rather than simply requiring one expert on the audit committee may be beneficial to investors. We equally suggested training and re-training of audit committee members to guarantee meaningful contributions. Research finds independent audit committees are generally effective in monitoring the financial reporting and auditing processes (e.g., Klein 2002; Carcello and Neal 2003; Abbott et al. 2004)

Okpala (2012) examined Audit Committee and Integrity of Financial Statements: A Preventive Mechanism for Corporate Failure, investigated the effect of audit committee oversight function on integrity of financial statements as a means preventing organizational failure. The population of this study consisted of 183 public quoted companies in the Nigerian Stock Exchange, 100 medium and large audit firms and 616 investor with about 10% holding in PLC. The sample size is determined by Yaro-Yeme’s formula. Data was elicited using structured questionnaires. Hypotheses were confirmed using Z-test. The result shows that there is significant relationship between audit committee activities and integrity of financial statements, which enhances the quality corporate governance and prevents organizational failure. The study recommended that a committed audit committee should be established and members to be appointed should possess analytical skill with strong financial background. The will go a long way to curb the incessant corporate failure in Nigeria.

Madawaki (2012) examines whether the formation of audit committees and its characteristics are associated with improved financial reporting quality. The sample of the study is the Nigerian listed companies prior to and after the introduction of mandatory audit committee requirements in The Code of Corporate Governance in 2003. The researcher uses an archival data from the annual reports, NSE and SBA Interactive. The model by Dechew and Dichev (2002) was used to measure the earnings quality as proxy for financial reporting quality. The result indicates that there was some evidence that earnings quality significantly reduced in the years after audit committee formation, thus providing some support for the notion that the formation of the audit committee improved financial reporting quality. Second finding shows that there was a weak association between the characteristics of audit committee and improved financial reporting quality. The audit committee independence and expertise are found to significantly associate with improved financial reporting quality. Audit committee meets 4 to 5 times a year and audit committee size consists of 4 members. The result also shows that 70% of the sample firms employed Non-Big 4 auditors. These findings provide evidence on the mandatory audit committee requirement under the NSE listing rules on how the companies respond towards The Code.

Okpala (2012) looked into how efficient are our financial system and the effectiveness of the audit infrastructure. The study investigated the effect of audit committee oversight function on integrity of financial statements as a means preventing organizational failure. The population of the study consisted of 183 public quoted companies in the Nigerian Stock Exchange, 100 medium and large audit firms and 616 investor with about 10% holding in PLC. Data was elicited using structured questionnaires. Hypotheses were confirmed using Z-test. The result shows that there is significant relationship between audit committee activities and integrity of financial statements, which enhances the quality corporate governance and prevents organizational failure. The study recommended that a committed audit committee should be established and members to be appointed should possess analytical skill with strong financial background. The will go a long way to curb the incessant corporate failure in Nigeria.

Uwuigbe, Fagbemi and Anusiem (2012) examined how corporate governance proxies (audit committee and ownership structure) influence the level of income smoothening among Nigerian Banks. To analyze this, the study employed the use of financial statements to gather relevant information needed for the study and was analyzed with the use of a regression analysis to test the hypotheses. The study therefore revealed that both independent variables influence the level of income smoothening, although not significant with audit committee. The study therefore recommends that there should be a fixed percentage of ownership for the directors. Also the Central Bank of Nigeria should de-emphasize the arbitrary application of codes and standards by banks and focus on introducing the use of penalties and/or enforcing existing ones more strictly. It is only when codes and have the capacity to serve as deterrents that they would become effective or increases their effectiveness.

Modum, Ugwoke and Onyeanu (2012) in their study queried the contribution of the audit committees to corporate performance of quoted companies in the Nigerian Stock Exchange, using secondary data on corporate financial performance represented by earnings per share; as dependent variable and Audit Committee sizes, Composition, frequency of meetings ,and regularity of members’ attendance, as independent variables, all collected from annual financial reports of the companies quoted on the stock exchange within the study period to test the hypothesis that : Audit Committee size, composition and frequency of meetings have significant positive effect on the financial performance of quoted non - financial companies on the Nigerian Stock Exchange. The Micro soft Special Package for Social Sciences (SPSS) was used to do the regression analysis which showed that there is a significant positive relationship between the Audit Committee Size , composition, frequency of meetings, regularity of members’ attendance and performance of quoted non - financial companies as in the earlier study on perception. Most of the companies had very low financial performance and had ineffective Audit Committees. This study could not simply corroborate the earlier one because while the perception of the managers reflected their expectations of the role and impact of the audit committees, the reality on ground as shown by the relationship between the quality of audit committee and financial performance show that Nigerian companies have not really benefited from the existence of these audit committees. Critically, these firms generally score very low in these indices hence their equally low earnings per share. Therefore, like in the previous study the recommendation is being made that the entire legal and regulatory framework together with the necessary institutional and environmental architecture for proper constitution and operation of an efficient Audit Committee should be maintained at all times to enhance corporate governance and improve financial performance of listed companies on the Nigerian Stock Exchange.

Atu, Atu , Atu and Abusomwan (2013) examined the extent to which inclusion of the audit committee report in the financial statement significantly affects the quality of financial reporting, examine the extent to which the qualification of audit committee member affects its report and examine the extent to which audit committee multiple directorships affect the function of the committee. To answer the research question put forward in this paper sample size of 50 respondents was selected. The data was analyzed using the Z-Test with the computer software known as SPSS and it was found out that audit committee report in the financial statement significantly affects the quality of financial reporting, the qualification of audit committee members, according to users’ perception, adds to the quality of the financial statement and Audit committee multiple directorship have positive effect on the function of the audit committee. It was concluded that the importance of audit committee is immerse and as such stakeholders of public limited companies should take extra care in setting up the committee.

Enofe,Aronmwan and Abadua (2013) study aimed at investigating users’ perception of the inclusion of audit committee report in corporate financial statements. Questionnaires were used to elicit information from respondents. The Chi-Square statistical tool was employed in the analysis and testing of the various hypotheses raised. It was discovered that the audit committee report does not significantly affect the quality of financial reporting although some users consider it in their decision making process. Hence, it is recommended that it should not be a compulsory report so as to reduce cost, waste and make the financial statement brief yet weighty and relevant.

Babalola, (2013) examined the impact of internal control system of firms in Nigeria on the effectiveness of audit committees with ten (10) firms collected across the manufacturing sector of the Nigerian economy and employing the cross-sectional time-series technique of panel model dichotomised into its short-run analyses and long-run situation fashion and covering the periods 2000-2009. findings that in the short-run condition, none of the features of internal control system of corporate firms really affect the effectiveness of corporate firms in Nigeria while estimates obtained from the long-run situation indicate that board size and management ownership significantly affect the effectiveness of audit committee in Nigeria with board composition, leverage position of firms, profitability and shareholding positively but insignificantly impact (positive influence) on audit committees’ effectiveness. Thereby, the effect of internal control system of firms and audit committees’ effectiveness can be seen as a long-run phenomenon in Nigeria. Stemming from these outcomes, this study proffers sound corporate governance, good governance, stable macroeconomic policies and appropriate audit committee’s composition as necessary policy suggestions.

Modum, Ugwoke and Onyeanu (2013) worked on Content Analysis of the Effect of Audit Committee Characteristics on Earnings per Share of Quoted Companies on the Nigerian Stock Exchange 2006-2012, using secondary data on corporate financial performance represented by earnings per share; as dependent variable and Audit Committee sizes, Composition, frequency of meetings , and regularity of members’ attendance, as independent variables, all collected from annual financial reports of the companies quoted on the stock exchange within the study period to test the hypothesis that : Audit Committee size, composition and frequency of meetings have significant positive effect on the financial performance of quoted non-financial companies on the Nigerian Stock Exchange. The Micro soft Special Package for Social Sciences (SPSS) is used to do the regression analysis which showed that there is a significant positive relationship between the Audit Committee Size , composition, frequency of meetings, regularity of members’ attendance and performance of quoted non-financial companies as in the earlier study on perception. Most of the companies had very low financial performance and had ineffective Audit Committees. This study could not simply corroborate the earlier one because while the perception of the managers reflected their expectations of the role and impact of the audit committees, the reality on ground as shown by the relationship between the quality of audit committee and financial performance show that Nigerian companies have not really benefited from the existence of these audit committees. Critically, these firms generally score very low in these indices hence their equally low earnings per share. Therefore, like in the previous study the recommendation is being made that the entire legal and regulatory framework together with the necessary institutional and environmental architecture for proper constitution and operation of an efficient Audit Committee should be maintained at all times to enhance corporate governance and improve financial performance of listed companies on the Nigerian Stock Exchange.

Madawaki and Amran (2013) examined whether audit committees are associated with improved financial reporting quality for a sample of Nigerian listed companies prior to and after a corporate governance code mandated new regulations for audit committees in 2003.Using a sample of 70 companies listed on the Nigerian Stock Exchange, this study uses archival data in the form of companies’ annual reports to measure the association between audit committees and improved financial reporting quality. Dechew and Dichev (2002)’s model was used to measure earnings as a proxy for financial reporting quality. The results indicate that formation of audit committees was positively associated with improved financial reporting quality. It was also found that audit committees having an independent chair and audit committee expertise were positively associated with financial reporting quality. Other audit committee characteristics examined were found to be insignificantly related to financial reporting quality.

In their studies, Modum, Ugwoke and Onyean (2013) was of the opinion that the quality of audit committee rather than its mere existence impacts on the performance of companies through a positive impact on corporate governance. The study uses secondary data on corporate financial performance represented by earnings per share; as dependent variable and Audit Committee sizes, Composition, frequency of meetings ,and regularity of members’ attendance, as independent variables, all collected from annual financial reports of the companies quoted on the stock exchange within the study period to test the hypothesis that : Audit Committee size, composition and frequency of meetings have significant positive effect on the financial performance of quoted non-financial companies on the Nigerian Stock Exchange. The study noted that most of the companies had very low financial performance and had ineffective Audit Committees. This study could not simply corroborate the earlier one because while the perception of the managers reflected their expectations of the role and impact of the audit committees, the reality on ground as shown by the relationship between the quality of audit committee and financial performance show that Nigerian companies have not really benefited from the existence of these audit committees. Critically, these firms generally score very low in these indices hence their equally low earnings per share. Therefore, like in the previous study the recommendation is being made that the entire legal and regulatory framework together with the necessary institutional and environmental architecture for proper constitution and operation of an efficient Audit Committee should be maintained at all times to enhance corporate governance and improve financial performance of listed companies on the Nigerian Stock Exchange.

Yadirichukwu and Ebimobowei (2013) examines the effect of audit committee and timelines of financial reports for thirty five firms quoted in the Nigerian Stock Exchange (NSE) for the period 2007-2011. The data for this study were collected from the annual reports and accounts. The collected data were analysed using relevant diagnostic tests, pooled least square and granger causality test. The result suggests that audit committee independence (ACI) is significantly related to the timeliness of financial reports; Audit committee meeting (ACM) is not significantly related to timeliness of financial reports; Audit committee expertise (ACE) is significantly related to the timeliness of financial reports and Audit committee size (ACS) is not significantly related to the timeliness of financial reports. On the basis of the empirical result, the paper made conclusions and recommendations for effective and efficient audit committee characteristics to meet the 21st century complex corporate environment.

Enofe, Aronmwan and Abadua (2013) investigated users’ perception of the inclusion of audit committee report in corporate financial statements. It was discovered that the audit committee report does not significantly affect the quality of financial reporting although some users consider it in their decision making process. Hence, it is recommended that it should not be a compulsory report so as to reduce cost, waste and make the financial statement brief yet weighty and relevant.

Chukwunedu, Ogochukwu and Onuora (2014) in their paper attempted to identify factors that affect audit committee quality in Nigeria. A hand administered questionnaire survey of 52 Accounting professionals was undertaken. Descriptive statistics were used to determine the most common factors. Independent t-tests were used to determine whether there were any significant differences in the perceptions of the factors according to gender, job type and experience. The questionnaire findings, which include some factors peculiar to Nigeria, suggest that many factors affect audit committee quality. These include financial literacy of members of the committee, ability of members to ask relevant questions, provision of remuneration to members of the committee, committee’s willingness to periodically evaluate itself, tenure of members to be pegged at a minimum of 3 years and provision of regular training for members. The findings uphold the Nigerian Security and Exchange Commission recommendation that an audit committee should have at least one financial expert in the team. The findings of this study are of particular relevance to the Nigerian regulatory authorities especially the Financial Reporting Council (FRC) as it is set to fashion out a new mandatory corporate governance code for establishments under its purview.

Ojeka, Iyoha and Obigbemi (2014) explored the influence of audit committee effectiveness on firm’s performance using four characteristics: independence, financial expertise, size, and meetings of the audit committee. The performance measures were Return on Equity (ROE), Return on Asset (ROA) and Return on Capital Employed (ROCE). Twenty- five (25) manufacturing firms were selected and from which data were collected for the period (2004-2011). Empirical analysis was carried out using regression and correlation. The result of the analysis showed a positive significant relationship between independence and financial expertise of the audit committee and ROA, ROE and ROCE. However, the size and meetings of audit committee showed no significant relationship with all performance variables. This study therefore recommends that the audit committee should be made more effective by ensuring that members are made up of independent non-executive directors and also ensure that more members with financial expertise especially accounting expertise be drafted into the audit committee and lastly ensure that audit committee meetings are tailored towards relevant issues that enhance the financial performance of the firm.

Okaro, Okafor and Oraka (2014) studies factors that affect audit committee quality in Nigeria. A hand administered questionnaire survey of 52 accounting professionals was undertaken. Descriptive statistics were used to determine the most common factors. Independent t-tests were used to determine whether there were any significant differences in the perceptions of the factors according to gender, job type and experience. The questionnaire findings, which include some factors peculiar to Nigeria, suggest that many factors affect audit committee quality. These include financial literacy of members of the committee, ability of members to ask relevant questions, provision of remuneration to members of the committee, committee’s willingness to periodically evaluate itself, tenure of members to be pegged at a minimum of 3 years and provision of regular training for members. The findings uphold the Nigerian Security and Exchange Commission recommendation that an audit committee should have at least one financial expert in the team. The findings of this study are of particular relevance to the Nigerian regulatory authorities especially the Financial Reporting Council (FRC) as it is set to fashion out a new mandatory corporate governance code for establishments under its purview.

Okolie (2014) attempted to evaluate whether corporate governance principles affect audit committee functions by ensuring that financial statements reflect the true financial position of companies. Data were analysed using correlation analysis. Spearman's correlation was calculated between the average scores on corporate governance variables and audit committee variables. The computations were done using SPSS statistical software. The study shows that corporate governance principles affect audit committee functions by ensuring that financial statements reflect the true financial position of companies. It is suggested that companies should be good corporate citizens\and that members of the audit committee should possess requisite accounting knowledge to, be able to effectively scrutinize the financial statements or query accounting practices of preparers of those financial statements.

