# THE EFFECT OF AUDIT COMMITTEE ATTRIBUTES AND AUDIT QUALITY ON THE FINANCIAL PERFORMANCE OF BANKS IN NIGERIA

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# ABSTRACT

The topic of corporate governance and financial performance has always been an essential and critical component for the Nigerian banking industry. Good corporate governance practices are considered important in mitigating risk for investors, improving investment capital and performance. This study examined the effects of audit committee attributes and audit quality on the financial performance of banks in Nigeria. The research used secondary data obtained from the Data Stream and annual reports of all banks in Nigeria for the year 2018-2020 with 66 firm-years observations. In addition, the regression was based on Panel Corrected Standard Error. The result showed that the audit committee size has a negative and significant association with bank financial performance. However, audit committee independence and audit quality exhibited significant and positive association with banks performance. This study provided suggestions for future research work and several recommendations for regulators and the Iraqi banking industry.

**Keywords:** audit committee size, audit committee independence, audit quality, financial performance, Nigeria.

# ABSTRAK

Topik berkenaan tadbir urus korporat dan prestasi kewangan merupakan komponen penting dan kritikal dalam industri perbankan Nigeria. Tadbir urus korporat yang baik adalah penting untuk mengurangkan risiko para pelabur, meningkatkan modal pelaburan serta prestasi. Kajian ini akan mengkaji kesan atribut jawatankuasa audit dan kualiti audit terhadap prestasi kewangan perbankan di Nigeria. Data sekunder yang diperoleh daripada aliran data dan laporan tahunan perbankan di Nigeria untuk tahun 2018 hingga 2020 dengan 66 tahun pemerhatian firma digunakan dalam kajian ini. Keputusan regrasi adalah berdasarkan Panel Piawaian Pembetulan Ralat. Hasil kajian menunjukkan saiz jawatankuasa audit mempunyai hubungan yang negatif dan signifikan dengan prestasi kewangan bank. Walau bagaimanapun, autonomi jawatankuasa audit dan kualiti audit menunjukkan hubungan yang positif dan signifikan dengan prestasi bank. Kajian ini juga memperuntukkan beberapa cadangan penyelidikan masa akan datang untuk di guna pakai oleh pengawal selia dan industri perbankan di Nigeria.

**Kata kunci:** saiz jawatankuasa audit, autonomi jawatankuasa audit, kualiti audit, prestasi kewangan, Nigeria.

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# LIST OF ABBREVIATIONS

| Abbreviation | Description of Abbreviation |
|---|---|
| ACSIZE | Audit Committee Size |
| ACIND | Audit Committee Independence |
| AQ | Audit Quality |
| CBN | Central Bank of Nigeria |
| CG | corporate Governance |
| BAGE | Bank Age |
| BOD | Board of Directors |
| FSIZE | Firm Size |
| LEV | Leverage |
| VIF | Variance Inflation Factor |

# CHAPTER ONE

# INTRODUCTION

## 1.1 Introduction

The banking industry is the pillar of any nation's economic growth because it affects the quantum of the money stock through its capability to generate deposits and liabilities. The financial system has been recognized as playing an important role in economic development (Gafoor, Mariappan and Thyagarajan, 2018). Thus, the inability of this department of government will affect the overall economy of any country. The financial crisis in Nigeria's economy and banking industry was blamed to the misapplication of the corporate governance (CG) laws (Abu, Okpeh, & Okpe, 2016). There have been many failures in the banking industry such as the Bank of Savannah, Societe Generale, Alpha Commercial Bank (in Nigeria), Kenya Trust Bank, Union Bank of Kenya, Capital Finance Co., Ltd. and Continental Bank of Kenya Co Ltd (Njoku, 2019). Given that these events have shaken the bank's efforts to comply with various merger procedures and the experience of a few stakehoders (banks) in the system, there is concern that the bank's CG needs to be strengthened. Hence, it is very important to put in place efficient CG laws in banks so that the banking system operates effectively and increases public confidence (Fernandes, Farinha, Martins and Mateus, 2017). The term CG refers to the norms, framework, and governance that a business or organisation commits to with its shareholders, lenders, employees, consumers, suppliers, and national governments (Tricker & Tricker, 2015).

The Basel Committee on Banking Supervision (BCBS) highlights the vitality of good CG practices in financial institutions to foster investor confidence and trust. Corporate governance's purpose is to safeguard shareholders from managers' opportunistic actions (Tran, Do, & Nguyen, 2020). CG, on the other hand, denotes to the procedures organizations' managed their affairs (Ujunwa, 2012). In regulating the institution, good CG principles promote transparency, fairness, accountability, and responsibility. Best corporate governance practice could result to higher firm performance (Orazalin, Mahmood, & Lee, 2016).

Nigeria is one of the world's leading oil producers as a developing country (Okougbo & Okike, 2015). Before 1952, Nigeria had no legislation regulating the banking industry. In 1892, the West African British Bank, began to operate in Nigeria. In 1917, Barclays Bank now (First Bank of Nigeria) became the second foreign bank to conduct business in Nigeria after BBWA. With the passage of the Banking Regulations in 1952, the Nigerian government began to supervise the banking industry. In the 1960s and 1970s, new financial institutions arose, and the Nigerian government took a more active role in regulating and owning banks. Until 1979, the banking industry in Nigeria was controlled by state-owned banks or banks mostly owned by the federal government. Private banks began to reappear in Nigeria after 1979.



The failure of the majority of these local banks prompted the lender of last resort, the central bank, to seek assistance in rescuing them. CBN began operations on July 1, 1959, and issued its first batch of Treasury notes in April 1960. The Lagos Bankers Clearing House was formed by the Central Bank in May 1961 to provide regulated banks with a framework for the seamless exchange and clearing of checks. The authorization of the CBN originated in the Parliamentary Act of 1958 and was amended in 1991, 1993, 1997, 1998, 1999 and 2007. Therefore, the bank is responsible for implementing the revised Banking and Other Financial Institutions Act (BOFI) (1991), and its main objective of guaranteeing excellent pedigree of banking and monetary solidity via its supervisory actions, and promoting well-organized payment systems.

The Securities and Exchange Commission Code of Corporate Governance (SEC, CCG), the Financial Reporting Council of Nigeria (FRCN), the Central Bank of Nigeria Code of Corporate Governance (CBN, CCG), and the National Insurance Commission Code of Corporate Governance (NIC, CCG). All of these bodies were established in Nigeria to oversee the preparation and reporting of financial data by public enterprises.

The Nigerian Company and Allied Matters Act (CAMA) 1990, as revised in 2004, requires public firms to create an audit committee under Section 359(3), (4), and (6). As a result, firms form ACs to strengthen accounting and reporting rules and guarantee that they comply with legal obligations and agreed-upon ethical norms, FRCN Act, 2011. The AC is in charge of guaranteeing the financial statements' integrity, confirming compliance with regulatory and legal requirements, assessing the individuality and credentials of outside auditors, and ensuring that the entity's internal and external audits are functioning properly (Nigerian GC SEC code, 2011).



Both locally and internationally, the concept of CG has piqued people's curiosity. According to recent research, organisations with effective governance procedures outperform companies with worse governance in a variety of ways, including enhancing the company's worth in emerging countries and contemporary monetary pools (Ghabayen, 2012). The audit committee (AC), audit quality, and the composition of a company's BOD, such as BOI, board size, transparency, accountability, and accountability, are all subjects covered in research on global corporate governance. CG is still a trendy topic that many scholars in numerous fields of knowledge are interested in.

The AC and external auditors are important parts of these CG processes. As a result, the audit committee is a useful CG oversight instrument that serves as a check on management discretion. Although the BOD can act as the general supervisor of management activities, the audit committee is clearly responsible for supervising financial reports (Krishnan, Wen & Zhao, 2011). Therefore, the audit committee is anticipated to emphasis primarily on the consequences of poor or erroneous financial reporting, including litigation and SEC actions (Krishnan et al., 2011). Therefore, the agency theory believes that the key function of the AC is to authorize that the agent acts in the best interest of the stakeholders.

Another significant governance and monitoring method for improving the reliability of financial data is the audit quality (DeFond & Zhang, 2014H). External auditors also play a vital role in CG as a supplement to the legal protection provided to external shareholders (Huang, 2006). This is because they help reduce principal-agent conflicts by ensuring financial reports are produced promptly without major errors and reducing the possibility of financial fraud. Better audit quality, according to previous studies, provides greater trust regarding the veracity of financial reports, which improves investor protection (Alves, 2013). As a result, audit quality has been regarded as another crucial governance and monitoring method that improves the financial information's credibility (DeFond & Zhang, 2014).