Musa, Oloruntoba and Oba (2014) investigates the effects of audit committee characteristics on the quality of financial reporting by deposit banks in Nigeria. The study employs a multivariate regression analysis to assess the aggregate and individual effect of certain audit committee characteristics on financial reporting of sample banks. The study documents a positive relationship between audit committee independence and quality of financial reporting. Findings also revealed that audit committee expertise has positive effect on the quality of financial reporting. Results demonstrate that audit committee size has an insignificant effect on quality of financial reporting; however, an aggregate significant effect of audit committee characteristics on financial reporting quality was established. The recommendations from this study highlight the need for financial expertise as a means of strengthening the monitoring and oversight role that the audit committee plays in financial reporting. Also, emphatic considerations should be given to audit committee independence as a key factor for ensuring the credibility of financial reports.

Ibadin, Ayemere and Afensimi(2014) using the agency theoretical framework found that audit committee characteristics have a constraining effect on earnings management. Specifically, audit committee financial expertise, audit committee size, audit committee independence and diligence showed an inverse and significant relationship with earnings management. This is in tandem with theoretical expectations and suggest that increases in these variables exert a declining influence on earnings management. The study concluded that there is the need for companies to focus on attributes that strengthen the effectiveness of their audit committee.

Uniamikogbo, Babatolu and Oyewo (2014) examined Audit Committee Multiple Directorships and Financial Reporting Quality in Nigeria. The study seeks to examine the interconnectedness between audit committee multiple directorship and financial reporting quality in Nigeria. The study adopted a survey research, using questionnaire as the research instrument to harvest the views of stakeholders of publicly quoted companies on the subject. Data was analysed using percentage analysis, weighted mean, and the Z-test statistics at 5% significance level. It was observed that audit committee multiple directorship impacts the quality of corporate financial reporting. Also, financial literacy of audit committee members enhances the effective overseeing of corporation’s financial controls and the quality of financial reporting. The study therefore supports the need for a high degree of financial literacy on the part of audit committee members to enhance effectiveness. It is recommended that regulatory agencies in Nigeria should also institute legislation similar to the Sarbanes Oxley act of the United States of America in order to curb the menace of earnings management and other unethical financial reporting practices.

Okaro, Okafor and Egbunike, (2015) examines the attributes that make for audit committee effectiveness in Nigeria from the perspective of Professional Accountants. A survey research design was adopted for the study. 120 Professional Accountants working as Auditors, Accountants and Accounting Academics in the South Eastern part of Nigeria and randomly selected were targeted at their monthly district society meetings and in their work places. The Professional Accountants were either members of the Institute of Chartered Accountants of Nigeria (ICAN) or members of Association of National Accountants of Nigeria (ANAN). 89 responses were received constituting 74% of the respondents. A questionnaire in the likert format was used to elicit the responses from the respondents. The data of study was analysed and ranked first on the basis of strongly agree responses and then on the basis of mean of the responses. The hypothesis of study was tested with ANOVA test statistic. Five most important factors stood out as having a strong influence on audit committee effectiveness in Nigeria. These are in that order:

- Financial literacy of members

- Only non-executive Directors should be members of the Committee

- Members must be open to regular training

- Members must be able to ask relevant questions

- Members must have machinery for periodic evaluation of their performances. Findings add to the scanty literature in this area in Nigeria and have implication for regulatory action.

Ibadin, Ayemere and Afensimi (2015) using the agency theoretical framework, the study postulates that audit committee attributes can impact significantly, constraining accrual-based distortion of financial reporting credibility and thus improve the quality of financial reporting. To support their arguments, audit committee size, audit committee financial literacy, audit committee attendance at meetings, audit committee independence and audit meetings frequency of meeting were regressed on financial reporting quality measured by discretionary accruals. The findings for the full sample and negative discretionary accruals sample confirm thier expectation that audit committee characteristics have a constraining effect on earnings management. Specifically, audit committee financial expertise, audit committee size, audit committee independence and diligence showed an inverse and significant relationship with earnings management. This is in tandem with theoretical expectations and suggest that increases in these variables we exert a declining influence on earnings management. The study concludes that there is the need for companies to focus on attributes that strengthen the effectiveness of their audit committees.

Ojeka, Iyoha, and Asaolu (2015) examined empirically the impact of audit committee financial expertise on the quality of financial reporting. The financial reporting quality was measured by reliability (total accrual quality) and relevance (audit report lag). Fifteen money deposit banks were selected and data was collected for the period (2003-2012). Analyses were carried out using Correlation, Ordinary Least Square and Panel Lest Square. The study found, after controlling for firm size, audit type, age of firm, audit committee meeting and audit committee size, that, audit committee financial expertise showed a negative coefficient for total accrual quality and audit report lag. This means financial expertise has a positive significant impact on financial reporting quality in Nigeria. The study, therefore, recommends that more attention should be given to the financial expertise of directors being recommended to the audit committee.

Dauda, (2015) worked on the effectiveness of audit committee and as well explores the relationship between audit committee effectiveness and the value of deposit money banks in Nigeria. The followings were identified as audit committee characteristics (Internal control, the integrity of financial reporting, commitment of audit committee members and meeting) and were used in identifying the effectiveness of audit committee. Eight questions-survey questionnaires related to the four identified characteristics were administered to 55 respondents spread amongst the five sampled banks. The questionnaire enables the study to seek the perceptions of the respondents on the effectiveness of audit committee in deposit money banks in Nigeria. The Chi Square statistical tool was used to test the two study’s hypotheses. The study finds that the Characteristics of Audit Committee practices relates to the effectiveness of Audit committees’ of the deposits money banks in Nigeria, hence portraying the committee’s effectiveness in performing its functions, the effectiveness of audit committee does not necessarily improve or otherwise on the value of the deposits money banks and results also indicate that activities as relate meeting of the audit committees’ of deposit money banks are not clearly stated in the annual accounts of the banks. It therefore recommends that detail issues of meetings of audit committees be clearly stated and or included in the annual reports of the banks.

Ibadin and Afensimi (2015) Using the agency theoretical framework, the study postulates that audit committee attributes can impact significantly, constraining accrual-based distortion of financial reporting credibility and thus improve the quality of financial reporting. To do this, audit committee size, audit committee financial literacy, audit committee attendance at meetings, audit committee independence and audit meetings frequency of meeting were regressed on financial reporting quality measured by discretionary accruals. The findings for the full sample and negative discretionary accruals sample confirm our expectation that audit committee characteristics have a constraining effect on earnings management. Specifically, audit committee financial expertise, audit committee size, audit committee independence and diligence showed an inverse and significant relationship with earnings management. This is in tandem with theoretical expectations and suggest that increases in these variables we exert a declining influence on earnings management. The study concludes that there is the need for companies to focus on attributes that strengthen the effectiveness of their audit committees.

Moses, Ofurum and Egbe (2016) researched into the influence of audit committee characteristics on quality of financial reporting in listed Nigerian banks. The study used documentary records gotten from the financial statements of fifteen twelve-monthly reports and accounts of the banks whose stocks are traded in the Nigerian Stock Exchange as at December 31, 2014. The research design utilized in this dissertation is correlation research design. They adopted Jones (1991) modified model which provided the measure for earnings management which is the representation for quality of financial reporting. The test of hypotheses and other breakdown of data were empirically completed by SPSS statistic 22.0. The outcomes of the study depicted that audit committee “independence has no significant effect on earnings management in quoted Nigerian banks. The study endorses that audit committee should be well-thought-out and operational so as to curtail earnings management. They also recommended the orientation and reorientation of audit committee members to guarantee significant influences on financial reporting quality

Eriabie and Izedonmi (2016) was of the opinion that members of the audit committee should have continuous training and seminars that will enable them to keep abreast and up to date as regards their roles and responsibilities. To this the also submitted that SEC should put in place regulations which ensures that audit committee members maintain at least an attendance level of 85%, for them to be retained in the committee the following year.

Eyenubo, Mohammed and Ali (2017) examined the impact of audit committee on financial reporting quality in listed firms in Nigeria Stock Exchange. The paper uses the conceptual approach on archival data in the form of annual report of listed companies’ annual reports to examine the relationship between audit committee and financial reporting quality. It also examine the role of audit committee in the relationship with financial reporting quality best code of practices of corporate governance and the relationship between independence, size, diligence, and expertise of audit committee.

Fasua and Osifo (2017) examines effective whistle-blowing mechanism and audit committee in Nigerian banking sector. The study employed a multi-variate regression technique as tool of analysis. A logistic regression analysis was used to estimate the relationships proposed in hypotheses. The study predicts that the Nigerian banking sector with more independent, meeting, expert, and diligent audit committees are likely to establish effective whistle blowing mechanism. The study finds a strong association between effective whistle blowing mechanism in Nigerian banking sector and audit committee independence, audit committee financial expertise, and audit committee meeting. The result of findings reveals that whistle blowing mechanism in Nigerian banking sector needs to be strengthened. Finally, the audit committee should be given the oversight duties in order to achieve desirable goals and objectives.

# **2.3.4. Gap in Literature**

Many studies have been carried out on audit committee effectiveness in developed and developing countries, with some in the Nigeria. Despite that, most of the work reviewed used interview and financial records of companies to collect data. Gabriel (2012) investigated audit committee attributes on financial reporting of Banks in Nigeria, while this study was on the characteristics of audit committee and financial reporting quality in Nigeria, the study further focused on independence, financial expertise, frequency of meetings and multiple directorship while the current study focused on composition, independence, members expertise, members financial expertise, authority, resources at disposal of audit committee as well as audit committee diligence.

Madawaki (2012) examined whether the formation of audit committee and its characteristics associated with the improved financial reporting quality as well as share ownership while this work is on the trend of audit committee characteristics and challenges confronting audit committee. Okpala (2012) investigated the effect of audit committee oversight function on the integrity of financial statements as a means of preventing organisational failure, but this work focused on the contribution of the management, internal audit external audit committee effectiveness in performing its oversight functions.

Ghafran (2013) focused on the impact of audit committee characteristics on financial reporting quality in the UK companies over the period 2007-2010. This work focused on audit committee characteristic and financial reporting quality in Nigeria among non-financial companies in Nigeria. Chang, Chen and Zhou (2013) work focused on what determines audit committee effectiveness and the consequences of audit committee effectiveness in China. The current work focused is on audit committee characteristics and quality of financial reporting in Nigeria. Babalola (2013) examined impact of internal control system on the effectiveness of audit committee effectiveness across manufacturing sector in Nigeria covering 2000-2009, while the focus of this work is on the contribution of internal control to effectiveness of audit committee. Eyenubo, Mohamed and Ali (2017) worked on impact of audit committee on financial reporting quality in Nigeria, the study uses conceptual approach on archival data in form of annual report, further to this the work focused on the relationship of audit committee with financial reporting quality best code of practice of corporate governance

This research makes a number of key contributions to the literature on audit committee and financial reporting quality. Firstly, it examines the pattern of audit committee characteristics, challenges confronting audit committee and the effect of audit committee characteristics on the quality of financial reporting, using Nigerian company data.

Secondly, developed countries has far more stringent audit committee regulations than Nigeria. Therefore, there is likely to be greater variation in audit committee characteristics among Nigerian companies than companies in developed countries. This research will investigate the following audit committee characteristics: independence, financial literacy, expert, current Knowledge in accounting and financial management and meetings.

Finally, most prior studies used the Jones (1991) discretionary accruals model and some of its variations to develop proxy measures of earnings management and, inversely, earnings quality. This research intends to use both Jones (1991) model and the more recently developed accrual estimation error model by Dechow and Dichev (2002) to estimate three proxies for financial reporting quality.

# **2.4. Conceptual Framework**

Audit committee characteristics and relationship with financial reporting are integrated in one conceptual framework. In this framework audit committee and financial reporting are independent and dependent variables respectively. The attempt of this work is to bridge the gap by providing a basis for the discerning the impact that audit committee has on the quality of financial reporting.



Figure 2.1: Audit Committee Effectiveness and Financial Reporting Quality

Figure 2.1 Shows that the diligence, composition, authority and resources available to the committee determine its performance in its quest to do its oversight roles. This in turn contribute to the financial reporting quality. An effective audit committee will minimize the agency problem between the shareholders (owners) and Management (agent), and thereby safeguard the interest of owners of business. When the audit committee is effective it reflects on the financial report earning quality, reliability of the report, its relevance, comparability and faithfulness. The model will guide us on the development of questionnaire.

# **CHAPTER THREE**

# **METHODOLOGY**

This chapter discusses research design, population of the study, sample size and sampling techniques for the study, sources of data collection, research instrument, validity of research instrument and testing, specification of models, measurement of variables, data analysis techniques the methodology adopted on data collection and analysed and interpreted, so that the objectives of the research work would be achieved.

# **3.1. Research Design**

This section set out operating guidelines within which the research was carried out. There are two main ways employed by researchers, namely; the quantitative and the qualitative. For this study, both quantitative and qualitative method was employed. The combination of methods provide opportunity for triangulation. By triangulation we mean the process of verification that increases validity by incorporating several viewpoints and methods. It refer to the combination of two or more theories, data sources, methods or investigations in one study of a single phenomenon to converge on a single construct, and can be employed in both quantitative (validation) and qualitative (inquiry) studies (Yeasmin & Rahman 2012).

Financial reporting quality was proxy through the use of three measures of earnings quality. These measures was based on the Jones (1991) model of discretionary accruals, modified Jones Model and the Dechow and Dichev (2002) accrual estimation error model.

# **3.2. Area of the Study**

This work is on audit committee characteristics and quality financial reporting in Nigerian. The area of the study for this research work were the non – financial companies listed on the Nigerian Stock Exchange. These companies are those required statutorily to have their account audited by external auditors, constitute audit committee and are bound to prepare and publish their financial statement for the use of shareholders and other stakeholders. Information will be obtained from audit committee chairmen, audit committee members, chief financial officers, internal auditors, external auditors and financial analysts. Lagos state was used, this because Lagos is central to almost all the companies. Furthermore, almost all the companies listed in the stock exchanges have their head office in Lagos. Thus, Lagos state could be said to be the most convenient place to carry out this type of study.

# **3.3. Population of the Study**

The population of the study comprised of all non- financial companies listed on the Nigerian Stock Exchange as at 31 December 2015. This is because up to 2015 financial listed companies have separate codes of corporate governance while other non-financial institutions have separate code of corporate governance. According to the Nigerian Stock Exchange Fact book as at 30 December 2015, a total of 295 companies are listed and had audit committee.

# **3.4. Sample Size and Sampling Techniques**

Sample size was limited to only companies that are listed as at 30, June 2015 and that are active traded. The study was carried out on fifty four (54) companies that have been consistently trading for the study period (that is from 2006 – 2015). A two-stage sampling technique was adopted. Stratified sampling was adopted in the first stage to ensure that each sector were equally represented, and simple random sampling technique was used in the second stage to ensure equal likelihood of every firm to be selected within its stratum. Three firms from each industry listed within the time frame under study was selected.

# **3.5. Sources of Data**

The study used both secondary and primary data. Secondary data was collected to assess the trend of audit committee characteristics and to examine effect of audit committee characteristics on the quality of financial reporting of quoted non – financial companies in Nigeria. The secondary sources of information used for this study are companies’ published annual financial statement for the years (2005 - 2015). These reports were collected directly from the companies’ websites or accessed using available financial database, Factbook and from the NSE, Ibadan Office. Secondary data was obtained for audit committee and other board variables. Questionnaire was considered appropriate for achieving the challenges confronting audit committee effectiveness and contributions of management and internal auditors to audit committee effectiveness in performing their oversight functions. The questionnaire was section B was structured into eleven parts, the reason for this was to enable the researcher achieve the research objective and as well answers the research questions. A copy of the structured questionnaire are attached as appendix to this work.

# **3.6. Research Instruments**

As earlier mentioned data was collected using both primary and secondary data, Primary data was collected for objectives two and four, through structured of questionnaire. The questionnaire was divided into two sections. Section A captures the socio-demographic characteristics of the respondents, and section B was structured into eleven parts was used to elicit information on responses on audit committee effectiveness. The questionnaire was structured in close-ended form. The questionnaire on audit committee practice by Mohiuddin (2012) was adapted for the purpose of this study. The data was sourced from audit committee chairman and members, chief financial officers, external and internal auditors as well as financial analysts.

# **3.6. 1 Validating the Research Instruments**

Validity can be sub-categorised as external and internal validity. Since multiple source of data collection instruments was used in this work, a test to prove the reliability of the instruments was carried out. A pilot test on some of the targeted respondents was carried out to prove the reliability and validity. Cronbach alpha Test was used to ascertain the validity and reliability of the research instrument

# **3.7** **Specification of Models**

The concept investigated in this research were audit committee characteristics and financial reporting quality. This measured through the development of three proxy measures for earnings quality. Earnings quality is one of the ways one can use to understand the concept of financial reporting quality. Other methods that could be used are third party assessments of the quality of the financial disclosures in annual reports or through surveys of stakeholders on their perceptions of financial reporting quality. It should however be noted that these types of approaches inherently develop subjective measures of financial reporting quality and can be subject to a bias towards higher quality financial reporting.

**Modified Jones model**

This research also used a modification of the original Jones (1991) model as proposed by Francis, Nanda, and Olsson (2005). They included the change in accounts receivable in the estimation model for normal or non-discretionary accruals (i.e., equation (3.1) above). This was done based on the reasoning that, not doing so, would produce values for abnormal (discretionary) accruals that are not centered on zero when the mean ΔREC is not zero (Francis et al. 2005). In this research, the estimation model was run on cross-sectional samples of companies in the same industry groups as the sample companies. Therefore, for this research, equation (1) above became:

**TA*i,t*/A*it*-1 = β1*i i*[1/A*it*-1] + β2*i*[ΔREV*it* - ΔREC*it* /A*it*-1] + β3*i*[PPE*it*/A*it*-1] + ε*i,t* (3.4)**

Where: TA*i,t* = Total accruals in year *t* for firm *i* (measured by operating profit after

tax– cash flow from operations);

A*it*-1 = Total assets in year *t* - 1 for firm *i;*

ΔREV*it* = Revenues in year *t* less revenues in year *t* - 1 for firm *i;*

ΔREC*it* = Net receivables in year *t* less net receivables in year *t* - 1 for firm *i;*

PPE*it* = Gross property, plant and equipment in year *t* for firm *i;*

ε*i,t* = Error term in year *t* for firm *i.*

A further modification of the Jones (1991) model was proposed by Dechow, Sloan and Sweeney (1995). This version of the Jones (1991) model adjusted the change in revenues for the change in receivables in the estimation of the level of non-discretionary accruals for each of the sample companies. In this research, the following estimation model will be run to estimate the level of non-discretionary accruals for each sample company using the industry specific coefficients for α*i*, β1*i* and β2*i* from equation (3.4). Therefore, for this research, equation (3.2) above became:

**NDA*it* = β1*i i*[1/A*it*-1] + β2*i i*[ΔREV*it* - ΔREC*it* /A*it*-1] + *b*3*i*[PPE*it*/A*it*-1] (3.5)**

Where: NDA*it* = Non-discretionary accruals in year *t* for firm *i*;

A*it*-1 = Total assets in year *t* - 1 for firm *i;*

ΔREV*it* = Revenues in year *t* less revenues in year *t* - 1 for firm *i;*

ΔREC*it* = Net receivables in year *t* less net receivables in year *t* - 1 for firm *i;*

PPE*it* = Gross property, plant and equipment in year *t* for firm *i.*

The change in receivables was included because of the assumption in the original Jones (1991) model that revenues were entirely non-discretionary. The modified Jones (1991) model in equation (4) “…implicitly assumes that all changes in credit sales in the event period result from earnings management” (Dechow, Sloan and Sweeney 1995). Dechow, Sloan and Sweeney (1995) justified the inclusion of the change in receivables by arguing that earnings management was more likely to occur in relation to credit sales rather than cash sales.

Using the modifications to the original Jones (1991) model proposed by Francis et al. (2005) and Dechow, Sloan and Sweeney (1995), the level of discretionary accruals will then be calculated using the approach in equation (3.3) above, i.e., nondiscretionary accruals will be subtracted from total accruals to give a measure of discretionary accruals. Discretionary accruals will be used to capture the extent of earnings management by the sample companies. Earnings management can be viewed as an inverse measure of earnings quality: the higher the extent of earnings management, the lower the quality of earnings and vice versa (Schipper & Vincent 2003). Therefore, the absolute values of the discretionary accruals will be used in this research as the first proxy for financial reporting quality.

# **3.7.1 The effect of audit committee characteristics on the quality of financial** **reporting of selected quoted companies in Nigeria**

This objective is interested in assessing the influence of audit committee on the quality of financial reporting. The functional relationship of the variables of interest is given below

This model given below;

**β1*ACSit*+β2ACDit+β3ACMit+E*it***

Where,

*EFRQit =* Financial reporting quality

*ACS=Audit committee size*

*AC****\_****MEETING= nos of Audit committee meetings*

*AC\_EXP= audit committee financial expertise*

*ACIND=Audit committee independence*

*.*

**A Priori Expectation**

Where   
**,**

# **3.8 Measurement of Variables**

**Measurement of variables**

This section explains the measures used for the independent variables, as well as several control variables. A summary of the measures for the variables is presented in the table 3.1.

Table 3.1: **Measurement of the Variables**

|  |  |  |
| --- | --- | --- |
|  | Variable Name | Variable measurement |
| Independent variables | Audit committee financial expertise  (ACE) | The proportion of audit committee members with professional accounting qualifications. |
|  | Directors on the audit committee  (ACE) | The proportion of directors in audit committee |
|  | Audit committee meeting  (ACE) | The number of audit committee meetings for the year. |
| Control variables | Board members with professional accounting qualification  (BAE) | The proportion of board members with professional accounting qualifications.  . |
|  | Board independence  (BID) | The proportion of independent directors on the board. |
|  | Board Meeting  (BMT) | The number of board meetings for the year. |
|  | Board SIZE  (Bsz) | The number of directors on the board. |
|  | Audit firm size  (AUD) | 1 = a company’s auditor was a Big 4 firm and 0 = otherwise. |

# **Source: Author's Compilation view**

# **3.9 Data Analysis techniques**

This study used both percentages, graphs and ordinary Least squares. The descriptive analysis involves measure of central tendency of mean, median and mode, measure of dispersion such as standard deviation, mean deviation, and minimum and maximum value of all variables of interest was computed in other to identify their characteristics and behaviour . Kurtosis, Jarque-Bera and Skewness was computed to have a clue as to the normality of the variables involved. Percentages, ratio, and tables of variables of interest was also shown. Inferential statistics employed, involves static and fractional response Panel Estimators for the appropriate multiple regression models. Also, appropriate diagnostics test of unit root test, correlation matrix, Hausman Test, Redundant Fixed Effects Tests. Static panel data estimators including pooled Ordinary Least Square (OLS), Fixed Effect Method and Random Effect Method.

The three independent variables audit expertise, audit committee independence and audit committee meeting were included as a primary interest which is used to proxy audit committee characteristics while the control variable board expertise, board independence, board meeting, board size and audit market segment were included in the model because these variables also drivers financial reporting quality

**3.9.1 Panel Unit Root Test**

The fundamental requirements of data with time dimension, is stationarity of the data, before any estimation can be carried out. For the purpose of this study, stationarity test was conducted using Augmented Dickey—Fuller (ADF) and Phillips–Perron (PP) tests. The equation and hypothesis of the Unit Root Test is given below

**3.8**

The essence of this test is to avoid spurious regression.

**3.9.2 Correlation Analysis and Variance Inflation Factor**

Correlation analysis, was carried out to ascertain the degree of association of the stimulus variables in the study, and also to avoid problem of multicollinearity. By rule of thumb, the degree of association of the covariance of explanatory variable is expected not to be greater than 0.7 or less than -0.7, a result outside the threshold shows possibility of multicollinearity. Hence, Variance Inflation Factor Diagnostic Test was conducted to ascertain the presence of multicollinearity.

**3.9.3 Hausman Test/ Redundant Fixed Effects Test.**

The Hausman Test was conducted to choose the appropriate static panel estimator between Random Effect Method (REM) and Fixed Effect Method (FEM). The null hypothesis underlying the Hausman test is that the REM and FEM estimators do not differ substantially. Where,

*H0;* Random effects are consistent and efficient

H1; Fixed effect/ pooled is appropriate

**3.9.4 Pooled Ordinary Least Square Method**

In Pooled Ordinary Least Square, data is assumed not having a time dimension and all assumptions of cross sectional data are applicable. Hence, there is only one constant. The Pooled OLS equation is given below:

**3.9.5 Fixed Effect Method**

This regression model, allows individual specific effects to be correlated with regressors. Each sampled firms has a different intercept term and same slope parameter. The fixed effect model is given below:

After estimating the equation above, the individual specific is to be recovered using

**3.9.6 Random Effect Method**

Random Effect Model (REM), assumes individual specific effect are distributed independently of the regressors. Each sampled firm has the same slope parameters and composite errors. This is expressed in the equation below:

Where the composite error term is given below

**3.9.7 Data Analysis and Techniques**

**Objective one:** **Examine the trend of audit committee characteristics in Nigeria.**

This was achieved through the use percentages and graphs.

**Objective Two: Assess the challenges confronting audit committee effectiveness in Nigeria.**

This objective was achieved using descriptive statistics through the use of

questionnaire and inferential statistics of Ordinary Least Square Method.

**Objective Three: Examine the effect of audit committee characteristics on the quality of financial reporting in Nigeria .**

This objective was achieved using the use of ordinary least square method.

**Objective four: Evaluate the contributions of the management, internal auditor and external auditor to audit committee effectiveness in performing its oversight functions in Nigeria.**

This was achieved through percentages.

**CHAPTER FOUR**

# **RESULT AND DISCUSSION**

This chapter dealt with presentation, analysis and interpretation of the data collected and analysed for the purpose of achieving the specific objectives of the study. It presented the results of the empirical study of audit committee effectiveness on the quality of financial reporting of selected quoted non – financial companies in Nigeria for the period of 2005 – 2015. Results obtained from the estimation output of E-view 9.0 for the empirical model was presented in accordance with the objectives of the study**.**

# **4.1 The pattern of audit committee characteristics among quoted non – financial companies in Nigeria;**

This section examined the trend of audit committee characteristics among quoted non-financial companies in Nigeria, the variable of audit committee characteristics included Audit committee meetings, audit committee accounting expertise, audit committee size, and Audit committee director members. Table 4.1 presented the average number and percentage change of audit characteristics variables from 2005 - 2015

In 2006, the table showed that there was 3% positive change in the audit committee meetings from 2005, the trend in the audit committee accounting expertise in this period also change by 5%, audit committee size and audit committee director members have an equal positive change of 2% each during this period. In 2007, there was no change in the audit committee meetings of the companies. Moreover, the percentage of audit committee member with accounting knowledge during this period changed by 2% and audit committee size had an upward change of 4% compare to previous year, this could be as a result of awareness of importance of audit committee in company quality financial reports, whereas there was no change in audit committee director members. In 2008, there was 1% positive change in both audit committee meeting and audit committee accounting expertise respectively, this signified that the meetings of audit committee improved compare to previous years but insignificantly. Also, the audit committee size increased by 3%, this increment in audit committee size was the highest over the last 3 previous years. In 2009, there was an increase of 2% in audit committee meetings, while audit committee accounting expertise, audit committee size and audit committee director member increased by 1% each during the period. This showed that there was no significant turn up in the pattern of the audit committee characteristics for the period from the previous. Also, in 2010, Audit committee meeting, accounting expertise, size and director members increased by 1%, 2%, 4% and 2% respectively. In 2011, there was a significant increase of 4% in audit committee meetings compare to previous years, this showed that the awareness of audit committee meetings was made known during the period, the audit committee accounting knowledge increased by 1% for the period, also, there was no change in audit committee size during the period while the number of director member of the audit committee increased by 2%. In 2012, the audit committee meetings maintained the same level of meetings with the immediate previous year, it was evidenced from the Table that there was an increase of 4% in the number of audit committee member with accounting knowledge, there was 1% increase in audit committee size while the audit committee director members increased by 3% during the period. During the period of 2013, there was 1% increase in audit committee meetings from 2012 – 2013. Although, the percentage increase was small but it showed that listed companies still gave a concern attitude towards the audit committee meetings, the audit committee accounting expertise increased by 3%, this implied that the need for audit committee member accounting and financial knowledge has been on increase while audit committee director member increased by 5%.In 2014, The pattern of audit committee characteristics slightly changed. There was an increase of 2% of the audit committee meetings, the accounting knowledge of the committee member has been on increase over the period, audit size increased by 1% while there was tremendous increase of 7% in audit committee director members for the year. The Table finally showed the pattern of audit committee characteristics for the period of 2015, it showed that there was 4% increase in the audit committee meetings, also, the number of committee member with accounting knowledge increased by 2% during the period, it also showed that the size of the audit committee member increased by 3%. Thus, this increase in the size could be a composition of both independent director member and shareholders of the companies and it’s an indication that proper attention has been given to the size of the committee member, while the audit committee director member increased by 2% during the period. The study found out that there has been a consistent increase in the percentage of audit committee characteristics functions and size over the study period. Hence, it can be concluded that stakeholders in listed non-financial companies in Nigeria wants an improved financial reporting quality by making use of audit committee characteristics’ which have positively change over year this is evidenced in Table 4.1, figure 4.1,4.2, 4.3 and 4.4 respectively. From 2010-2015 the average audit committee members exceeds six (6) members slightly as stipulated by CAMA (2004), the rationale for this could be the need for greater confidence in the quality of financial reporting and again most listed companies nowadays combined the risk management and audit committee members as a single unit. In conclusion those companies with more than maximum number as a result of the inclusion of risk management committee do not display higher quality in financial reporting. this result is in line with the work of (Habbash, Sindezinuen & Salama, 2013; Soliman & Ragab, 2014; Othman, Ishak, Arif & Aris, 2014).