## 1.2 Problem Statement

Unwarranted risk taking, insufficient loan selection management, and one-sided credit administration are all consequences of poor management and internal control in Nigeria. The banks in Nigeria do not assess the credit and risk and classified based on the degree of risk, rather they still depend on the classification which is unscrupulous for granting loans (Agwu, 2014). The competing problems of the failed banks in Nigeria have remained in that they shared one thing in common. The management of the banks in Nigeria had been issuing non-performing and unsecured loans (Adebisi & Matthew 2015).

Furthermore, according to Uzoma (2015), Nigeria's recent financial distress has been linked to governance malfeasance within combined institutions, as a result, for large segments of the industry, it has become a way of life. He also noted that CG has failed at some banks because of executive misinformation, participation in the acquisition of unsafe mortgages at the expense of creditors, and a lack of experience in enforcing proper CG practises managing the affairs of banks.

Similarly, the competing problems of the failed banks have remained in that they shared one thing in common. The management of the banks had been issuing non-performing and unsecured loans which led the Central Bank of Nigeria (CBN) to inject N620 billion equivalent to (4.1 billion US Dollars) as a bailout (Kuye, Ogundele & Obaro, 2013). However, the CBN certified the banks as distressed just a few months after the auditors had certified their health (Okaro & Okafor, 2015H). Most recently were the financial scandals relating to concealment and accounting manipulations by the Stanbic IBTC Holdings Plc in 2015 (Marshall, 2015). The foregoing issues have led to hesitation among stockholders on the trustworthiness and dependability of monetary information in Nigeria (Okaro & Okafor, 2015). In view of the above, Nigeria has formulated various laws and regulations to regulate, preserve and clean the financial system and improve financial reporting practices.

However, to address fundamental deficiencies in the quest to mitigate the risk of failure in the Nigerian financial sector, the CBN has in 2005 requires all commercial banks to have a minimum capitalization base of $193.8m (N25b) in order to continue operating. Other measures taken by CBN from 2005 to date include; establishment of the financial stability committee, the establishment of the Asset Management Corporation of Nigeria (AMCON), review of supervisory procedures and methodology, renewed collaboration with other regulators, adoption of a common year-end for banks, and revision of corporate governance that include risk management framework and its reporting among others (CBN, 2010).

The FRCN issued another regulatory order in 2015, suspending the Chairman and CEO of Skye Bank, Oceanic Bank, and Intercontinental Bank for allegations of concealment, accounting manipulations, and insufficient disclosures in financial reports, all of which are in violation of Section 62 of the FRC. The FRC has suspended the audit company (KPMG) for its approach, which failed to uncover the violations in the two accounting periods (Odunsi, 2015). This cast doubt on the financial statement's integrity and called into question the auditors' impartiality.

An efficient audit committee and a quality audit should be developed to successfully supervise and oversee management actions to assure good CG. Shareholders and other stakeholders will trust companies with good CG practices (Sarbah, & Xiao, 2015). The AC's principal role, according to the agency theory, is to guarantee that administrators do the best for stockholders. Furthermore, external auditors play an important function in CG as a supplement to the legal protection of external shareholders (Aguilera, Desender, Bednar, & Lee, 2015). This can be utilised instead of monitoring, and it can help enhance financial reporting and investor trust in the company's record.

In addition to the statutory functions of the AC, the SEC Code (2011) states that the AC is expected to assist in the oversight of the integration of the entity's financial requirements. Furthermore, it ensures the progress of a comprehensive internal control outline for the firm and obtains assurance and reports on the effectiveness of the entity's internal control system on a yearly basis in the financial report. At least once a year, the committee is mandated to revisit and evaluate an internal auditor's report explaining the quality and strength of the internal controls, as well as any issues or authorizations for improvements raised as a result of the firm's most recent internal control assessment (SEC Code, 2011).

In addition, the number, time, and length of meetings must be sufficient to ensure that the committee achieves its objectives. It should be noted that the norms also recommend that AC members have a basic understanding of finance. In addition, at least one member of AC must have accounting or financial management experience. In addition, Section 359 (4) of CAMA (2004) requires that AC be composed of equal representatives of directors and shareholders. This uniqueness of the AC organization in Nigeria makes the committee more flexible, as either directors or shareholders can chair the committee. It has been argued that the presence of shareholders in AC can undermine their independence in the decision-making process and thus their ability to supervise (Ahmed, 2017).

Consequently, the existing study proposes to shore up the gap by looking into the joint effect of AC attributes (size and independence), and audit quality on the FP of banks in Nigeria. Therefore, serves as evidence for further research in this area to use the empirical finding and discuss its implication from the Nigerian banks' perspective.

### 1.3 Research Questions

This research proposes to respond to the subsequent research questions based on the discussion of the problem statement above:

1.What is the relationship between Audit Committee size and Nigerian bank performance?

2. What is the relationship between Audit Committee independence and Nigerian bank performance?

3. What is the relationship between audit quality and Nigerian bank performance?

## 1.4 Research Objectives

The primary aim of this research is to investigate the impact of audit committee attributes and audit quality on the FP of banks in Nigeria.

the following objectives are the specific objectives.

1. To investigate the relationship between Audit Committee size and Nigerian bank performance.

2. To investigate the relationship between Audit Committee independence and Nigerian bank performance.

3. To investigate the relationship between audit quality and Nigerian bank performance.

## 1.5 Significance of the Study



The current research adds to the present corpus of knowledge on AC attributes (size and independence) and audit quality on FP, especially in Nigeria. This research will suggest valuable insight for regulators concerning the need to put into action a good corporate governance structure that will serve as a guide for stakeholders of banks under consideration. The conclusions of this research are expected to be beneficial to the practitioners (auditors and forensic accountants), and BOD who are in charge for promoting the oversight of companies. Thus, improving performance. The research will also act as a manual for current and possible depositors, and monetary predictors who are the primary users of monetary statements. The research findings will help shareholders comprehend the implication of each element in improving the trustworthiness and reliability of financial disclosure, which will boost the trust of both potential and current investors.

Therefore, this research is anticipated to be useful for regulators, investors, and policy makers, especially given the current arguments in previous research regarding the controversial ceremonial and symbolic function of the audit committee rather than the expected effective supervision ((Wu, Hsu, & Haslam, 2015; Cohen, Gaynor, Krishnamoorthy & Wright, 2007).

### 1.6. Scope of the Study

From 2018 through 2020, this research will focus on 22 banks listed on the NSE. The motive for selecting this segment is that the banking sector of any economy is viewed as critical in the development process because it accelerates the pace of a country's sustainability and economic progress. ACS and independence are two traits that fall under the scope of AC attributes. Concerning company financial performance, the focus of this research will be on return on assets (ROA), which will be used to predict the FP of listed banks in Nigeria.

### 1.7 Summary of the Chapter

This chapter highlighted the overall picture of the study's work. The background explains the banks scandals and corporate failure in the Nigerian banking sector and shows the importance of good and reliable supervision of corporate governance. The chapter explains the problem statement, the main objective and research questions, scope as well as the significance of the study to be able to proffer solution to the existing problems as raised in the problems statement.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1. Introduction

This chapter reviews the existing literature on audit committee attributes (size and independence) and the impact of audit quality on performance. It includes a detailed explanation of CG. The notion of CG in Nigeria, CG development in Nigeria, CG regulation in Nigeria, the CBN, the concept of financial performance, and finally, the theoretical framework of the study was identified and explored in this section.

## 2.2. The of Corporate Governance (CG)

CG is one-of-a-kind and multifaceted, and its meaning varies based on the setting and cultural climate of the country in question (Tariq and Abbas, 2013). Various scholars and practitioners define CG. Mayer (1999) defined CG as the method, information, and structure utilised to oversee and control an organization's and management's operations. Coleman and Nicholas Biekpe (2006), on the other hand, described CG as the relationship between shareholders and the corporation, or the company's overall relationship with society. OECD defines CG as a system that directs and supervises business. The power system explains the rules and regulations for making corporate-related decisions, as well as the allocation of rights and obligations among the organization's various members (such as shareholders, managers, and other interested parties).

CG is one of the main elements that predicts the financial strength of an organization and the capability to resist economic crises. Some key elements include the accuracy and reliability of financial information systems, good CG regulations, and supervision (Shleifer and Vishny

1997). Therefore, the foundation of CG is that the management of the organization ensures that they receive compensation for the services they provide in the organization (Voeller, Bremert, & Zein, 2013). CG can help investors and managers align their interests and ensure that companies operate in their best interests. Effective CG promotes the well-organized utilisation of funds both inside the organisation and across the economy. It also aids in the attraction of lower-cost venture capital by boosting national and international investor confidence (Rehmans & Mangla, 2010).

The organisation of the BOD, the board's tasks, remuneration, the functions of institutional directors' services, the ownership of directors, financial reporting, and the accountability of members of the BOD are all topics covered in CG. and the formalisation of auditing functions (Rashid, 2020; Gutiérrez and Surroca, 2014). Company management, auditors, BOD, shareholders, and other shareholders are all involved in CG. These associations contain laws and incentive mechanisms, which in turn provide a structure for establishing company goals and objectives, as well as the means to determine the realization of these goals and observe performance. Therefore, this is the most significant aspect of good CG (Pandya, 2011). The goal of establishing a CG mechanism is to increase transparency and increase the credibility of financial performance, because it provides good quality to ensure the financial reporting process. (Puspitaningrum and Atmini, 2012).



### 2.3 Corporate Governance (CG) Development in Nigeria

In Nigeria, because of persistent distress in the banking industry, inadequate supervision by authorities, carelessness amongst the directors and managers, and poor performance led to the issue of first Code of CG for banks and non-banks financial institutions in the 4th quarter of 2003 by the Bankers' Committee (Demaki, 2013). Nevertheless, the NCCG is surrounded by less impact and weaknesses, as the group of Banks' Chief Executive Officers (CEOs) issued it. To enhance CG in Nigeria, the CAC through the SEC issued Best Practice Guides (CBP) on CG for listed or listed companies in 2003 (Adelegan, 2009; Afolabi, 2015).

Moreover, at the end of 2003, the banking industry in Nigerian was in distress due to poor corporate governance practice that results from weak internal control systems, poor performance, overrule of internal control measures, override of authority limit, excessive risk taking, and absence of risk management processes. This is consistent with the 2004 report from the SEC, which stated that Nigerian corporate governance practices are inefficiently, because less than 50% of publicly traded companies in Nigeria observe with corporate governance practices (Mmadu, 2013). This led to the merger of the banks in 2005, which required banks to possess a lowest capital base of N25b (US $ 187.5 million), reducing Nigerian banks from 89 to 24. In this regard, The CBN gave a new code of CG for banks and non-banks financial institutions in 2006.



As mentioned above, it is widely believed that poor CG has led to the let-downs of Nigerian companies. In order to improve CG, the SEC established a national committee led by Mr. Mahmoud, M. B. in September 2008 to review the 2003 CGguidelines for listed companies. The committee was allowed to identify deficiencies and limitations in the 2003 Code, and identify ways to improve, promote greater compliance, and link the Code to international best practices. At its 43rd meeting, the SEC offered amendments based on what the committee had submitted to them and issue a new Code (Ofo, 2011). The new 2011 code highlights areas that were not fully articulated in the previous 2003 code.

The CBN issued a new Code of Best Practice for CG Codes for Banks and Non-Bank Financial Institutions in 2014. The new code set new rules and regulations for all aspects of CG and is expected to strengthen CG for financial institutions, especially in the area of board structure (compensation of non-executive directors, compensation policy for directors, chairmen and names of members of each committee, etc.) and risk management, compliance and reporting practices (same as NCCG, 2011) (CBN, 2006 and 2014). However, the 2011 code was also termed by poor compliance by the listed companies since the code was voluntary and does not prescribe any sanction or penalties for non-compliance. in order to ensure full compliance and advance the superiority of monetary information, the NSEC updated the regulations of the 2011 code from a voluntary code to a mandatory code in 2014 and made it applicable to all listed companies on the NSE. The upgrade upheld the provision of 2011 code. The code recommends that listed companies include a information on submission with the code in their financial statements.



### 2.4 CG Regulation in Nigeria

In Nigeria, the law governing company affairs is called the (CAMA) Act as amended in 2004. The introduction of CAMA aims to improve the quality of financial statement disclosure and protect the interests of all relevant parties. CAMA is an act made by the CAC, which is responsible for registering companies in Nigeria. The 1990 CAMA has a number of agreements or articles that define rules for sound corporate governance, including shareholder rights, board of director roles and rights, board qualities and composition, and organisational capacities.

Another regulatory body in Nigeria is the CAC, which is in charge of registering businesses and establishing guidelines to improve their operations. The Investment and Securities Act (ISA 1999) is a Nigerian law that permits the SEC to oversee the activity of all corporations registered in the nation. The corporate governance principles of publicly traded firms are among these organisations' accomplishments in corporate governance (2003, 2011, 2014 and 2018). Since 2018, the NSE and the CBN have been in charge of and enforcing corporate governance. Another endeavour to increase the efficacy of CG is Nigeria's recent adjustment to IFRS.

Furthermore, the Financial Reporting Council (FRCN) is a chartered institution established in Nigeria in accordance with the law, responsible for issuing authoritative statements, guiding accountants in preparing and presenting financial reports. FRCN has established standards that uniformly apply various methods to accounting data. Its predecessor was the NASB established in 1982. However, the NASB is inadequate to meet the challenges faced by financial reporting practices. Therefore, FRCN was established in 2011 to abolish NASB. FRCN is responsible for promulgating and issuing accounting standards in Nigeria. FRCN is also in charge of executing the International Accounting Standards Board's (IASB) IFRS (IASB). The FRCN has set January 1, 2012, as the actual date of meeting between NAS and IFRS.



**2.5 The Central Bank of Nigeria (CBN)**

The CBN is the highest in charge of the monetary system. It was established in 1958 by the CBN Act. The CBN Act of 1958 (as modified) and the Banking Act of 1969 (as amended) provide the legislative foundation for the central bank's functioning and supervision of banks. The Banking Decree of 1969, which enlarged the CBN's authority to oversee and control other financial institutions, was revoked in 1991 by the Banks and Other Financial Institutions Decrees (BOFID) 24 and 25. The bank's principal responsibilities include promoting currency constancy and ensuring a strong monetary system, as well as serving as a financial advisor to the establishment. The CBN's regulatory focus is on deposit money banks (DMBs), as well as bureaux de change, main mortgage institutions, microfinance institutions, discount houses, development finance institutions, and finance firms (CBN, 2010).

The supervisory function of CBN consists of four (4) different departments, namely, the Department of Financial Policy and Supervision, (FPS) the Department of Banking Supervision, (DBS) Other Financial Institutions Supervision Department, and the Department of Consumer Protection. CBN, 2016). The FPS department is in charge of developing and enforcing rules and regulations that aim to improve the financial system's stability. Banks and other financial entities are also granted licences and permissions by the government. Nonetheless, the Banking Supervision Department is in charge of Deposit Money Banks (DMBs) and Discount Houses, while DBS is in charge of other financial organisations. The Consumer Protection Department creates and implements a strong customer protection framework that boosts consumer trust in the Nigerian financial system.

## 2.6 Financial Performance

The concept of FP has been a central idea of a debate in both literature and practice. This is because it is an essential situation for the endurance and development of an association. However, Kakanda, Bello, and Abba (2016) view FP as a process of effectively managing the limited resources available to the organization to achieve predetermined goals. In addition, company performance is the increase in the wealth of a shareholder from the beginning of one period to the end of another period (Berger and Patti, 2002).

Neely, Gregory, and Platts (1995) discuss that performance is measured based on assessing and quantifying the competence and efficacy of management in liquidating their defined responsibilities. Berger and Patti (2002) explain that the FP of a firm can be resolute using ratios resulting from financial reports, which are largely a declaration of monetary state and declaration of complete revenue, or the use of stock prices data on the capital market. Firm performance and its measurement are most required by organizations to assess the effectiveness and efficiency of management, and it helps in providing vital information in decision making for the overall operation of the business

However, Teeratansirikool, Siengthai, Badir and Charoenngam (2013) believe that performance measurement plays a significant role in the formulation, implementation, and monitoring of strategic plans. It helps company managers assess the extent to which predetermined organizational goals are being achieved, which are used as a basis for compensating managers. Performance measurement helps corporate executives understand whether the company is moving in the direction of the plan, which are also the expectations of shareholders and other parties who have interests in the company. Previous research on financial performance have utilised bookkeeping-like performance measures such as ROA, ROE and EPS include (Abubakar, Ado, Bambale, & Amos, 2019; Zainuddin et al., 2017; Ado 2016).



## 2.7. Theoretical Framework

The theoretical frameworks that were adopted in this research is the agency theory The agency theory initiated from the study of Berle and Means (1932). They studied the notion of agency and its application in the expansion of large companies. It is believe that the interests of management and directors are different from the interests of the owners of the company. They applied the principal-agent concept and explained the root causes of these struggles. Likewise, Jensen and Meckling (1976) and Berle and Means (1932) research and officially established the idea of agency theory They argue that the organization of the company is to decrease the cost of obtaining an agent (agent cost) while meeting the interests of the principal. They generally recognize that in any given situation, managers and owners have different goals and motivations, which can be expressed in different ways. This reveals evidence of disagreement among the parties.