# **Table 4.1:** **Average Number and Percentage Change of Audit Characteristics Variables from 2005 - 2015**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | AVERAGE AUDIT CHARACTERISTICS | | | | % CHANGE IN AUDIT CHARACTERISTICS | | | |
| YEAR | ACMEET | ACACCEXPT | ACSIZE | ACDRMEB | ACMEET | ACACCEXPT | ACSIZE | ACDRMEB |
| 2005 | 3.00 | 1.92 | 5.43 | 2.94 | 0% | 0% | 0% | 0% |
| 2006 | 3.10 | 2.01 | 5.52 | 3.01 | 3% | 5% | 2% | 2% |
| 2007 | 3.11 | 2.04 | 5.76 | 3.02 | 0% | 2% | 4% | 0% |
| 2008 | 3.14 | 2.06 | 5.85 | 3.12 | 1% | 1% | 2% | 3% |
| 2009 | 3.19 | 2.09 | 5.91 | 3.15 | 2% | 1% | 1% | 1% |
| 2010 | 3.21 | 2.12 | 6.13 | 3.20 | 1% | 2% | 4% | 2% |
| 2011 | 3.33 | 2.13 | 6.15 | 3.24 | 4% | 1% | 0% | 2% |
| 2012 | 3.34 | 2.21 | 6.22 | 3.35 | 0% | 4% | 1% | 3% |
| 2013 | 3.36 | 2.28 | 6.35 | 3.52 | 1% | 3% | 2% | 5% |
| 2014 | 3.42 | 2.39 | 6.39 | 3.75 | 2% | 4% | 1% | 7% |
| 2015 | 3.56 | 2.44 | 6.57 | 3.83 | 4% | 2% | 3% | 2% |

***Source: Author’s Computation 2017***

*ACMEET = Audit committee meeting, ACACCEXPT = Audit committee accounting expertise, ACSIZE = Audit Committee Size, ACDRMEB = Audit Committee Director Member*

# **Figure 4.1: Trend of audit committee characteristics: percentage change in audit committee meeting and accounting expertise**.

***Source: Author’s Computation, 2017***.

*ACMEET = audit committee meeting, ACACCEXPT = audit committee accounting expertise*

# **Figure 4.2 Average of Audit committee meeting and Accounting Expertise Per Year.**

***Source: Author’s Computation, 2017***.

*ACMEET = audit committee meeting, ACACCEXPT = audit committee accounting expertise*

Key note

|  |  |  |
| --- | --- | --- |
| colour |  |  |
| Blue | *ACMEET* | *Audit Committee Meeting* |
| Red | *ACACCEXPT* | *Audit Committee Accounting Expertise* |

# **Figure 4.3 Percentage change in audit committee size and director member**

***Source: Author’s Computation, 2017.***

*ACSIZE = audit committee Size, ACDRMEB = audit committee*

Key note

|  |  |  |
| --- | --- | --- |
| colour |  |  |
| Blue | *ACSIZE* | *Audit committee Size* |
| Red | *ACDRMEB* | *Audit Committee* |

# **Figure 4.4 Average of audit committee size and audit committee director members**

***Source: Author’s Computation, 2017.***

*ACSIZE = audit committee Size, ACDRMEB = audit committee*

Key note

|  |  |  |
| --- | --- | --- |
| Colour |  |  |
| Blue | *ACSIZE* | *Audit committee Size* |
| Red | *ACDRMEB* | *Audit Committee* |

# **4.2 The challenges confronting audit committee effectiveness among quoted non – financial companies Nigeria.**

# **4.2.1 Demographic Characteristics of Respondents**

In order to know the socio-demographic distribution of the sampled respondents, the Researcher presented the demographic characteristics distribution of the respondents in Table 4.2. The variable included sex, marital status, age, educational qualification, accounting professional qualification, length of service and Accounting working experience. The table showed that larger percentage 68.79% of the respondents were male while 31.21% of them were female. In addition, the table 4.2 presented the marital status of the respondent, it was empirically found that 19.89% of the respondents were Single, 56.03% of them were married, and 8.16% of them have divorced while 15.95% were widows. This indicated that larger percentage of the respondents were married while few of them have divorced. Also, it showed the age distribution of the respondents. It revealed that 12.06% of the respondents were between the ages of 18 – 25 years, 14.54% of them were between 26 – 35 years, 21.63% were between 36 – 45 years, while 51.77% were above 45 years. The age distribution showed that many of the respondents were still in their active age, also the larger percentage of respondents age were married, this is in line with the percentage of married respondents above. Furthermore, the table showed that 8.16% of the respondents were holder of secondary school certificate, 26.95% of them completed the OND/NCE program, 42.55% of them were B.Sc./HND holder while 22.34% of them were M.sc/PhD holders, this signified that majority of the respondents were Graduate. More so, this empirical study revealed that 69.15% of them have professional accounting qualification while 30.85% of them did not have any professional qualification. It further revealed that 52.13% of the respondents have held their current positions for 6 – 10 years, 34.39% of them held their current office for 11 – 15 years, while 13.48% of them have held it for 16 – 20 years.

The table finally showed that 79.08% of the respondents had previous accounting work experience, while 20.92% of them have never done work related to accounting before.

## **Table 4.2 Demographic Characteristics Distribution of Respondents**

|  |  |  |
| --- | --- | --- |
| Parameters | Frequency | Percentage |
| Sex |  |  |
| Male | 194 | 68.79 |
| Female | 88 | 31.21 |
| Total | **282** | **100** |
| Marital Status |  |  |
| Single | 56 | 19.86 |
| Married | 158 | 56.03 |
| Divorce | 23 | 8.16 |
| Widow | 45 | 15.95 |
| Total | **282** | **100** |
| Age |  |  |
| 18 – 25 | 34 | 12.06 |
| 26 – 35 | 41 | 14.54 |
| 36 – 45 | 61 | 21.63 |
| Above 45 | 146 | 51.77 |
| Total | **282** | **100** |
| Highest Educational Qualification | 25 | 35.7 |
| No Formal Education | 0 | 0 |
| Primary | 0 | 0 |
| Secondary | 23 | 8.16 |
| OND/NCE | 76 | 26.95 |
| HND/B.sc | 120 | 42.55 |
| M.sc/PhD | 63 | 22.34 |
| Total | **282** | **100** |
| Do you have Prof. Qualification in Accounting | 7 | 10 |
| Yes | 195 | 69.15 |
| No | 87 | 30.85 |
| Total | **282** | **100** |
| How long have you been holding your current |  |  |
| 6 – 10 years | 147 | 52.13 |
| 11 – 15 years | 97 | 34.39 |
| 16 – 20 years | 38 | 13.48 |
| Total | **282** | **100** |
| Do you have any previous work experience in Accounting or related area? |  |  |
| Yes | 223 | 79.08 |
| No | 59 | 20.92 |
| Total | **282** | **100** |

**Field survey, 2017**

# **4.2.2 Reliability Analysis of research instrument**

It is pertinent to test for the reliability of the data sets of the variable before running any analysis on them, the researcher used Cronbach’s Alpha method to test for the reliability of the data series. Table 4.3 presented the reliability test of all the 48 variables in the data series. The minimum value of Cronbach’s Alpha for reliability test should not be less than 0.70. The result from the Table 4.3 showed that the resulted Cronbach’s Alpha for the variables used in this study was 0.939, which is approximately equal to 94% which was more than the normal standard. This indicated that the data series of the variables used were reliable and free from error.

|  |  |  |
| --- | --- | --- |
| **Reliability Statistics** | | |
| ***Cronbach's Alpha*** | ***Cronbach's Alpha Based on Standardized Items*** | ***Number of Items*** |
| 0.939 | 0.935 | 48 |
|  | | |

# **Table 4.3 Reliability Analysis**

***Source: Author’s Computation, 2017***

Table 4.4 showed the challenges confronting the effectiveness of audit committee. Also the table showed the mean, standard deviation and mean rank. It was evident from table 4.4 that the mean values of all the variables were higher than the standard deviations. This indicated that the data is less volatile. The table, showed that five out of the eight challenges stated in the questionnaire were agreed by the respondents to have impact on auditee committee effectiveness, these include lack of supports from management, lack of experience and expertise in the relevant field, attitude of members to meetings, non-inclusion of majority external/independent members and lack of diligence on the part of audit committee members. While three were not agreed to, these include resources at the disposal of audit committee, amount of authority delegated to audit committee as well as non-appointment of audit committee chairperson from external/independent members. The table shows that the major challenge confronting audit committee effectiveness is lack of support from top management, having a mean rank of 1 with a mean value of 4.21 and standard deviation 0.94, 88% of the respondents agreed to this challenge. Another major challenge confronting audit committee effectiveness is lack of experience and expertise in the relevant field. This was agreed upon by 78.4% of the respondents with a mean of 4, ranked second with a standard deviation of 1.060. 68.1% agreed that attitude of audit committee members to meetings is another problem affecting the audit committee effectiveness with a mean of 3.78, standard deviation of 0.940 and mean rank of 3. From the table it shows that audit committee members takes audit committee meetings as formality. 68.1% of the respondents with a mean 3.65, ranking fourth and standard deviation of 1.379. The table also showed that 62.5% of the respondents with a mean 3.58, ranked fifth with a standard deviation of 1.316 table 4.4 showed that 46.2% and 35.8% of the respondents strongly agreed and agreed respectively, that lack of experience and expertise in some major relevant field such as accounting and management could affect the effectiveness of the audit committee. However, despite the larger percentage of the respondents that were objective about the agreement of the statement, though quite low, 12.1% and 5.7% of them strongly disagreed and disagreed respectively while 3.9% of them were neutral about the question. Furthermore, the inclusion of independent/external member on the audit committee could checkmate the operation of the committee member, majority of the respondents agreed that the exclusion of independent/external member in the audit committee was a factor that constitute a challenge in the effectiveness of the audit committee.

Another major challenge was the Non-appointment of audit committee chairperson from external/independent members, The survey found out that very few of the respondents agreed to the statement, this was evidence from the Table 4.4, that 7.8% and 5.7% of the respondents claimed that without the appointment of independent member as chairperson on the audit committee, it could be hard to achieve effectiveness, whereas 36% and 44% of the respondents strongly disagreed and disagreed respectively to the statement. It is reasonable enough to conclude that audit committee effectiveness would not be compromised even without the appointment of independent member to chair the audit committee. In addition, another major challenge was the attitude of audit committee member to attend meetings, the audit committee usually meet four times in a year, though it varies among companies, the attitude of the audit committee does affect the effectiveness of the committee, the research study found out that more than half (68.1%) of the respondent strongly agreed and agreed that attitude of audit committee member to attend meeting would not promote the effectiveness of the audit committee. In contrary, 26.6% of the respondents strongly disagreed to the statement, they were of the view that the attitude of the audit committee member would not affect the effectiveness of the audit committee. From the majority of the respondents’ point of view, we can conclude that where the audit committee member fails to attend committee meetings, there is likelihood of ineffective audit committee. Also, lack of diligence on the part of audit committee members seems to be a challenge to the effectiveness of audit committee. The study found out that, majority, 29.9% and 32.6% of the respondents strongly agreed and agreed respectively that lack of diligence on the part of audit committee would affect the effectiveness of audit committee, moreover, 13.1% and 14.5% of the respondents strongly disagreed to the statement while 9.9% neutral to it. Furthermore, the table showed that authority delegation could also be a challenge towards the effectiveness of audit committee, it was empirically found out that, 11.3% and 9.9% of the respondents subscribed that delegation of authority was a challenge towards the attainment of effective audit committee. However, majority 68.1% in total of the respondents strongly disagreed and disagreed respectively that authority delegation was not a challenge to the effectiveness of audit committee. The Table also showed that Lack of supports from top management was a challenge to the effectiveness of audit committee, a larger percentage of the respondents supported the statement, the Table showed that 43.3% and 44.7% of the respondents strongly agreed and agreed respectively that lack or inadequate support from top management is likely to pose a challenge to the effectiveness of the audit committee. Whereas, despite the larger percentage of the respondents that agreed to the statement, 5.3% and 3.2% of the respondents strongly disagreed and disagreed respectively to the statement, while 3.5% of them were neutral or undecided.

The study concluded that the lack of relevant experience and expertise, Non-inclusion of majority independent/external members, attitude of audit committee members to meetings affect, and Lack of support from top management were the major challenges confronting the effectiveness of audit committee.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Variables  Table 4.4: Assessment of the challenges confronting audit committee effectiveness in Nigeria | SA | A | SD | D | U | Mean | Std. Dev. | Remark | Mean  Rank |
| Lack of experience and expertise in the relevant field constitute a great challenge to ACE | 120(42.6%) | 101(35.8%) | 34(12.1%) | 16(5.7%) | 11(3.9%) | 4.07 | 1.060 | A | 2 |
| Non-inclusion of majority independent/external members is another factor that constitute challenges to ACE. | 93(33%) | 95(35.1%) | 28(9.9%) | 22(7.8%) | 40(14.2%) | 3.65 | 1.379 | A | 4 |
| Non-appointment of AC chairperson from external/independent members affects ACE. | 22(7.8%) | 16(5.7%) | 103(36.5%) | 124(44%) | 17(6%) | 2.65` | 0.965 | U | 8 |
| Attitude of AC members to meetings affect ACE. | 57(20.2%) | 135(47.9%) | 75(26.6%) | 1(0.4%) | 14(5.0%) | 3.78 | 0.940 | A | 3 |
| Lack of diligence on the part of AC members constitute a great challenge to ACE. | 84(29.9%) | 92(32.6%) | 37(13.1%) | 41(14.5%) | 28(9.9%) | 3.58 | 1.316 | A | 5 |
| The amount of authority delegated to the AC determined its effectiveness. | 32(11.3%) | 28(9.9%) | 91(32.3%) | 101(35.8%) | 30(10.6%) | 2.76 | 1.132 | U | 7 |
| The resources at the disposal of the AC go a long way to determine its effectiveness. | 32(11.3%) | 28(9.9%) | 91(32.3%) | 101(35.8%) | 30(10.6%) | 2.80 | 1.056 | U | 6 |
| Lack of supports from top management will affect effectiveness of Audit committee | 122(43.3%) | 126(44.7%) | 15(5.3%) | 9(3.2%) | 10(3.5%) | 4.21 | 0.944 | A | 1 |

***Source: Author’s Computation, 2017***

# **4.3 The influence of audit committee on the quality of financial reporting of selected quoted companies in Nigeria**

# **4.3.1 Descriptive Statistics**

Prior to various analysis that were run to achieve each objective of the study, the researcher presented the descriptive statistics of variables that were used in the model 3.9. The descriptive statistics of all the variables used were presented in Table 4.6. The variables included financial reporting quality (FRQ), audit committee accounting expertise (ACE), audit committee director member (ACD), audit committee meetings (ACM), board accounting expertise (BAE), board independence (BID), board meeting (BMT), board size (BSZ) and audit market (AUD). The table presented information about the mean, median, maximum and minimum values, standard deviation, kurtosis, and Jarque-Bera statistics of each variable, the mean value of FRQ, ACE, ACD, ACM, BAE, BID, BMT, BSZ and AUD were 5.7684, 2.0385, 2.8919, 3.0402, 3.1394, 5.9550, 4.3781, 9.2401 and 0.6861 respectively. The result showed the maximum and minimum values of the variables for the study. These results indicated that there was no serious outlier from the data series, although, there are some variables which dataset were not complete due to the fact that some datasets were difficult to find, the total observation of data was 583. Table 4.5 further showed an information about the standard deviation of each variable. The standard deviation of all FRQ, ACE, ACD, ACM, BAE, BID, BMT, BSZ and AUD were 0.6391, 1.1273, 0.3423, 0.6208, 1.1040, 2.1718, 1.2684, 2.3501, and 0.4647 respectively. These showed that the variable for the study were stable and with low volatility as it was evidently proved that none of the variable has its standard deviation value higher than its means. All the variables were positively skewed except FRQ, ACD and AUD. This is evidenced from the value of the mean and median. The result showed that mean value is greater than median. The Jarque-Bera statistic showed that all the variables reject the null hypothesis of normal distribution, with p-value < 0.05 for all the variable of study. In addition, Kurtosis measured the peakness flatness of the distribution of a series for all the variables of study. The result of the kurtosis was greater than 3.0 (which is the standard for normally distributed data series).