The difference in the scope and nature of information between managers and shareholders exacerbates agency problems. Managers usually participate more in business activities for a longer period of time than shareholders, and therefore understand company activities better than owners, which leads to information asymmetry (Aboody and Lev, 2000). Therefore, the management can put its own interests above the interests of shareholders to maximize wealth. In merging the interests of the owners and management, a variety of power structures can be implemented. Internal processes such as the AC and external mechanisms such as external auditors are examples of these (Fama and Jensen, 1983). As a result, the ideal mixture of instruments used might be called a compound mechanism, in which one mechanism's efficiency is dependent on the usefulness of another (Davis & Useem, 2002).

As a result, larger audit committees give the desired two-task of monitoring resourceful conduct and minimising data irregularity, based on the assumptions of agency theory. The AC is a critical component of sound CG, and it is required to generate accurate monetary reportage results in the yearly statement (Jensen and Meckling, 1976). Furthermore, according to the notion, a large audit committee with appropriate resources can approve company irregularities more swiftly (Sarens and Abdolmohammadi, 2011).

## 2.8 Review of Empirical Study

### 2.8.1 AC Size and Financial Performance

Most global CG practices necessitate the AC to have three members (Smith, 2003). Globally, the size of the AC is receiving growing attention and is seen as a signal that the company has control rights, and most importantly, it emphasizes the value of improving company performance. The size of the AC is well-thought-out one of the most important aspects of the AC characteristics that are used to fix the performance of the corporation. It is measured by determining the amount of active audit members in the AC of a particular company (Nuryanah, Islam & Armstrong, 2011). Similarly, Saibaba and Ansari (2011) discuss that the size of the AC is supporting the BOD to implement, maintain, and monitor CG activities, which will help both the business and shareholders.

Salehi and Shirazi (2016) studied 100 organisations listed on the Tehran Stock Exchange from the 2013 to 2014. The findings of the study from the fixed effect generalised least square (FGLS) model presented indication of a positive substantial impact between AC size and financial revelation quality. In Indonesia, Setiany et al. (2017) investigated the AC characteristics and voluntary financial revelation. The authors demonstrated that the AC size had a positive significant impact on voluntary financial disclosure, hence improving the performance of the organisation. AlMatari, AlSwidi, and Fadzil (2014) discovered a link between the AC size and financial performance. According to Samoei and Rono (2016), the size of the AC has a considerable influence on the establishment's performance. This demonstrates that having audit members present reduces financial misstatements and improves quality control. Additionally, Chan and Li (2008) discovered a negative connection between the company's worth (Tobin Q) and the AC size.



Conversely, the larger AC would result in control being managed inefficiently, as a result generating unnecessary AC meetings (Vafeas, 1999). The study by Chan and Li (2008) found a negative connection between firm value (Tobin’s Q) and ACS. In Nigeria, study conducted by Umobong and Ibanichuka (2017) indicated that increase in AC size would decrease firm performance. While Olayinka (2019) revealed that AC size has no significant effect on firms’ performance in Nigeria.

### 2.8.2 Audit Committee Independence and Financial Performance (FP)

Most global regulations require a higher percentage of AC members to be independent directors (SOX Act, 2002). The most anticipation is that an independent AC would provide better financial report monitoring. Previous researches on AC have recognized that an independent AC serves an vital position in controlling managers‟ opportunistic behaviours and improving financial performance (Salehi, & Shirazi 2016; Bédard et al., 2010; Sharma & Kuang, 2014). Hamdan, Sarea and Reyad (2013) studied companies listed on the Amman Stock Exchange Market and they found significant association among the value of the firm on the independent AC. In Oman, there is a clear link between AC independence and FP (Rahman, Meah, & Chaudhory, 2019). In a similar vein, Yasser et al. (2015) discovered a link between the independent AC and corporate performance. Hutchinson and Zain (2009), on the other hand, looked at 60 Malaysian companies and found no link between the AC independence and the firm's success.



Contrarily, Bansal and Sharma, (2016) revealed no significant relationship between ACI and FP of companies in Indians. While Robin and Amran (2016) reported a negative connection between AC independent and FP. The sample of the study was 122 family-controlled listed companies in Indonesia Stock Exchange from 2010 to 2014. Dar *et al.* (2011) from Pakistan shows a negative connection as well. In Kenya, Wakaba (2014) as well found that audit committee does have negative relation with FP

### 2.8.3 Audit Quality Independence and Financial Performance (FP)

The quality of information in financial statements largely depends on the quality of audited financial reports (Samaila, 2015). However, Defond and Zhang (2014, P21) explain that audit quality "as a continuous construct that assures financial reporting quality with high-quality auditing, providing greater assurance of high-quality financial reporting". Therefore, better audits are recognized for their independent assurance of the reliability of financial statements, thereby enhancing investor protection and enhancing investor confidence. Francis (2004) described that the low quality of audits led to the failure of large companies such as Enron and Cadbury. However, because the quality of the audit is complex and unobservable.

Agency theory explain that auditor is appointed to audit management activities of and to decrease agency conflict between the shareholders and management (Jensen & Meckling, 1976). Ching et al. (2015) study public listed companies in Malaysia to studied the association between audit quality (AQ), earnings management, and FP. The finding indicated that high AQ can lead to better company FP. In Nigeria, Ugwu, Aikpitanyi, and Idemudia, (2020) studies the influence of audit quality on the financial performance among 15 listed DMBs for the period between 2011-2017. The research showed significant and positive connection between AQ and FP. Similarly, Enekwe, Nwoha, and Udeh, (2020) investigated the influence of AQ on FP among listed manufacturing companies in Nigeria. The study concluded that AQ positively influences FP of manufacturing companies in Nigeria. Finally, Iliemena and Okolocha (2019) investigated the influence of AQ on FP of industrial goods companies in Nigeria. The finding showed that AQ has significant positive effect on FP.

Table 2.1
*Summary of Selected Empirical Studies on audit committee attributes, audit quality and financial performance*

| Author (s) | Countries | Dependent Variable | Independent Variable | Findings |
|---|---|---|---|---|
| Saibaba, M. D., & Ansari, V. A. (2011) | India | Firm value | Audit committee independence<br>CEO no n-duality | Positive<br><br>positive |
| AlMatari, AlSwidi, and Fadzil (2014) | Yemen | Financial performance | AC size<br>AC independence | Positive<br>Positive |
| Samoei, R. K., & Rono, L. (2016) | Nairobi | Financial performance | AC size<br>AC experience | Positive<br>Positive |
| Chan and Li (2008) | China | Firm value | AC independence | Negative |
| Hamdan, Sarea, and Reyad, (2013) | Jordan | Firm value | AC independence | Positive |
| Rahman, Meah, & Chaudhory, 2019 | Oman | financial performance | AC independence | Positive |
| Yasser et al. (2015) | Pakistan | Firm performance | board size<br>board composition<br>AC independence | Positive<br>Positive<br>Positive |
| Bansal and Sharma, (2016) | India | Firm performance | AC independence | Insignificant |
| Ugwu, Aikpitanyi, and Idemudia, (2020) | Nigeria | Financial performance | Audit quality | Positive |
| Enekwe, Nwoha, and Udeh, (2020) | Nigeria | Financial performance | Audit quality | Positive |
| Iliemena and Okolocha (2019) | Nigeria | Financial performance | Audit firm rotation<br>audit fees | Positive<br>Positive |
| Olayinka (2019) | Nigeria | Firm performance | Audit committee size.<br><br>Audit committee meeting.<br><br>Financial literacy of audit | Insignificant<br><br>Insignificant<br><br>insignificant |

committee members

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## 2.9. Summary of the Study

This chapter presents a review of the literature on the impact of ACS, independence, and quality on firm financial performance, as well as an overview of CG and its regulation in Nigeria. Prior study has found a link between the effectiveness of the AC attributes (size and independence) and audit quality in monitoring and controlling management and FP. The evidence also showed that AC attributes (size and independence) and audit quality are related with corporate reporting transparency and quality financial information.

# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 Introduction

The chapter also explains the research methodology. These include an explanation of the study design, population, sampling, and data collection sources. It also discusses variable measurements and definitions, model specifications, and analysis technique; and lastly, the chapter concludes with a chapter summary.

## 3.2. Research Framework

The AT is utilised in this study to investigate the connection between AC attributes (size and independence), AQ, and FP Agency costs arise because of differences in ownership and management control, because of information asymmetry between management and owners (Jensen & Meckling, 1976). Agency theory entails monitoring devices must align with the interests of management and owners to reduce potential conflicts of interest and opportunistic managerial behaviour (Jensen & Meckling, 1976).