# **Table 4.5: DESCRIPTIVE STATISTICS**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | FRQ | ACE | ACD | ACM | BAE | BID | BMT | BSZ | AUD |
| Mean | 5.7684 | 2.0386 | 2.8919 | 3.0402 | 3.1394 | 5.9550 | 4.3781 | 9.2401 | 0.6861 |
| Median | 6 | 2 | 3 | 3 | 3 | 6 | 4 | 9 | 1 |
| Maximum | 7 | 22 | 4 | 6 | 6 | 14 | 9 | 17 | 1 |
| Minimum | 3 | 1 | 1 | 1 | 1 | 2 | 2 | 5 | 0 |
| Std. Dev. | 0.6391 | 1.1273 | 0.3423 | 0.6208 | 1.1040 | 2.1718 | 1.2684 | 2.3501 | 0.4647 |
| Skewness | -2.2831 | 13.4137 | -2.7509 | 0.4132 | 0.1216 | 0.6858 | 1.4293 | 0.6852 | -0.8020 |
| Kurtosis | 7.5690 | 237.75 | 11.3349 | 5.5955 | 2.4857 | 3.8343 | 5.8393 | 3.3312 | 1.6432 |
|  |  |  |  |  |  |  |  |  |  |
| Jarque-Bera | 1013.5 | 96672.9 | 2422.91 | 176.8397 | 7.253657 | 61.97145 | 372.0193 | 48.29521 | 107.212 |
| Probability | 0.0000 | 0.0000 | 0.0000 | 0.0000 | 0.0266 | 0.0000 | 0.0000 | 0.0000 | 0.0000 |
|  |  |  |  |  |  |  |  |  |  |
| Sum | 3363 | 848 | 1686 | 1739 | 1689 | 3436 | 2408 | 5387 | 400 |
| Sum Sq. Dev | 237.73 | 527.38 | 68.192 | 220.075 | 654.54 | 2716.82 | 883.33 | 3214.31 | 125.555 |
|  |  |  |  |  |  |  |  |  |  |
| Observations | 583 | 416 | 583 | 572 | 538 | 577 | 550 | 583 | 583 |

***Source: Author’s Computation, 2017***

*FRQ= Financial Reporting Quality, ACE=Audit Committee Accounting Expertise, ACD= Audit committee Director member, ACM= Audit Committee meeting, BAE= Board Accounting Expertise, BID= Board Independence, BMT= Board meeting, BSZ= Board Size, AUD= Audit market.*

# **4.3.2 Multicollinearity Test**

In order to achieve a robust and to avoid spurious regression result, it was pertinent to examine if multicollinearity is a problem among the explanatory variables. One of the basic assumption of OLS is that regressors should not explain each other. Before regressing the equational model, a multicollinearity test was conducted on the explanatory variables of the equation model. There are various method to test for multicollinearity in a model, such methods include; correlation matrix analysis, eigenvalue method, variance inflation factor (VIF) method. However, this study employed correlation matrix analysis and variance inflation factor method. The pairwise correlation method was employed and the result were presented in Table 4.6. The correlation test among the explanatory variables showed that the regressors had a weak correlation with one another, this showed that there is less likelihood of multicollinearity problem. Although, variables are correlated with each other but exhibited less than 0.7 (a commonly used rule of thumb degree of association). Also, in other to reinforce the authenticity of the non-existence of multicollinearity problem in our explanatory variables, the researcher therefore used another higher method of Variance Inflation Factor (VIF) in table 4.7 was used to examine the level of multicollinearity in the explanatory variables, the result form the VIF showed that none of the variable was collinear, since the VIF for each variable was less than 5, (Gujarati 2003).

This is an indication that the estimated model from the variables was free from the problem of understatement of the standard error, which could have affected the inference drawn from the model.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| VARIABLE | ACE | ACD | ACM | BAE | BID | BMT | BSZ | AUD |
| ACE | 1.0000  *(0.0000)* |  |  |  |  |  |  |  |
| ACD | 0.039934  *(0.4431)* | 1.0000  *(0.0000)* |  |  |  |  |  |  |
| ACM | 0.119316  *(0.0215)* | 0.02282  *(0.6613)* | 1.0000  *(0.0000)* |  |  |  |  |  |
| BAE | 0.060519  *(0.2449)* | 0.226325  *(0.0000)* | 0.222909  *(0.0000)* | 1.0000  *(0.0000)* |  |  |  |  |
| BID | 0.082259  *(0.1137)* | 0.135177  *(0.0091)* | 0.310398  *(0.0000)* | 0.14473  *(0.0052)* | 1.0000  (*0.0000)* |  |  |  |
| BMT | 0.088302  *(0.0894)* | 0.103924  *(0.0455)* | 0.15319  *(0.0031)* | 0.250732  *(0.0000)* | 0.022283  *(0.6688)* | 1.0000  *(0.0000)* |  |  |
| BSZ | 0.104819  *(0.0436)* | 0.142487  *(0.006)* | 0.213595  *(0.0000)* | 0.200617  *(0.0001)* | 0.634962  *(0.0000)* | 0.011083  *(0.8315)* | 1.0000  *(0.0000)* |  |
| AUD | 0.095847  *(0.0652)* | 0.186595  *(0.0003)* | 0.288807  *(0.0000)* | 0.208611  *(0.0001)* | 0.295008  *(0.0000)* | 0.093249  *(0.0728)* | 0.32113  *(0.0000)* | 1.0000  *(0.0000)* |

# **Table 4.6: Correlation Matrix of the Regressors**

***Source: Author’s Computation, 2017***

note; P-value are in *parenthesis ( )*

*FRQ= Financial Reporting Quality, ACE=Audit Committee Accounting Expertise, ACD= Audit committee Director member, ACM= Audit Committee meeting, BAE= Board Accounting Expertise, BID= Board Independence, BMT= Board meeting, BSZ= Board Size, AUD= Audit market*

# **Table 4.7: Variance Inflation Factor**

|  |  |  |
| --- | --- | --- |
| Variable | VIF | 1/VIF |
|  |  |  |
| Bsize | 2.27 | 0.440007 |
| Bind | 2.19 | 0.456001 |
| Acmeet | 1.23 | 0.815376 |
| Baccexp | 1.17 | 0.855241 |
| Aud | 1.18 | 0.851033 |
| Bmet | 1.08 | 0.925691 |
| Acdrmeb | 1.09 | 0.921412 |
| Acaccexpt | 1.02 | 0.977926 |
|  |  |  |
| Mean VIF | 1.43 |  |

***Source: Author’s Computation, 2017***

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# **4.3.3 Panel Unit Root Test**

The stationarity of a time series data can strongly influence its behavior or properties. In other to have a good and robust regression results, the variables used in the model were subjected to unit root test using ADF-Fisher Chi-Square, PP-Fisher Chi-Square test. This is evidenced in the Table 4.6 as all the variables were significant and the data series were stationary at order of integration zero, as it was evidently shown that all the variables have their p-value < 0.05. All the variables subjected to unit root test in the model were all stationary at level. This was to reinforce and ensure the robustness and to boost confidence in the reliability of the results. Unit Root tests were carried out to determine the order of integration and also to ensure that estimates of parameters obtained from regression models using ordinary least square (OLS) are not spurious.

# **Table 4.8 Panel Unit Root Test.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | ADF- Fisher | | PP- Fisher | | Order of  integration |
| Variable | **T-STAT** | **pp-Value** | **T-STAT** | **pp-Value** | **I (0)** |
| FRQ | 84.4347 | 0.0000 | 116.332 | 0.0000 | **I (0)** |
| ACE | 90.9854 | 0.0000 | 124.237 | 0.0000 | **I (0)** |
| ACD | 41.2309 | 0.0000 | 61.2660 | 0.0000 | **I (0)** |
| ACM | 134.634 | 0.0000 | 146.720 | 0.0000 | **I (0)** |
| BAE | 281.029 | 0.0000 | 328.003 | 0.0000 | **I (0)** |
| BID | 337.004 | 0.0000 | 423.028 | 0.0000 | **I (0)** |
| BMT | 218.632 | 0.0000 | 295.475 | 0.000 | **I (0)** |
| BSZ | 268.661 | 0.0000 | 368.442 | 0.0000 | **I (0)** |
| AUD | 25.5027 | 0.0126 | 41.4356 | 0.0000 | **I (0)** |

***Source: Author’s Computation, 2017.***

*FRQ= Financial Reporting Quality, ACE=Audit Committee Accounting Expertise, ACD= Audit committee Director member, ACM= Audit Committee meeting, BAE= Board Accounting Expertise, BID= Board Independence, BMT= Board meeting, BSZ= Board Size, AUD= Audit market*

# 

# **4.3.4 Audit Committee and Financial Reporting Quality.**

The financial quality being the response variable was captured by discretionary accruals (DIA) while the explanatory variables include audit committee accounting expertise (ACE), audit committee director member (ACD), audit committee meetings (ACM), board accounting expertise (BAE), board independence (BID), board meeting (BMT), board size (BSZ) and audit market (AUD) are the regressors used in achieving the objective. The table 4.10 reports the influence of audit committee formation on the quality of financial reporting of selected quoted companies in Nigeria for the period of 2005 – 2015. Ordinary least square methods of three models namely fixed effect; random effect and ordinary were estimated. Post estimation diagnostic test of Hausman test and redundant fixed effect test were adopted in selecting the most appropriate model to capture the influence of audit committee formation on the quality of financial reporting. The test indicated that random effect is not an appropriate model and non-normality of the variables will not encourage the use of ordinary least square, therefore, in estimating the parsimonious model of the variable, fixed effect will be an appropriate assumption. The explanatory power of all regressors jointly, in explaining the responses variable showed that 95.82 % of the financial reporting quality was accounted for by the explanatory variables, while after adjusting the co-efficient of determination due to degree of freedom, the percentage of financial reporting quality felt to 95.18%, this implies that about 95.18% of the financial reporting quality was accounted for by the explanatory variables. The F-statistics of 148.5385, with the p-value < 0.05 so that the explanatory variables are jointly different from zero and Durbin-Watson statistics of 2.303841 reported the likelihood of very weak autocorrelation.

Based in the result on Table 4.10 four of the eight explanatory variables were statistically significant, the variables include audit committee accounting expertise (ACE) with (***β*** = 0.015952, t= 2.22251 at p-value < 0.05), audit committee director member (ACD) (***β*** = 1.308417, t= 25.84755 at p-value < 0.05), board independence (BID) (***β*** = -0.02423, t= -2.320087 at p-value < 0.05) and board meeting (BMT) (***β* =** 0.091574, t= 7.301439 at p-value < 0.05) were significant at 5% level of significance

From the results, audit committee accounting expertise (ACE) was positively and significantly related to financial reporting quality. This signified that listed non-financial companies would have a quality financial reporting when the number of audit committee accounting expertise increases as a proportion of audit committee member, when audit committee financial expertise increases. Also, strong industry expertise by the audit committee will reflect that estimates are realistic leading to higher quality financial reporting. it reduces the amount of time needed to sufficiently discuss, comprehend, and evaluate significant accounting policies and unusual transactions with the auditor, thereby reducing the time needed to complete the audit and increasing financial reporting quality. It also, ensure a thorough work will also be done by the external auditors and internal control officers since, good corporate mechanism are been instituted. Most corporate organisation in Nigeria improve the financial reporting quality by using more financial expertise in the audit committee. This result is in line with the study of Leong, Wang Suwardy and Kusnadi, (2015); Othman, Ishak, Arif and ArisHabbash, (2014); Sindezguen and Salam, (2013); Cohen, Krishnamoorthy and Wright, (2010); Abbott, Parker, & Peters (2004).

We also empirically found out that there was a positive relationship between audit committee director member (ACD) and financial reporting quality. This signified that with the inclusion of independent director member in the audit committee, there is high tendency of achieving a quality financial reporting and also increasing the confidences of stakeholders other than the management. Since it the responsibility of the management to protect the interest of their shareholder and present a fair financial report to them, in other to achieve this, most corporate bodies tends to increases the independent director member on the audit committee, thereby increasing the financial reporting quality. This result is in conformity with the result of Bhasin, (2016), Kituku and Ahmad (2016), Nasser (2015). Musa, Oloruntoba and Oba, (2014), Ojeka, Iyoha and Obigbemi (2014), Habbash, Sindezguen and Salam, (2013) Chapple, Jubb and LeeAbbott, Parker (2012) and Peters (2004) but also not in line with the studies of (Jerubet, Chapg'eno and Tenai, (2017); Glover – Akpey and Azembila, (2016); Leong, Wang Suwardy and Kusnadi, (2015); Othman, Ishak, Arif and Aris, (2014) .