By merging the attention of owners and management, a range of governance devices can be deployed. External mechanisms, such as external auditors, and internal devices, such as the AC (Fama & Jensen, 1983). As a result, a well-thought-out composite of instruments can be created, in which the efficiency of one mechanism is dependent on the efficiency of the other (Davis & Useem, 2002). Figure 3.1 depicts the study research framework, which includes all variables. The following paragraphs go into detail about each variable and the development of hypotheses.

## 3.3. Hypothesis Development

### 3.3.1 ACS and FP

It has been suggested that the bigger the AC size, the more specialists will be presented to supervise and control monetary reports and provide shareholders with self-assurance. Prior studies asserted that a larger AC leads to advance its status and power within an entity, and thus will demand a higher AQ (Kalbers & Fogarty, 1993). Ghafran and O'sullivan (2013) conducted a review of studies on the various roles of the AC in governance. Their findings on the stock market's reaction to audit committee show that investors value the formation of audit committee. In addition, Muhammad, Rehman and Waqas (2016) steered a study on 80 firms listed on the Karachi Stock Exchange. The research used ROA and ROE as measures of performance. Findings indicated a positive relationship between the existence of an AC and firm performance. Rahman, Meah, and Chaudhory (2019) utilised a total of 503 listed manufacturing firms on Dhaka Stock Exchange (DSE) during the period of 2013 to 2017. The study found that audit committee size is significantly related with firm performance. Zraiq and Fadzil (2018) researched the connection between the AC and the performance of Jordanian firms. According to the results, a large AC size improves Jordanian firm performance. Kyereboah-Coleman (2007) explained that there is a positive connection between the AC size and performance, which is related to the effectiveness of monitoring financial errors.

According to Kajola (2008), having more members on the committee means having more experts available to oversee internal controls and financial reporting. Larger AC size contains different skilled resources, which leads the firm to resolve problems more effectively and improves the firm's overall performance. Aldamen et al., 2012. Nonetheless, some researchers claim that there is no link between AC size and FP (Ghabayen 2012; Nuryanah & Islam 2011). In line with the preceding arguments, the research hypothesised:

**H1: There is a significant connection between ACS and FP of banks in Nigeria.**

### 3.3.2 AC Independence and FP

AC independence is frequently regarded as the essential distinguishing function in checking the financial reporting process, monitoring, and supervising firm performance because it improves directors' ability to monitor a company's firm performance efficiently and effectively (Aldamen et al., 2012). It has been recommended that an independent AC does not have a private or financial dependency on the managers. As a result, Abbott et al. (2003) argued, within the context of AT, that an independent AC may be more willing to disagree with managers on various issues. Furthermore, because they have full knowledge of the company's future stance, non-executive directors are in the best position to overseers and report any misguided information in relation to the company's performance from management.



Extensive research has yielded conflicting findings regarding the connection between an independent AC and FP. Mohammed, Flayyih, Mohammed, and Abbood (2019), for example, studied the impact of AC characteristics on the performance of firms listed on the Iraqi stock exchange. The results revealed a link between AC independence and firm performance. Hamdan Sarea and Reyad (2013) studied firms listed on the Amman Stock Exchange Market and discovered a significant connection between the firm's value and its performance on the independent AC. Also, Al-Matar, Al-Swidi, and Fadzil (2014) discovered a significant positive connection between audit committee independence and FP in Oman. Chou and Buchdadi (2017) showed that independent board has a positive impact on the accounting-based profit of the bank in Indonesia.

In contrast, Bansal and Sharma (2016) discovered no link between AC independence and FP in their study of Indian companies. Hutchinson and Zain (2009), on the other hand, studied 60 Malaysian firms and discovered no significant connection between the independence of the AC and the FP. As a result, Wakaba (2014) discovered in Kenya that AC has a negative connection with firm performance. In line with the preceding arguments, the study hypothesised:

**H2: There is a significant connection between AC independence and FP of banks in Nigeria.**

### 3.3.2 Audit quality and Financial Performance

Dure to the information asymmetry and agency issues between managers and stockholders, the financial statement audit is projected to improve the reliability of the reported earnings (Johnson, Khurana, & Reynolds, 2002). The Big Four professional auditors have been suggested to have more knowledge and expertise in detecting unethical accounting practises than smaller firms (Zango et al., 2016).



Farouk and Hassan (2014) investigated the influence of AQ on the FP of listed corporations in Nigeria. The findings show that audit quality has a significant influence on the FP of Nigerian companies. Furthermore, Hazaea et al. (2020) investigated the connection between AQ and FP among companies listed on the Tehran Stock Exchange from 2005 to 2010. The result shows a positive association between audit quality and FP. According to Ching, Teh, San, and Hoe (2015), audit quality improves firm financial performance. Iliemena and Okolocha (2019) investigated the influence of AQ on FP in twenty-four (24) Nigerian industrial firms. AQ has a significant positive impact on FP. Finally, Ogbodo (2017) examined the influence of AQ on the FP of Nigerian banks. According to the findings, AQ has a significant influence on ROA. This research differs from current study from the sample size and the study period. the study proposed that:

**H3: There is a significant connection between AC independence and FPof banks in Nigeria.**

### 3.4. Research Design

The research design includes data gathering and evaluation. The nature of the research has revealed this. It entails strengthening the validity and reliability of the study. The study design's main purpose is to figure out what relationship occurs between the research questions, the data collected, and the findings reached (Asika, 2004). This quantitative research employs a correlational research design to examine the impact of AC attributes (size and independence) and AQ on the FP of banks in Nigeria.



### 3.5. Respondents of the Research

The current study concentrates on 22 banks that were listed on the NSE between 2018-2020. This sector was chosen because of the banking industry's strength, which has numerous positive externalities. Banks are regarded as the primary institutions in charge of the economic payment system and the foundation of economic stability. The period (2018 to 2020) was chosen due to the reform of the SEC (2018) Code of CG in Nigeria, which became effective in 2018, and serves as a guide for banks.

#### 3.5.1 Sample Size and Sampling Technique

The population of the study will be maintained as the sample, which comprises of all commercial banks operating in Nigerian from 2018 to 2020, and whose data are available for the said period. However, due to the availability of data for the three years (2018 to 2020) period, 22 commercial banks were utilized as the sample for this study, in which 66-year observations are obtained. Moreover, the data on the audit committee attributes, audit quality, and financial performance were collected from the data stream and annual reports and accounts of the 22 sampled banks spanning from 2018 to 2020. The total sample is shown below

Table 3.1.

*Listed Banks in Nigeria*

| No | Commercial banks |
|---|---|
| 1 | Access bank |
| 2 | Citibank of Nigeria |
| 3 | Eco bank of Nigeria |
| 4 | Fidelity bank plc |
| 5 | First bank of Nigeria |
| 6 | First city monument bank |
| 7 | Globus bank |
| 8 | Guaranty trust bank |
| 9 | Heritage bank |
| 10 | Keystone bank |
| 11 | Polaris bank |
| 12 | Providus bank |
| 13 | Stanbic IBTC bank |
| 14 | Standard chartered bank |
| 15 | Sterling bank pls |
| 16 | SunTrust bank |
| 17 | Titan trust bank |
| 18 | Union bank of Nigeria |
| 19 | United bank for Africa |
| 20 | Unity bank |
| 21 | Wema bank plc |
| 22 | Zenith bank plc |



### 3.6 Data Collection Sources and Methods

Thomson Reuters data streams will be used to collect financial data. Non-financial data will be removed from the yearly statements of Nigerian commercial banks. Non-financial data will be used to extract variables related to AC size, AC independence and audit quality. While the financial data will be used to calculate return on assets, and other control variables.

## 3.7 Techniques for Data Analysis and Statistical Tool

The study data is panel data with two attributes (cross-section and time series). The study examined data from various banks for several years, which is why panel data was used. Furthermore, descriptive words will be used in data analysis. Descriptive statistics give a detailed explanation of the data's nature. The linear link between the variables in the study will also be determined using correlation. Regression analysis is utilised to investigate the connection between the explanatory variable and the dependent variable. In addition, Stata will be utilised in the study to perform various robustness tests to increase the reliability and validity of statistical inference. Normality, multicollinearity, heteroscedasticity, and serial correlation tests are among them. For analysis, Stata is utilised.

### 3.7.1 Normality Test

The normality test is one of the assumptions that requires the disturbance term to have a normal distribution. This normality only applies to the predictor variables (Gujarati, 2004). Typically, distributed data allows for general discovery generalisation. The large variation in the normal distribution, on the other hand, can lead to misleading conclusions.



### 3.7.2 Multicollinearity Test

The multicollinearity test is a diagnostic test used to detect collinearity or other conditions between predictor variables. Typically, this is accomplished through correlation. The correlation matrix only shows the possibility of multicollinearity; according to Gujarati (2004), the correlation between predictors should not exceed 0.8. When the correlation is greater than 80% multicollinearity can be suspected. More tests are then recommended to confirm the presence of multicollinearity, which is typically accomplished using the variance inflation factor (VIF). A VIF test with an average value of less than 10 and a tolerance value of less than 1 indicates the absence of multicollinearity (Gujarati, 2004).

### 3.7.3 Homoscedasticity Test

Homoscedasticity is an important linear assumption. It denotes the condition in which the random variation of the connection between the predictor variable and the explained variable is constant across all predictor variable values. While heteroscedasticity defies this assumption. Heteroskedasticity exists when random disturbances differ for all predictor values. The presence of heteroscedasticity, on the other hand, will always distort the significance of statistical inference (Gujarati, 2004).

### 3.7.4 Autocorrelation Test

Examining the association between observed interference elements in time or space is another diagnostic test connected with panel data analysis (Gujarati & Porter, 2009). The Wooldridge autocorrelation test is performed during panel data analysis to see if there is any autocorrelation in the data (Carneiro, 2006). The test comprises determining the implication of the null hypothesis, which claims that the linear panel data model has no unique mistakes. The presence of autocorrelation in the model is indicated by a significant F value. A random effects model or a fixed effects model is utilised to tackle this problem because the model always gives a consistent estimator (Gujarati & Porter, 2009).

## 3.8 Measurement of Variables

### 3.8.1. Measurement of the Variables

Measurements for dependent variables (DV), independent variables (IV), and control variables (CV) are included in this section. The following are the variables that will be measured in the study:

#### 3.8.1.1. Dependent Variables

ROA is calculated by dividing net income before interest expenses by total assets for the same fiscal year (ROA) (Makki & Lodhi 2014). Total assets divided by net profit (NP/TA). This is due to the fact that ROA, as an accounting-based performance measure, can be influenced by corporate managers in order to demonstrate the effectiveness and efficiency of operations to shareholders (Kakanda, 2017).

#### 3.8.1.2. Independent Variables

The AC attributes (size and independence) and audit quality are measured as independent variables in this section, which are stated as follows:

According to Al-Matari, Al-Swidi, and Fadzil (2012), ACS is defined as the total quantity of members on the AC. The proportion of independent non-executive directors on the AC to the total number of AC members is referred to as AC independence (ACIND) (Bala & Kumai, 2015). When a firm is audited by BIG4 auditors, the audit quality is measured as a dummy variable of 1; when a firm is audited by non-BIG4 auditors, the audit quality is measured as a dummy variable of 0. (Lakhal, 2015).

#### 3.8.1.3. Control Variables

However, the size of the company has a significant impact on its performance. Large companies may be less active than small businesses because of management supervision and agency issues (Lehn et al., 2009). While it is possible to benefit from economies of scale, be stronger in the market, and hire more skilled managers, large corporations are more effective (Kyereboah Coleman & Biekpe, 2005).

The number of years a bank has been in business determines its age. Bank age is employed as a CV in certain data-driven researches to evaluate the connection between CG and company performance (Ahmed et al., 2010) Leverage is the use of borrowed capital to increase a company's performance. Tauseef, Lohano, and Khan (2015) investigated the association between CG and FP using leverage as a CV. Debt has an impact on a company's financial success, according to this research. Increased leverage, according to AT, will improve the efficiency of the board of directors.

Table 3.2

*Summary of the Operationalization of Research Variables*

| No | Variables | Acronym | Operationalization | Source |
|---|---|---|---|---|
| Dependent Variable: | | | | |
| 1 | Return on Assets | ROA | Net profit divided by total assets (NP/TA) | Makki and Lodhi (2014ABD) |
| Independent Variables: | | | | |
| 1 | Audit committee size | ACS | Measured as serving members on the audit committee. | Al-Matari, Al-Swidi, and Fadzil (2012) |
| 2 | Audit committee independence | ACIND | Measured as a percentage of non-executive independent directors on the audit committee. | Heenetigala and Armstrong (2011) |
| 3 | Audit quality | AQ | Measured as a dummy variable of "1" when a firm is audited by big4 auditors and "0" otherwise. | Lakhal, (2015). |
| Control variable: | | | | |
| 1 | Firm Size | FSIZE | Natural log of total assets | Kurawa and Kabara (2014) |
| 2 | Bank Age | BAGE | Number of years since the company start incorporation | Basuony and Ehab (2015) |

| | | | | |
|---|---|---|---|---|
| 3 | Leverage | LEV | Total debts divided by total asset | Huda & Abdullah (2013) |

**3.9 Research Model**

This research investigates the impact of AC attributes (size and independence) and AQ on FP of banks in Nigeria. The model of the research is displayed below.

The regression equation is estimated as follow:

$$ROA_{it} = a_0 + \beta_1 ACS_{it} + \beta_2\, ACIND_{it} + \beta_3\, AQ_{it} + \beta_4\, FSIZE_{it} + \beta_5 BAGE_{it} + \beta_6\, LEV_{it} + \varepsilon \quad Model\, 1$$

Where: ROA = Return on assert, ACS = Audit committee size, ACIND = Audit committee independence, AQ = Audit quality, FSIZE = Firm size, BAGE = Bank age, LEV= Leverage, ε it = Error term



**3.10. Summary the Chapter**

The objective of the research is to examine the connection between AC attributes (size and independence) and on the FP of banks in Nigeria. This chapter describes the research methods and presents the propositions that have been established. Also, the theoretical framework, research methods, research design, and data analysis are covered.

# CHAPTER FOUR

# RESULT AND DISCUSSION

## 4.1. Introduction

This chapter introduces the results of data analysis and the interpretation of the overall goal. This chapter is divided into several subsections, together with descriptive statistics, correlation analysis, and regression analysis using panel-corrected standard errors (PSCE), normality test, multicollinearity test, heteroscedasticity, and serial correlation test. This chapter also introduces research hypothesis testing and a summary of the research findings of the association between the dependent variable and the independent variable.

## 4.2. Descriptive Statistics

A descriptive analysis provides basic data about the sample target, that leads to a more straightforward and precise explanation of the results (Genser, Cooper, Yazdanbakhsh, Barreto, & Rodrigues, 2007). The mean, standard deviation, minimum, and maximum of the variables are shown in Table 4.1 for the study period 2018-2020, totaling 66 observations

Table 4.1
*Summary of Descriptive Statistics*

| Variable | Mean | Std. dev. | Min | Max |
|---|---|---|---|---|
| ROA | 0.029 | 0.122 | -0.017 | 1.002 |
| ACSIZE | 4.818 | 1.264 | 3.000 | 7.000 |
| ACIND | 0.493 | 0.149 | 0.200 | 1.000 |
| AQ | 0.727 | 0.449 | 0.000 | 1.000 |
| FSIZE | 14.081 | 1.194 | 10.353 | 15.921 |
| BAGE | 32.363 | 33.398 | 1 | 126 |
| LEV | 0.599 | 0.259 | 0.105 | 1.088 |

ROA = return on asset; ACSIZE = Audit committee size; ACIND = Audit committee independence; AQ = Audit quaity; FSIZE = Firm size; BAGE = Bank age; LEV = Leverage

The findings of descriptive statistics derived from the variables included in the model are shown in Table 4.1. The descriptive statistics were calculated using Stata version 14 and included mean, standard deviation, minimum, and maximum. The average mean return on asset (ROA) is 0.029, with a maximum of 1.002 and a minimum of -0.017, according to the descriptive study. In terms of the CG variables, the descriptive statistics of AC size (ACSIZE) demonstrate that the mean value is four members, with a minimum of two and a maximum of seven. Furthermore, the average level of AC independence is 0.0.493, with a maximum of 1.000 and a low of 0.300. This implies that the majority of the banks in this study followed the NCCG, which mandates that all banks form an AC of at least three members, with the majority of non-executive directors. The average mean of Big4 score of 0.727 indicates that 72% of banks in Nigeria were audited by Big 4 firms.

In terms of firm size (FSIZE), banks in Nigeria have a mean of 14.081 with a minimum of 10.353 and a maximum of 15.921. In terms of bank age (BAGE), Table 4.1 reveals that the average bank age is 32.363 years old, with a minimum of 1 and a maximum of 126 years. Finally, the mean value for leverage (LEV) is 0.599, with a minimum value of 0.105 and a high value of 1.088.