The study also found out that board independence (BID) was negatively and statistically significantly related to financial reporting quality. This signifies that there is an inverse relationship between the board independence and financial reporting quality, the result proved that board independence tend to decrease the quality of financial reporting, this result is in line with the agency theory. Directors member are expected to act in the interest of the shareholder and provide a fair and good financial report that show a true picture of the affairs of the company. However, executive directors sometimes act otherwise, when power is solely with them thereby acting to their own self-interest, as a result of this, board independence is likely to reduce financial reporting quality. The study finally found that board meeting was positively and statistically significant related to financial quality, the study reported that financial reporting quality would increase by 9.15% given a 100% increase in the board meeting, that is, when there is regular meeting among the board of directors, its evidently proven that financial quality will increase. This result is in conformity with the result of Ibadin, Ayemere and Afesimi, (2015); Othman, Ishak, Arif and Aris, (2014); Habbash, Sindezguen and Salam, (2013); Chapple, Jubb and Lee, (2012).

# **Table 4.9: Influence of audit committee formation on the quality of financial reporting of selected quoted companies in Nigeria**.

**Response Variable: Financial Reporting Quality.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Variable | | Pooled  Effect | Fixed  Effect | Random  Effect |
| ACE | coff  t-stat  p-value | |  | | --- | | 0.02163 | | 1.21971 |   *(0.2235)* | 0.015952  2.22251  (0.0269)\* | 0.016242  2.268558  (0.0238)\*\* |
| ACD | coff  t-stat  p-value | |  | | --- | | 1.11654 |   24.5995  *(0.0000)\*\*\** | 1.308417  25.84755  (0.0000)\*\*\* | 1.296597  27.14495  (0.0000)\*\*\* |
| ACM | coff  t-stat  p-value | |  | | --- | | -0.08688 |   -2.37339  *(0.0181)\*\** | 0.016232  0.728841  *(0.4666)* | 0.017107  0.788441  *(0.4309)* |
| BAE | coff  t-stat  p-value | 0.038485  1.709479  *(0.0881)*\* | 0.018384  1.180488  *(0.2386)* | 0.024414  1.631508  *(0.1036)* |
| BID | coff  t-stat  p-value | 0.04585  2.962781  *(0.0032)\*\*\** | -0.02423  -2.320087  (*0.0209)\*\** | -0.02034  -2.00296  *(0.0458)\*\** |
| BMT | coff  t-stat  p-value | 0.059007  3.265611  *(0.0012)\*\*\** | 0.091574  7.301439  *(0.0000)\*\*\** | 0.091417  7.530626  *(0.0000)\*\*\** |
| BSZ | coff  t-stat  p-value | 0.007778  0.541254  *(0.5886)* | 0.001855  0.154492  *(0.8773)* | 0.008226  0.728857  *(0.4665)* |
| AUD | coff  t-stat  p-value | 0.16087  3.433782  *(0.0007)\*\*\** | -0.04539  -0.89856  *(0.3695)* | -0.03283  -0.69359  *(0.4883)* |
| C | coff  t-stat  p-value | 1.962936  11.57153  *(0.0000)\*\*\** | 0.676187  3.369110  *(0.0008)\*\*\** | 1.279351  7.308668  *(0.00000)\*\*\** |
| R-Squared | | 0.650139 | 0.958296 | 0.67643 |
| Adj.R-sq | | 0.643312 | 0.951844 | 0.670116 |
| F-Stat | | 95.23654 | 148.5385 | 107.1392 |
| Prob (F-stat) | | (0.0000) | (0.0000) | (0.0000) |
| Durbin-Watson Stat | | 0.421741 | 2.303841 | 2.355615 |
| Redundant Fixed Effect Test | | [551.788416] *(0.0000)* | | |
| Hausman Test | | [24.938262] *(0.0016)* | | |

***Source: Author’s Computation, 2017.***

***Note \*\*\*,\*\* and \* shows level of significant at 1%,5% and 10% respectively***

**4.3.5 The** **contributions of the management and internal audit to audit committee’s effectiveness in Nigeria**.

This section examined the contributions of the management, internal control and external auditor to the effectiveness of audit committee in performing its oversight functions among quoted non-financial companies in Nigeria. Among the oversight function include audit committee formation, audit committee independence, and Audit committee diligence. Table 4.11 presented the level of agreement in percentage among the respondents about the question related to Audit committee formation. The Table showed that 46.1% and 29.8% of the respondents strongly agreed and agreed respectively that member of the audit committee should be appointed in consultation with the audit committee chairperson. However, despite the agreement of the respondents, though few (3.5%) and (4.6%) of the respondents strongly disagreed and disagreed respectively that committee members should not be appointed in consultation with the audit committee chairperson while 16% of them were undecided on this. The table 4.10 further showed that 77.7% of the respondents were of the view that it is important for Audit committee members to have sufficient knowledge in the entity's business, whereas, 6.7% and 6.4% of the respondents strongly disagreed and disagreed respectively to the statement, the possible reason for their disagreement could be from the view that even in most companies, shareholders were part of their audit committee and such shareholder may not have any knowledge of the business entity, 9.2% of the respondents were undecided on the statement. The Table further showed the agreement of the respondents on statement about the majority of the audit committee member should be an independent non - executive director, few of the respondents agreed to the statement while a larger percentage (59.7%) of the respondents totally disagreed to the statement. It was a norms and standard among the companies that there is equal number of independent director member and non - director member on the audit committee, in most companies, their independent director members are 3 while non-director members are also 3. The Table further concluded that 41.1% and 23.4% of the respondents strongly agreed and agreed respectively that the formation of audit committee will improve financial quality, a good proportion of the formation of the audit committee member tend to increases the quality of financial reporting, since the power of each member is evenly distributed.

# **Table 4.10: Audit Committee Composition**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Variables | SA | A | SD | D | U | Mean | Std. Dev. |
| Audit committee member should be appointed in consultation with the audit committee chairperson | 130(46.1%) | 84(29.8%) | 10(3.5%) | 13(4.6%) | 45(16%) | 3.85 | 1.450 |
| Audit committee members must have sufficient knowledge in the entity's business. | 122(43.3%) | 97(34.4%) | 19(6.7%) | 18(6.4%) | 26(9.2%) | 3.96 | 1.261 |
| Majority of audit committee members must be independent /non-executive directors. | 40(14.2%) | 44(15.6%) | 102(36.2%) | 64(22.7%) | 32(11.3%) | 2.99` | 1.187 |
| The formation of audit committees is associated with improved financial reporting quality. | 116(41.1%) | 66(23.4%) | 14(5.0%) | 18(6.4%) | 68(24.1%) | 3.51 | 1.630 |

***Source: field survey, 2017.***

# **4.3.6 Audit committee Diligence**

In addition to objective four of the study, the researcher presented Table 4.11 which showed the level of agreement among the respondents on the question relating to the diligence of the audit committee in achieving effectiveness. The Table showed that majority (86.9%) of the respondents agreed that there should be charter which outline the objectives, duties and responsibilities of audit committee, where the functions and duties of each audit committee member is made known to them, there is likelihood of attaining audit committee effectiveness, despite this larger percentage of respondents that agreed to the statement, 8.2% of them were contrary about the statement while 5.0% of them were neutral on the statement. The Table further showed that 71% of the respondents supported that all the members of audit committee should have clear knowledge of their responsibilities, when audit committee member fully understand what is expected of him/her to do, there will be lesser time to waste on the assignment delegated to each member, in contrary, 22.3% of the respondents were of the opinion that member of the audit committee do not need to have a clear knowledge of their responsibilities while 6.7% of them were undecided on the statement. The table finally concluded that 91.3% of the respondents both strongly agreed and agreed audit committee member should be people that can devote sufficient time to the audit committee affairs, where member of the audit committee do not devote their time to meetings call by audit committee, it could be hard for them to perform effectively thereby deterring the quality of financial reporting. However, 4.6% and 1.8% of the respondents disagreed to the statement while 2.1% of them were undecided on the question. The study concluded that members of audit committee should be diligent enough to understand their role in the attainment of the quality financial reporting and effective audit committee. Therefore, the major oversight functions that suggested by the researcher include Audit committee formation, audit committee independence and audit committee diligence.

# **Table 4.11: Audit Committee Diligence**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Variables | SA | A | SD | D | U | Mean | Std. Dev. |
| There should be charter which outline the objectives, duties and responsibilities of audit committee. | 168(59.6%) | 77(27.3%) | 14(5.0%) | 9(3.2%) | 14(5.0%) | 4.33 | 1.055 |
| All the members of audit committee should have clear knowledge of their responsibilities | 124(44.0%) | 76(27.0%) | 32(11.3%) | 31(11.0%) | 19(6.7%) | 3.90 | 1.263 |
| Audit committee members should be people that will be able to devote sufficient time to the committee’s affairs | 198(70.2%) | 60(21.3%) | 13(4.6%) | 5(1.8%) | 6(2.1%) | 4.56 | 0.839 |

***Source: field survey, 2017.***

# **CHAPTER FIVE**

**SUMMARY, CONCLUSION AND RECOMMENDATION**

This chapter contained summary of the major findings, conclusion and recommendations on issues discovered on audit committee effectiveness and financial reporting quality of quoted non-financial companies in Nigeria.

**5.1 Summary of Findings**

The study examined audit committee effectiveness and the quality of financial reporting of quoted non – financial companies in Nigeria. It examined the pattern of audit committee characteristics, assessed the challenges confronting audit committee, examined the effects of audit committee characteristics on the quality of financial reporting of quoted non-financial companies in Nigeria, as well as evaluated the contributions of the management, internal control and external auditor to audit committee’s effectiveness in performing its oversight functions among quoted non – financial companies in Nigeria.

The study used both primary and secondary data. The data were sourced through the administration of 300 structured pre - tested questionnaire primary that were purposively administered on audit committee chairmen (50), audit committee members (50), chief financial officers (50), internal auditors (50), external auditors (50) and financial analysts (50). Secondary data were also sourced from audited financial reports of the sampled companies on variables such as financial reporting quality, audit committee accounting expertise, audit committee director member, audit committee meetings, board accounting expertise, board independence, board meeting, board size and audit market, for the period of 2006 - 2015.

Descriptive statistics such as, percentages, measure of central tendencies and dispersion were used to analyse the values and features that are typical characteristics of audit committee such as financial reporting quality, audit committee, accounting expertise, audit committee director member, audit committee meeting, board accounting expertise, board independence, board meeting, board size, audit market, also inferential statistical analysis tools such as correlation and multiple regressions, for statics regression (pooled, random and fixed effects) were used.

The secondary data used being panel in nature necessitated several diagnostics tests, such as stationarity test of Augmented Dickey—Fuller (ADF) and Phillips–Perron (PP) tests, which was used to examine the existence of unit root of the variable in the data series. Correlation analysis was also carried out to check for the extent of the existence of multicollinearity problem among the regressors. Furthermore, Hausman Test and Redundant Fixed Effects Tests were carried out in order to select appropriate panel multiple regression analysis.

**5.2 Conclusion**

Based on the data collected and analysed, using both descriptive and inferential statistics, the study revealed that:

i). audit committee characteristics is steadily rising over the year, and this is to improve the confidence of the stakeholder in the financial reporting quality

ii). the challenges of audit committee members are Lack of expertise, Exclusion of chairperson from independent member, Attitude of Audit committee member, resources at disposal.

iii). audit committee member averagely considered appropriateness of the accounting policies and principles adopted and any amendments thereto, as well as the methods of applying those policies/principles, ensuring that they are in accordance with the stated financial reporting framework. The audit committee must however, ensure improvement in quality by ensuring the effectiveness of the internal control, risk management system instituted by management and critical appraisal of related party transactions.

(iv). the audit committee role in improving financial statement can only be guaranteed with a well constituted audit committee that has a committee characteristic of right proportion of independent members in the committee (ACIND), right number attendance of audit committee meetings in the year (ACMTG), and proportion of financial experts in the audit committee (ACFEXP) and Board independence (BIND). These characteristics are positive significant drivers of financial reporting.

(v). the management, internal control and external auditor also contribute towards effective

**5.3. Recommendations**

Based on the findings from this study and conclusions reached, the following recommendations were suggested to quoted non-financial in Nigeria and also other stakeholders

1. Policies should be formulated to ensure that financial expertise, audit independent should be of a greater proportion in the audit committee of any company to ensure improvement in the quality of the financial reporting and also audit committee meeting should be held regularly.
2. For proper functioning of audit committee corporate body should to minimize challenges such as lack of expertise, Exclusion of chairperson from independent member, attitude of audit committee member, resources at disposal of the committee.

**5.4 Contributions to Knowledge**

The study has advanced the body of knowledge on the relationship between audit committee and quality financial reporting. It also looked at the challenges witnessed by audit committee in the delivering of its oversight function.

**5.5 Limitation of the Study**

This study was limited to non- financial companies in Nigeria exempting financial institution like banks and insurance companies.

**5.6 Suggestion for further studies**

This work dealt with issue on audit committee effectiveness and financial reporting quality by considering pattern of audit committee characteristics among quoted companies, challenges confronting audit committee effectiveness, the effect of audit committee characteristics on the quality of financial reporting as well as an evaluation of the contribution of management, internal control and external audit to the effectiveness of audit committee in performing its oversight function.

Further study may be conducted on the non-financial quoted companies and on the activities of non-quoted companies.

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**Appendix I**

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## 

BOWEN UNIVERSITY, IWO

FACULTY OF SOCIAL AND MANAGEMENT SCIENCIES

DEPARTMENT OF ACCOUNTING

## *Questionnaire*

Dear Respondent,

**Introduction**

The research work is aimed at studying **Audit Committee effectiveness and Financial reporting Quality quoted Non- financial Companies in Nigeria**, as part of my Ph.D. Accounting programme.

I hereby assure you that the details provided in the completed instrument is purely for academic purposes and would be treated strictly as confidential. Provision of accurate information by you would contribute immensely to the success of the study. It should also be noted that findings of the study will be presented in an aggregate form and individual company will not be identified.

May I also use this opportunity to thank you in advance for your contribution and cooperation by devoting a few moments of your time in this interesting and topical piece of research.

Thank you.

**Olatunde WRIGHT**

**Bowen University, Iwo.**

**Department of Accounting,**

**Faculty of Social and Management Sciences.**

*Section A: Background Details*

1. Sex a. Male ( ) b. Female ( )
2. Marital Status a. Single ( ) b. Married ( ) c. Separated ( ) d. Widowed ( )
3. Age : (18-25) ………. (26-35)…….. (36-45)……… Above 45……….
4. Highest educational qualification a. No formal ( ) b. Primary education ( ) c. Secondary education ( ) d. OND/NCE ( ) e. HND/B.Sc. ( ) f. M.Sc./Ph.D. ( )
5. Do you have Professional Qualification in Accounting (e.g. ACA/ ACCA etc.) Yes ( )

No ( ).

1. What is the job title you hold within your company? \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
2. Please specify for how long you have been holding the current position in this company …………
3. Do you have any previous work experience in Accounting or related area?

Yes ( ) No ( )

(If yes specify number of years of such experience ………….

*Section B: Responses on the Audit Committee Effectiveness*

The following statements deal with your perception towards issues that relate to Audit Committee. Kindly indicate to what extent do you agree or disagree with each of the following statements by ticking the appropriate box.

Note that 1= Strongly Disagree, 2= Disagree, 3 = Undecided, 4= Agree and 5 = Strongly Agree.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| 1. **A** | **Audit Committee Composition** | **5** | **4** | **3** | **2** | **1** |
| 1. | Audit Committee members should be appointed in consultation with the audit committee chairperson. |  |  |  |  |  |
| 2. | Audit committee members must have sufficient knowledge in the entity's business. |  |  |  |  |  |
| 3. | |  | | --- | | Majority of audit committee members must be independent /non-executive directors. | |  |  |  |  |  |
| 4. | The formation of audit committees associated with improved financial reporting quality? |  |  |  |  |  |
| **B** | **Audit Committee Independence** | **5** | **4** | **3** | **2** | **1** |
| 1. | The chairman of the committee must be independent member. |  |  |  |  |  |
| 2. | Majority of audit committee members are independent /non-executive directors. |  |  |  |  |  |
| 3. | In the case of the statutory audit committee , its chairperson should be an independent non- executive director or an independent shareholder. |  |  |  |  |  |
| 4**.** | Audit Committee Independence give credence to Financial Report |  |  |  |  |  |
| **C** | **Audit Committee Diligence** | **5** | **4** | **3** | **2** | **1** |
| 1. | There should be charter which outline the objectives, duties and responsibilities of audit committee. |  |  |  |  |  |
| 2. | The charter should be reviewed on yearly basis. |  |  |  |  |  |
| 3. | All the members of audit committee should have clear knowledge of their responsibilities. |  |  |  |  |  |
| 4. | Audit committee members should be people that will be able to devote sufficient time to the committee’s affairs |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
| **D** | **Audit Committee Authority** | **5** | **4** | **3** | **2** | **1** |
| 1. | Audit committee must have adequate authority to be able to carry out their work. |  |  |  |  |  |
| 2. | Audit committee must have access to relevant documents that help them in their assignment. |  |  |  |  |  |
| 3. | Audit committee should have power to invoke investigation on any matter within its Charter. |  |  |  |  |  |
| 4. | Audit committee should be able to call meeting between the committee and external auditor. |  |  |  |  |  |
| **E** | **Audit Committee Meetings** | **5** | **4** | **3** | **2** | **1** |
| 1. | |  | | --- | | Agendas of audit committee meeting should be finalised by the chairperson. | |  |  |  |  |  |
| 2. | |  | | --- | | Audit committee chairperson should however allow the input of other committee members before finalising the agenda of the meetings. | |  |  |  |  |  |
| 3. | Audit committee members should have the meeting agenda as well as other related documents, well in advance of the meeting. |  |  |  |  |  |
| 4. | Numbers of meeting called for should be adequate enough to enable the committee carry out its responsibilities. |  |  |  |  |  |
| **F** | **Audit Committee Role in Financial Reporting** | **5** | **4** | **3** | **2** | **1** |
| 1. | Audit committee should exercise oversight over the integrity of the company’s financial statements. |  |  |  |  |  |
| 2. | Audit committee should ascertain whether the accounting and reporting policies of the company are on accordance with the legal requirements and ethical practices. |  |  |  |  |  |
| 3. | Audit committee should review the scope of auditing requirements. |  |  |  |  |  |
| 4. | Audit committee should from time to time review the effectiveness of the company’s system of accounting and internal control. |  |  |  |  |  |
| **G** | **Audit Committee Role in External Auditing** | **5** | **4** | **3** | **2** | **1** |
| 1. | Audit committee should recommend to the board regarding the appointment, removal and remuneration of the external auditors of the company |  |  |  |  |  |
| 2. | Audit committee should reviews and approves the terms of the Engagement Letter prepared for the external auditors. |  |  |  |  |  |
| 3. | Audit committee should monitor external audit firm’s compliance with ethical practices. |  |  |  |  |  |
| 4. | Audit committee should review and monitor the response of the management to the external auditor’s findings and management letter. |  |  |  |  |  |
| **H** | **Audit Committee Role in Internal Auditing** | **5** | **4** | **3** | **2** | **1** |
| 1. | Audit committee should recommends and approves the appointment or termination of the Chief internal auditor. |  |  |  |  |  |
| 2. | Audit committee should authorize the internal auditor to carry out investigations into any activities of the company which may be of interest or concern to the committee. |  |  |  |  |  |
| 3. | Audit committee should establish an internal audit function and ensure there are other means of obtaining sufficient assurance of regular review or appraisal of the system of internal control in the company. |  |  |  |  |  |
| 4. | Audit committee should ensure the development of a comprehensive internal control framework for the company. |  |  |  |  |  |
| **I** | **Challenges Confronting audit committee among Quoted Non-financial Companies** |  |  |  |  |  |
| 1. | Lack of experience and expertise in the relevant field constitute  A great challenge to audit committee effectiveness. |  |  |  |  |  |
| 2. | Non - inclusion of majority independent / external members is another factor that constitute challenges to audit committee effectiveness. |  |  |  |  |  |
| 3. | Non – appointment of audit committee chairperson from external/ independent members affects audit committee effectiveness. |  |  |  |  |  |
| 4. | Attitude of audit committee members to meeting affects audit committee effectiveness. |  |  |  |  |  |
| 5. | Lack of diligence on the part of audit committee members constitute a great challenge to audit committee effectiveness. |  |  |  |  |  |
| 6. | The amount of authority delegated to audit committee determine its effectiveness. |  |  |  |  |  |
| 7. | The resources at the disposal of the audit committee go a long way to determine its effectiveness. |  |  |  |  |  |
| 8. | Lack of support from top management affects effectiveness of audit committee. |  |  |  |  |  |
| **J** | **Audit committee Role in Management** | **5** | **4** | **3** | **2** | **1** |
| 1. | The level of support on the part of management go a long way to determine the effectiveness of audit committee. |  |  |  |  |  |
| 2. | Management openness and cooperation is of paramount importance in making audit committee effective |  |  |  |  |  |
| 3. | Management provides audit committee with sufficient information and resources, including secretariat support to carry out its duties. |  |  |  |  |  |
| 4. | Prompt responses from management to audit committee aided the oversight function-n of audit committee. |  |  |  |  |  |

**Thank you once again for your generous cooperation.**

**Appendix II**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | DAC | ACACCEXPT | ACDRMEB | ACMEET | BACCEXP | BIND | BMET | BSIZE | AUD |
| Mean | 5.768439 | 2.038554 | 2.891938 | 3.040210 | 3.137546 | 5.949740 | 4.380000 | 9.234991 | 0.686106 |
| Median | 6.000000 | 2.000000 | 3.000000 | 3.000000 | 3.000000 | 6.000000 | 4.000000 | 9.000000 | 1.000000 |
| Maximum | 7.000000 | 22.00000 | 4.000000 | 6.000000 | 6.000000 | 14.00000 | 9.000000 | 17.00000 | 1.000000 |
| Minimum | 3.000000 | 1.000000 | 1.000000 | 1.000000 | 1.000000 | 2.000000 | 2.000000 | 5.000000 | 0.000000 |
| Std. Dev. | 0.639130 | 1.128660 | 0.342299 | 0.620823 | 1.106794 | 2.168085 | 1.267199 | 2.349529 | 0.464472 |
| Skewness | -2.283081 | 13.39736 | -2.750934 | 0.413274 | 0.114321 | 0.691773 | 1.431583 | 0.691384 | -0.802055 |
| Kurtosis | 7.569044 | 237.1754 | 11.33498 | 5.595509 | 2.485777 | 3.860499 | 5.851869 | 3.340111 | 1.643292 |
|  |  |  |  |  |  |  |  |  |  |
| Jarque-Bera | 1013.594 | 960657.5 | 2422.910 | 176.8397 | 7.099416 | 63.82244 | 374.2492 | 49.25676 | 107.2192 |
| Probability | 0.000000 | 0.000000 | 0.000000 | 0.000000 | 0.028733 | 0.000000 | 0.000000 | 0.000000 | 0.000000 |
|  |  |  |  |  |  |  |  |  |  |
| Sum | 3363.000 | 846.0000 | 1686.000 | 1739.000 | 1688.000 | 3433.000 | 2409.000 | 5384.000 | 400.0000 |
| Sum Sq. Dev. | 237.7393 | 527.3831 | 68.19211 | 220.0752 | 657.8216 | 2707.542 | 881.5800 | 3212.806 | 125.5575 |
|  |  |  |  |  |  |  |  |  |  |
| Observations | 583 | 415 | 583 | 572 | 538 | 577 | 550 | 583 | 583 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Covariance Analysis: Ordinary | | |  |  |  |  |  |  |
| Date: 09/29/17 Time: 09:41 | | |  |  |  |  |  |  |
| Sample: 2005 2015 | |  |  |  |  |  |  |  |
| Included observations: 594 | | |  |  |  |  |  |  |
| Balanced sample (list wise missing value deletion) | | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Correlation | |  |  |  |  |  |  |  |
| t-Statistic | ACACCEXPT | ACDRMEB | ACMEET | BACCEXP | BIND | BMET | BSIZE | AUD |
| ACACCEXPT | 1.000000 |  |  |  |  |  |  |  |
|  | ----- |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| ACDRMEB | 0.039957 | 1.000000 |  |  |  |  |  |  |
|  | 0.443103 | ----- |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| ACMEET | 0.119310 | 0.022917 | 1.000000 |  |  |  |  |  |
|  | 0.021542 | 0.66132 | ----- |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| BACCEXP | 0.060540 | 0.226325 | 0.222909 | 1.000000 |  |  |  |  |
|  | 0.244920 | 0.000002 | 0.000000 | ----- |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| BIND | 0.082259 | 0.135177 | 0.310398 | 0.144734 | 1.000000 |  |  |  |
|  | 0.113712 | 0.009112 | 0.000000 | 0.00520 | ----- |  |  |  |
|  |  |  |  |  |  |  |  |  |
| BMET | 0.088379 | 0.103924 | 0.153190 | 0.250732 | 0.022283 | 1.000000 |  |  |
|  | 0.08940 | 0.04550 | 0.00310 | 0.00000 | 0.000007 | ----- |  |  |
|  |  |  |  |  |  |  |  |  |
| BSIZE | 0.104819 | 0.142487 | 0.213595 | 0.200617 | 0.634962 | 0.011083 | 1.000000 |  |
|  | 0.04360 | 0.00600 | 0.000014 | 0.00010 | 0.00000 | 0.8315 | ----- |  |
|  |  |  |  |  |  |  |  |  |
| AUD | 0.095847 | 0.186595 | 0.288807 | 0.208611 | 0.295008 | 0.093249 | 0.32113 | 1.000000 |
|  | 0.06520 | 0.00301 | 0.000001 | 0.000001 | 0.00000 | 0.0728 | 0.0000 | ----- |
|  |  |  |  |  |  |  |  |  |
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| Panel unit root test: Summary | | | |  |
| Series: ACACCEXPT | | |  |  |
| Date: 09/29/17 Time: 09:57 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -7.43429 | 0.0000 | 22 | 199 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -4.02842 | 0.0000 | 22 | 199 |
| ADF - Fisher Chi-square | 90.9854 | 0.0000 | 22 | 199 |
| PP - Fisher Chi-square | 124.237 | 0.0000 | 21 | 189 |
|  |  |  |  |  |
|  |  |  |  |  |
| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

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| Panel unit root test: Summary | | | |  |
| Series: ACDRMEB | | |  |  |
| Date: 09/29/17 Time: 09:59 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
| Balanced observations for each test | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -8.24442 | 0.0000 | 5 | 50 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -5.36528 | 0.0000 | 5 | 50 |
| ADF - Fisher Chi-square | 41.2309 | 0.0000 | 5 | 50 |
| PP - Fisher Chi-square | 61.2660 | 0.0000 | 5 | 50 |
|  |  |  |  |  |
|  |  |  |  |  |
| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

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| Panel unit root test: Summary | | | |  |
| Series: ACMEET | | |  |  |
| Date: 09/29/17 Time: 10:00 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
| Balanced observations for each test | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -13.7569 | 0.0000 | 17 | 170 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -10.2671 | 0.0000 | 16 | 160 |
| ADF - Fisher Chi-square | 134.634 | 0.0000 | 16 | 160 |
| PP - Fisher Chi-square | 146.720 | 0.0000 | 16 | 160 |
|  |  |  |  |  |
|  |  |  |  |  |
| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

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| Panel unit root test: Summary | | | |  |
| Series: DAC | | |  |  |
| Date: 09/29/17 Time: 10:02 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
| Balanced observations for each test | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -11.1221 | 0.0000 | 10 | 100 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -7.83334 | 0.0000 | 10 | 100 |
| ADF - Fisher Chi-square | 84.4347 | 0.0000 | 10 | 100 |
| PP - Fisher Chi-square | 116.332 | 0.0000 | 10 | 100 |
|  |  |  |  |  |
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| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

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| Panel unit root test: Summary | | | |  |
| Series: AUD | |  |  |  |
| Date: 09/29/17 Time: 10:02 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
| Balanced observations for each test | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -3.80344 | 0.0001 | 6 | 60 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -2.39581 | 0.0083 | 6 | 60 |
| ADF - Fisher Chi-square | 25.5027 | 0.0126 | 6 | 60 |
| PP - Fisher Chi-square | 41.4356 | 0.0000 | 6 | 60 |
|  |  |  |  |  |
|  |  |  |  |  |
| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

**Appendix III**

**PANEL UNIT ROOT TEST SUMMARY**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Panel unit root test: Summary | | | |  |
| Series: BACCEXP | | |  |  |
| Date: 09/29/17 Time: 10:05 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -21.5223 | 0.0000 | 36 | 335 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -13.8335 | 0.0000 | 33 | 311 |
| ADF - Fisher Chi-square | 281.029 | 0.0000 | 33 | 311 |
| PP - Fisher Chi-square | 328.003 | 0.0000 | 33 | 311 |
|  |  |  |  |  |
|  |  |  |  |  |
| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

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| Panel unit root test: Summary | | | |  |
| Series: BIND | | |  |  |
| Date: 09/29/17 Time: 10:08 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -25.1743 | 0.0000 | 38 | 373 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -16.3207 | 0.0000 | 38 | 373 |
| ADF - Fisher Chi-square | 337.004 | 0.0000 | 38 | 373 |
| PP - Fisher Chi-square | 423.028 | 0.0000 | 38 | 373 |
|  |  |  |  |  |
|  |  |  |  |  |
| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

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| Panel unit root test: Summary | | | |  |
| Series: BMET | | |  |  |
| Date: 09/29/17 Time: 10:09 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -17.8962 | 0.0000 | 28 | 276 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -12.6558 | 0.0000 | 26 | 256 |
| ADF - Fisher Chi-square | 218.632 | 0.0000 | 26 | 256 |
| PP - Fisher Chi-square | 295.475 | 0.0000 | 26 | 256 |
|  |  |  |  |  |
|  |  |  |  |  |
| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