### 4.3. Correlation Analysis

Correlation analysis is utilised to discuss the degree of correlation between one variable and another variable (Asteriou and Hall, 2007). The correlation shows the likelihood of the existence of multi-collinearity using a correlation matrix, where the association between the predictors must not exceed 0.8. According to Gujarati (2004), where the correlation is greater than 80%, it raises the possibility of multi-collinearity. Then, a further test is recommended to confirm the existence of multi-collinearity, and this is usually done using the variance inflation factor (VIF). An average value of less than 10 and a tolerance value of less than 1 from the VIF test indicate the nonexistence of multi-collinearity (Gujarati, 2004).

Overall, the results show that multi-collinearity has not posed a threat to the research variables. The highest correlation amongst the predictor variables was 44% between the audit quality (AQ) and bank age (BAGE).is within the 90% threshold recommended by Gujarati (2004).

This study first measures the connection between the IV and the DV. Therefore, correlation analysis is utilised to explore the connection of the independent variables, because it will help estimate many models which discover no relationship in circumstances where the correlation estimation is 0 and a correlation of ± 1.0 means a complete negative or positive correlation. Zero (0) means there is no relationship, one (1) means perfect relationship. Furthermore, when r = ± 0.30 to ± 0.49, the relationship is considered small, and when r ≥ 0.50, the strength of the relationship is considered substantial. Table 4.2 shows the correlation between variables.



Table 4.2:
*Pearson correlation*

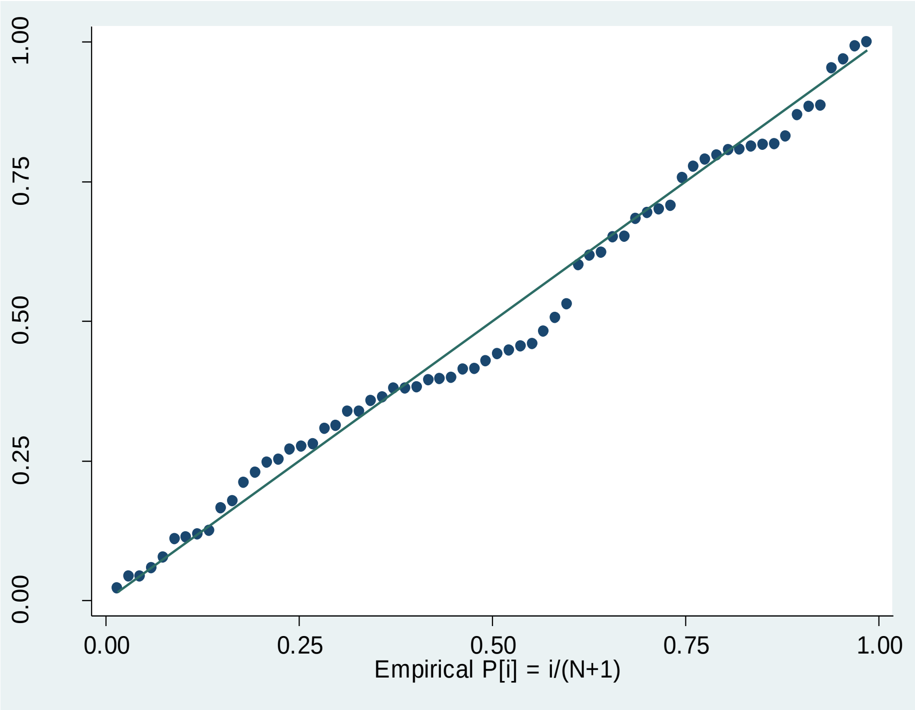
| Variables | R0A | ACSIZE | ACIND | AQ | FSIZE | BAGE | LEV |
|---|---|---|---|---|---|---|---|
| ROA | 1 | | | | | | |
| ACSIZE | -0.2880 | 1 | | | | | |
| ACIND | 0.0044 | 0.2440 | 1 | | | | |
| AQ | 0.0911 | 0.2639 | 0.0202 | 1 | | | |
| FSIZE | -0.2134 | 0.2312 | 0.1311 | 0.3341 | 1 | | |
| BAGE | 0.1615 | -0.1694 | 0.0307 | 0.4378 | 0.2716 | 1 | |
| LEV | 0.2245 | -0.0794 | -0.2034 | -0.0432 | -0.0432 | 0. 0105 | 1 |

ROA = return on asset; ACSIZE = Audit committee size; ACIND = Audit committee independence; AQ = Audit quality; FSIZE = Firm size; BAGE = Bank age; LEV = Leverage

Table 4.2 above shows the significant correlation, weak positive correlation, and significant negative correlation between the DV (ROA) and the IV. The correlation between ACS and firm size with ROA is -0.2880 and -0.2134. which shows they are negatively correlated. This indicates that these variables can reduce the ROA. Furthermore, a positive correlation was found between AC independence, audit quality, bank age, leverage, and ROA 0.0044, 0.0911, 0.1615, and 0.2245, respectively. This result indicates that these variables can increase ROA.

### 4.4 Normality Test

A fundamental step in multivariate analysis is testing for normality. The process of determining the distribution pattern of the residual is known as normality. Hair, Black, Babin, and Anderson (2010), explained that normality can be determined using a statistical (mathematical) or graphical approach. In explaining normality, P-plot was utilised. A P-plot is a visual inspection of the distribution that allows the reader to judge the data physical distribution. It plots the observed value against its distribution, giving the reader the shape and insight on the data gap and outlying value (Ghasemi & Zahediasl, 2012). However, the normality result is figured 4.1 thus, the residual plots below show that the variables are not different from normal.




### 4.5. Test for Heteroskedasticity

The standard error component of multivariate analysis believes that the disturbances contain a homoscedastic variance that is spread over a range of individual variables (Baltagi, Jung, & Song, 2008). While heteroskedasticity is not lethal when dealing with panel data, the cross-sectional observations are probable to change if the observations rise, and as such the data may indicate some level of heteroskedasticity (Vogelsang, 2012).

The BreuschPagan / CookWeisberg heteroscedasticity test was applied in this research to test the homoscedasticity of the regression model. The null hypothesis assumes that the variance of the error term is homogeneous. The outcomes in Table 4. 3 show that there is a heteroscedasticity problem because the p-value is less than the 0.05 threshold ($P < 0.05$). To rectify the heteroscedasticity problem, a panel corrected the standard error (PCSE) is employed. Beck and Katz (1995) recommended PCSE as a suitable method to correct heteroscedasticity in panel data.

Table 4.3

*Breuch -Pagan / Cook -Weighberg Test*

| DVs | Chi2 (1) | Prob > Chi2 | Null (H0) |
|---|---|---|---|
| ROA | 282.59 | 0.000 | Rejected |

## 4.6. Test for Multicollinearity

VIF test is utilised to ascertain the existence of high collinearity between the IV. Whether two or more variables are measuring the same thing or variables are independent of one another. VIF result of 10 and more reveals high collinearity, which needs a solution. If the multicollinearity test realizes the presence of collinearity, a strong relationship among the independent variables exists. Hair et al. (1995) explains that one of the methods to know the existence of the correlation between independent variables is to perform a multicollinearity test that explains the degree to which one variable's effect can be managed by the other variable.

Table 4.4

*Multicollinearity Test using Variance Inflation Factor*

| Variable | VIF | 1/VIF |
|---|---|---|
| ACSIZE | 1.35 | 0.740197 |
| ACIND | 1.13 | 0.886504 |
| AQ | 1.50 | 0.664848 |
| BAGE | 1.47 | 0.680852 |
| LEV | 1.05 | 0.955836 |
| FSIZE | 1.22 | 0.822078 |
| Mean VIF | 1.29 | |

Table 4.4 displays the results of the multicollinearity test using VIF, which revealed that there is no problem with multicollinearity because the VIF of each IV is less than the threshold value of 10. As a result, the study concludes that multicollinearity between the independent variables is not a concern. To explain the dependent variable, demonstrate that each variable is independent.

### 4.7. Test for Serial Correlation

The Wooldridge test for autocorrelation in panel data is performed to determine whether there exists a serial correlation or otherwise. There are many ways to prove the existence of autocorrelation. This study uses the Wooldridge test to detect autocorrelation. There is no autocorrelation of any order, according to the null hypothesis. As a result, if the p-value is greater than 0.05, the data are not auto correlated. The results in Table 4.5 specify that the presence autocorrelation problems because the p-value is significant ($p < 0.05$). To solve the inherited autocorrelation problem, this study adopted panel-corrected standard error (PCSE) regression suggested by Beck and Katz (1995).