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| Panel unit root test: Summary | | | |  |
| Series: BSIZE | | |  |  |
| Date: 09/29/17 Time: 10:10 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
| Balanced observations for each test | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -18.6046 | 0.0000 | 35 | 350 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -13.3708 | 0.0000 | 35 | 350 |
| ADF - Fisher Chi-square | 268.661 | 0.0000 | 35 | 350 |
| PP - Fisher Chi-square | 368.442 | 0.0000 | 35 | 350 |
|  |  |  |  |  |
|  |  |  |  |  |
| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

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| Panel unit root test: Summary | | | |  |
| Series: AUD | |  |  |  |
| Date: 09/29/17 Time: 10:10 | | | |  |
| Sample: 2005 2015 | | |  |  |
| Exogenous variables: Individual effects | | | | |
| User-specified lags: 0 | | |  |  |
| Newey-West automatic bandwidth selection and Bartlett kernel | | | | |
| Balanced observations for each test | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  | Cross- |  |
| Method | Statistic | Prob.\*\* | sections | Obs |
| Null: Unit root (assumes common unit root process) | | | | |
| Levin, Lin & Chu t\* | -3.80344 | 0.0001 | 6 | 60 |
|  |  |  |  |  |
| Null: Unit root (assumes individual unit root process) | | | | |
| Im, Pesaran and Shin W-stat | -2.39581 | 0.0083 | 6 | 60 |
| ADF - Fisher Chi-square | 25.5027 | 0.0126 | 6 | 60 |
| PP - Fisher Chi-square | 41.4356 | 0.0000 | 6 | 60 |
|  |  |  |  |  |
|  |  |  |  |  |
| \*\* Probabilities for Fisher tests are computed using an asymptotic Chi | | | | |
| -square distribution. All other tests assume asymptotic normality. | | | | |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Redundant Fixed Effects Tests | | |  |  |
| Equation: Untitled | | |  |  |
| Test cross-section fixed effects | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Effects Test | | Statistic | d.f. | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| Cross-section F | | 24.804937 | (44,317) | 0.0000 |
| Cross-section Chi-square | | 551.788416 | 44 | 0.0000 |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Cross-section fixed effects test equation: | | | |  |
| Dependent Variable: DAC | | |  |  |
| Method: Panel Least Squares | | |  |  |
| Date: 09/29/17 Time: 10:21 | | |  |  |
| Sample: 2005 2015 | | |  |  |
| Periods included: 11 | | |  |  |
| Cross-sections included: 54 | | |  |  |
| Total panel (unbalanced) observations: 594 | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| ACACCEXPT | 0.001106 | 0.013432 | 0.082339 | 0.9344 |
| ACDRMEB | 1.596668 | 0.047304 | 33.75324 | 0.0000 |
| ACMEET | -0.017320 | 0.026637 | -0.650227 | 0.5160 |
| BACCEXP | 0.012430 | 0.016016 | 0.776120 | 0.4382 |
| BIND | 0.012796 | 0.011782 | 1.086082 | 0.2782 |
| BMET | 0.027259 | 0.012525 | 2.176323 | 0.0302 |
| BSIZE | 0.023257 | 0.011205 | 2.075543 | 0.0386 |
| AUD | -0.010337 | 0.037672 | -0.274397 | 0.7839 |
| C | 0.755030 | 0.163454 | 4.619210 | 0.0000 |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.788531 | Mean dependent var | | 5.781081 |
| Adjusted R-squared | 0.783844 | S.D. dependent var | | 0.648675 |
| S.E. of regression | 0.301585 | Akaike info criterion | | 0.464497 |
| Sum squared resid | 32.83432 | Schwarz criterion | | 0.559690 |
| Log likelihood | -76.93197 | Hannan-Quinn criter. | | 0.502309 |
| F-statistic | 168.2629 | Durbin-Watson stat | | 0.850508 |
| Prob(F-statistic) | 0.000000 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 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 | | 24.938262 | 8 | 0.0016 |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Cross-section random effects test comparisons: | | | | |
|  |  |  |  |  |
| Variable | Fixed | Random | Var(Diff.) | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| ACACCEXPT | 0.019145 | 0.018578 | 0.000001 | 0.4574 |
| ACDRMEB | 1.233227 | 1.289671 | 0.000330 | 0.0019 |
| ACMEET | 0.000268 | -0.001688 | 0.000036 | 0.7439 |
| BACCEXP | 0.010070 | 0.012217 | 0.000027 | 0.6781 |
| BIND | -0.007050 | -0.005548 | 0.000008 | 0.5862 |
| BMET | 0.098040 | 0.093885 | 0.000016 | 0.2921 |
| BSIZE | 0.041871 | 0.042271 | 0.000027 | 0.9390 |
| AUD | -0.164314 | -0.126302 | 0.000497 | 0.0881 |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Cross-section random effects test equation: | | | |  |
| Dependent Variable: DAC | | |  |  |
| Method: Panel Least Squares | | |  |  |
| Date: 09/29/17 Time: 10:29 | | |  |  |
| Sample: 2005 2015 | | |  |  |
| Periods included: 11 | | |  |  |
| Cross-sections included: 54 | | |  |  |
| Total panel (unbalanced) observations: 584 | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| C | 1.462246 | 0.191403 | 7.639630 | 0.0000 |
| ACACCEXPT | 0.019145 | 0.007398 | 2.588016 | 0.0101 |
| ACDRMEB | 1.233227 | 0.048802 | 25.26990 | 0.0000 |
| ACMEET | 0.000268 | 0.021242 | 0.012619 | 0.9899 |
| BACCEXP | 0.010070 | 0.014831 | 0.678990 | 0.4976 |
| BIND | -0.007050 | 0.009815 | -0.718323 | 0.4731 |
| BMET | 0.098040 | 0.011626 | 8.432648 | 0.0000 |
| BSIZE | 0.041871 | 0.012107 | 3.458558 | 0.0006 |
| AUD | -0.164314 | 0.048593 | -3.381434 | 0.0008 |
|  |  |  |  |  |
|  |  |  |  |  |
|  | Effects Specification | |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Cross-section fixed (dummy variables) | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.952403 | Mean dependent var | | 5.781081 |
| Adjusted R-squared | 0.944596 | S.D. dependent var | | 0.648675 |
| S.E. of regression | 0.152686 | Akaike info criterion | | -0.788985 |
| Sum squared resid | 7.390197 | Schwarz criterion | | -0.228402 |
| Log likelihood | 198.9622 | Hannan-Quinn criter. | | -0.566317 |
| F-statistic | 121.9836 | Durbin-Watson stat | | 2.584216 |
| Prob(F-statistic) | 0.000000 |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Dependent Variable: DAC | | |  |  |
| Method: Panel Least Squares | | |  |  |
| Date: 09/29/17 Time: 09:48 | | |  |  |
| Sample: 2005 2015 | | |  |  |
| Periods included: 11 | | |  |  |
| Cross-sections included: 54 | | |  |  |
| Total panel (unbalanced) observations: 589 | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| ACACCEXPT | 0.021630 | 0.001773 | 1.219710 | 0.2235 |
| ACDRMEB | 1.11654 | 0.045388 | 24.5995 | 0.0000 |
| ACMEET | -0.08688 | 0.036605 | -2.37339 | 0.0181 |
| BACCEXP | 0.038485 | 0.022513 | 1.709479 | 0.0881 |
| BIND | 0.045850 | 0.055331 | 2.962781 | 0.0032 |
| BMET | 0.059007 | 0.018069 | 3.265611 | 0.0012 |
| BSIZE | 0.007778 | 0.014370 | 0.541254 | 0.5886 |
| AUD | 0.16087 | 0.046849 | 3.433782 | 0.0007 |
| C | 1.962936 | 0.169635 | 11.57153 | 0.0000 |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.650139 | Mean dependent var | | 5.710177 |
| Adjusted R-squared | 0.643312 | S.D. dependent var | | 0.684049 |
| S.E. of regression | 0.408435 | Akaike info criterion | | 1.066741 |
| Sum squared resid | 73.90078 | Schwarz criterion | | 1.148651 |
| Log likelihood | -232.0835 | Hannan-Quinn criter. | | 1.099019 |
| F-statistic | 95.23654 | Durbin-Watson stat | | 0.421741 |
| Prob(F-statistic) | 0.000000 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Dependent Variable: DAC | | |  |  |
| Method: Panel Least Squares | | |  |  |
| Date: 09/29/17 Time: 08:57 | | |  |  |
| Sample: 2005 2015 | | |  |  |
| Periods included: 11 | | |  |  |
| Cross-sections included: 54 | | |  |  |
| Total panel (unbalanced) observations: 583 | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| ACACCEXPT | 0.015952 | 0.007177 | 2.222510 | 0.0269 |
| ACDRMEB | 1.308417 | 0.050620 | 25.84755 | 0.0000 |
| ACMEET | 0.016232 | 0.022270 | 0.728841 | 0.4666 |
| BACCEXP | 0.018384 | 0.015573 | 1.180488 | 0.2386 |
| BIND | -0.02423 | 0.010443 | -2.320087 | 0.0209 |
| BMET | 0.091574 | 0.012542 | 7.301439 | 0.0000 |
| BSIZE | 0.001855 | 0.012007 | 0.154492 | 0.8773 |
| AUD | -0.04539 | 0.050514 | -0.89856 | 0.3695 |
| C | 0.676187 | 0.200702 | 3.369110 | 0.0008 |
|  |  |  |  |  |
|  |  |  |  |  |
|  | Effects Specification | |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Cross-section fixed (dummy variables) | | | |  |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.958296 | Mean dependent var | | 5.781081 |
| Adjusted R-squared | 0.951844 | S.D. dependent var | | 0.648675 |
| S.E. of regression | 0.177320 | Akaike info criterion | | -0.483132 |
| Sum squared resid | 9.872881 | Schwarz criterion | | 0.109182 |
| Log likelihood | 145.3793 | Hannan-Quinn criter. | | -0.247859 |
| F-statistic | 148.5385 | Durbin-Watson stat | | 2.303841 |
| Prob(F-statistic) | 0.000000 |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Dependent Variable: DAC | | |  |  |
| Method: Panel EGLS (Cross-section random effects) | | | | |
| Date: 09/29/17 Time: 10:26 | | |  |  |
| Sample: 2005 2015 | | |  |  |
| Periods included: 11 | | |  |  |
| Cross-sections included: 54 | | |  |  |
| Total panel (unbalanced) observations: 574 | | | |  |
| Swamy and Arora estimator of component variances | | | | |
|  |  |  |  |  |
|  |  |  |  |  |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|  |  |  |  |  |
|  |  |  |  |  |
| ACACCEXPT | 0.016242 | 0.007159 | 2.268558 | 0.0238 |
| ACDRMEB | 1.296597 | 0.047765 | 27.14495 | 0.0000 |
| ACMEET | 0.017107 | 0.021697 | 0.788441 | 0.4309 |
| BACCEXP | 0.024414 | 0.014964 | 1.631508 | 0.1036 |
| BIND | -0.02034 | 0.010154 | -2.00296 | 0.0458 |
| BMET | 0.091417 | 0.012139 | 7.530626 | 0.0000 |
| BSIZE | 0.008226 | 0.011286 | 0.728857 | 0.4665 |
| AUD | -0.03283 | 0.047333 | -0.69359 | 0.4883 |
| C | 1.279351 | 0.175046 | 7.308668 | 0.0000 |
|  |  |  |  |  |
|  |  |  |  |  |
|  | Effects Specification | |  |  |
|  |  |  | S.D. | Rho |
|  |  |  |  |  |
|  |  |  |  |  |
| Cross-section random | | | 0.255180 | 0.7364 |
| Idiosyncratic random | | | 0.152686 | 0.2636 |
|  |  |  |  |  |
|  |  |  |  |  |
|  | Weighted Statistics | |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.67643 | Mean dependent var | | 1.157381 |
| Adjusted R-squared | 0.670116 | S.D. dependent var | | 0.359222 |
| S.E. of regression | 0.159878 | Sum squared resid | | 9.227488 |
| F-statistic | 107.1392 | Durbin-Watson stat | | 2.355615 |
| Prob(F-statistic) | 0.000000 |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  | Unweighted Statistics | |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
| R-squared | 0.736517 | Mean dependent var | | 5.781081 |
| Sum squared resid | 40.91029 | Durbin-Watson stat | | 0.474736 |
|  |  |  |  |  |
|  |  |  |  |  |

**APPENDIX IV**

**List of Sampled Quoted companies**

S/N COMPANY

1 7UP BOTTLING COMPANY PLC

2 ACADEMY PRESS PLC.

3 AFROMEDIA PLC.

4 AG LEVENTIS NIGERIA PLC.

5 AIRLINE SERVICES & LOGISTICS PLC.

6 ASHAKA CEMENT PLC.

7 AVON CROWN CAPS PLC.

8 BENUE CEMENT COMPANY PLC.

9 BERGER PAINTS PLC.

10 BETA GLASS CO PLC

11 CAP PLC

12 CAPITAL HOTEL PLC.

13 CHAMS PLC

14 CHELLARAMS PLC.

15 DANGOTE FLOUR MILL PLC.

16 DANGOTE SUGAR REFINERY PLC.

17 DUNLOP NIG PLC.

18 EKOCORP PLC.

19 FIRST ALLUMINIUM PLC.

20 FLOUR MILL OF NIGERIA PLC

21 FRIESLAND CAMPINA PLC.

22 GSK PLC.

23 GUINNESS PLC

24 HONEYWELLPLC.

25 JULIUS BERGER NIG PLC.

26 LAFARGE PLC.

27 LEASING PLC.

28 LIVESTOCK FEEDS PLC.

29 MAY & BAKER PLC.

30 MEYER PAINT PLC.

31 MOBIL OIL NIGERIA PLC.

32 MORRISONS PLC.

33 NEIMETH PLC.

34 NESTLE PLC.

35 NGC PLC.

36 NIGERIAN BREWERIES PLC PLC.

37 NORTHERN NIG FLOUR MILL PLC.

38 OANDO PLC.

39 OKITIPUPA OIL PLC.

40 OKOMU OIL PLC.

41 PAINTS AND COATING PLC.

42 PRESCO PLC.

43 PZ CUSSONS PLC.

44 R.T BRISCOE PLC.

45 RED STAR EXPRESS PLC.

46 ROYAL EXCHANGE PLC.

47 STARCOMS PLC.

48 THOMAS WYATT NIG PLC.

49 TOTAL NIGERIA PLC.

50 UAC OF NIG PLC.

51 UNILEVER PLC.

52 UNION DICON SALT PLC.

53 VITAFOAM PLC.

54 VONO PLC.