Table 4.5
*Wooldridge test for Autocorrelation in Panel Data*

| | **F (1, 44)** | **Prob > Chi2** | **Null (H0)** |
|---|---|---|---|
| ROA | 17.640 | 0.0004 | Rejected |



### 4.8. Regression Analysis

In this study, the data have issues of heteroscedasticity and autocorrelation. Panel Corrected Standard Error (PCSE) was used to overcome this problem as suggested by Beck and Katz (1995). PCSE is a panel regression model that reflects the likelihood of coexistent correlations, responsible for spherical errors and deviations and permitting for inference from linear models. Also, PSCE was suggested as superior for panel data with heteroscedasticity and autocorrelation (Moundigbaye et al., 2018). The authors say that PCSE handles both autocorrelation and heteroscedasticity issue and provides a standardized coefficient for more effective hypothesis testing. Therefore, this study follows previous studies such as Lazzem and Jilani (2018) who used PCSE to analyze data with similar behavior. Therefore, the next section introduced the regression results based on PCSE.

Table 4.6

*Result of the Panel Corrected Standard Error Regression*

| Variables | Coef | t-stat | P>\|z |
|---|---|---|---|
| **Independent** | | | |
| ACSIZE | -0.858 | -2.07 | 0.038 |
| ACIND | 0.221 | 1.67 | 0.094 |
| AQ | 0.174 | 2.73 | 0.006 |
| **Control variables** | | | |
| FSIZE | -0.557 | -3.60 | 0.000 |
| BAGE | 0.027 | 1.05 | 0.293 |
| LEV | 0.808 | 1.41 | 0.157 |
| Cons | 0.806 | 3.10 | 0.002 |
| R-square | | | 0.223 |
| Prob > chi2 | | | 0.0000 |
| Number of groups | | | 22 |
| Obs | | | 66 |

ROA = return on asset; ACSIZE = Audit committee size; ACIND = Audit committee independence; AQ = Audit quality; FSIZE = Firm size; BAGE = Bank age; LEV = Leverage

### 4.8.1. ROA as Dependent Variable

Table 4.6 reveals that the cumulative R-square is 0.223, and Prob> chi2 is significant (P <0.000). This means that the general model is adequate to explain the level of variability between the DV and the explanatory variable. Therefore, the regression model explains that 22% of the total change in ROA is affected by independent variables (ACS, ACI, audit quality) and CV (firm size, bank age, leverage).

### 4.8.2. Hypotheses Testing

The findings of the examination of the association between financial performance (ROA as a DV) and ACS, independence, and audit quality are shown in this section. The regression analysis is used to present the CV, which are the business size, bank age, and leverage stated in the study.

#### 4.8.2.1. ACS and FP

As shown in Table 4.6 AC size has a negative and significant association with bank FP (Coeff -0.858, P=0.038). The result indicated that AC size decreases bank performance. This finding supported the first hypothesis (H1) that there is a significant connection between ACS and bank FP. This supported the result of Aldamen et al. (2012) who contended that the larger audit committee will eradicate the monitoring procedure and reduce the FP. Also, the outcome is similar to Samoei and Rono (2016) who reported a significant negative connection between ACS and FP.

Also, the outcome is similar to Samoei and Rono (2016) who reported a significant negative relationship between audit committee size and firm performance. However, the finding contradicts agency theory which suggest that larger groups can benefits from ideas, skills and expertise of individual members which in turn improves control and monitoring capacity.

#### 4.8.2.2. ACI Independence and FP

Table 4.6 reveals that AC independence has a positive significant association with bank FP (Coeff 0.221, P= 0.094). This rersult supported the second hypothesis (H2) that there is a significant connection between ACI and bank FP. This result indicated AC independence improves bank FP. This shows that the independence of AC members is effective in the supervision and monitoring of management behavior, thereby improving performance. The result is similar to Al-Matar et al. (2012) who discovered a significant positive connection between ACI and FP in Oman. The finding supported the agency theory which suggested that independent members to be the best controllers of managers action (Fama & Jensen, 1983). Additionally, agency theory considers audit committee with high levels of independence capable of detecting and reducing practices.

### 4.8.2.3. Audit Quality and Financial Performance (FP)

According to Table 4.6 audit quality has a positive and significant association with bank FP. This was observed from the regression coefficient of (Coeff 0.174, P= 0.006). The outcome supported the third hypothesis (H3) which stated that there is a significant connection between audit quality and FP of banks. The positive value reported in this study shows that an increase in audit quality will lead to an increase in banks' performance and vice versa. This outcome supported the result of Hazaea et al. (2020) who demonstrated a positive association between audit quality and FP. This supported the argument that Big Four professional auditors have more knowledge and expertise in detecting unethical accounting practices than smaller firms (Zango et al., 2016). This supported the agency theory preposition that external auditors will improve monitoring and improve financial performance.



### 4.8.2.4 Control Variables and Financial Performance

In this research firm size, bank age, and leverage were used as CV. The result in Table 4.6 shows a negative significant association between firm size and FP (Coeff -0.557, P= 0.000). However, the result in Table 4.6 reveals that bank age has a positive but insignificant association with FP (Coeff 0.027, P= 0.293). This means that bank age does not have any significance on FP. Finally, leverage has a positive insignificant relationship with FP(Coeff 0.808, P= 0.157).

### 4.12. Summary of the Chapter

This chapter deliberated the outcome from Panel Corrected Standard Error and diagnostics test result to establish the relationship effect of AC attributes (size and independence) and AQ on the FP of banks in Nigeria. The findings show that there is a significant connection between ACS, ACI, audit quality, and FP, hence all three (3) hypotheses of the study are supported. The research employed secondary data obtained from the annual report and data stream using a sample of twenty-two (22) banks in Nigeria.

# CHAPTER FIVE

# SUMMARY AND RECOMMENDATIONS

## 5.1. Introduction

This chapter describes the research overview, results, research contributions, and research implications. The chapter also discusses research limitations and suggestions on the possible ways for upcoming study. The chapter also provides a summary of the overall results on the connection between ACS, ACI, and AQ and FP.

## 5.2. Overview of the study

The study examines 22 banks in Nigeria between 2018-2020. The research's objective was to investigate the effect of AC attributes (size and independence), and audit quality on the FP of banks in Nigeria. From findings revealed that ACS is negatively associated with FP This shows that an increase in the AC members of banks will have a negative impact on their performance. The inference can be made that the result is in line with the notion that a small AC may be better in terms of monitoring and may not be easily manipulated by the managers as compared to a large audit committee. However, ACI has a positive significant connection with FP. This shows that with an increase in ACI, FP will rise, and the reverse is the case. Furthermore, AQ has a positive and significant association with financial performance. This shows that audit quality improves the financial performance of banks in Nigeria.



Other variables were also investigated, including firm size, bank age, and leverage. The study indicated a negative significant association between firm size and financial performance. Additionally, bank age has a positive but insignificant association with financial performance. Finally, leverage has a positive insignificant relationship with financial performance.

### 5.3. Implication of the Study

The study examined the impact of AC attributes (size and independence) on the FP of banks in Nigeria. However, this research has documented the importance of the presence of independent non-executive directors in the AC and audit quality (Big4) as they show a signal to investors that the bank has robust corporate governance which, in turn, promotes their protection and thus, enhances FP. This research recommends that the Nigerian SEC should, in the forthcoming code, recognize the presence of independent non-executive directors in the AC and make it compulsory for the banks to have their financial statements being audited by Big4. The research's findings would be extremely useful to the Nigerian stock market, government, auditing and accounting authorities, and auditing and accounting professional organisations. Furthermore, the study would aid the Nigerian government and regulators in formulating new regulations and deliberating on corporate governance concerns relating to bank performance. It has been known that both the shareholders and companies are depending on sound corporate governance mechanisms particularly as a way of enhancing banks' performance.

### 5.4. Limitation of the Study

This study considers ACS, ACI, and audit quality. There are other factors that may affect the banks' performance, including the type of ownership structure, risk management committee (Abubakar, 2018; Acero, Serrano, & Dimitropoulos, 2017), and the application of other FP indicators such as Tobin's Q (Topal, & Dogan, 2014). Future research can be extended to include these factors.

## 5.5. Recommendation for Future Studies

The sample banks in this research are based on commercial banks in Nigeria. The justification for selecting this industry is that these industries have contributed to economic growth and national GDP, and the number of banks has created a large number of jobs and also implemented a corporate governance structure. Therefore, further study can be conducted on other corporate governance variables e.g., AC financial expertise, board diversity, board meetings, CEO characteristics, and ownership structure.

## 5.6. Conclusion

The research examines the effect of AC attributes (size and independence) and AQ on the FP of banks in Nigeria has been concluded. The research examines the connection between the three IVs (ACS, ACI, and audit quality). While the dependent variable is the ROA. all three (3) independent variables were found to be significantly related to FP. Specifically, based on the outcome of the Panel Corrected Standard Error AC size was found to be negatively related to FP. While two variables namely ACI and audit quality were discovered to be positive and significantly related to the FP.

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