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Audit Committee Characteristics and Financial Performance of Deposit Money Banks in Nigeria

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Abstract: **The purpose of this study was to assess the predictive power of audit committee features on the financial performance of listed Deposit Money Banks (DMBs) in Nigeria between 2009 and 2018. Thirteen (13) banks were used over 10 years making a total of 130 firm year observation. The independent variable was audit committee size, while the dependent variable was DMB financial performance measured by return on capital employed (ROCE). The study used an ex-post factor research approach to address the research questions and the nature of the study data. The study used the panel fixed effect approach (and the estimates were obtained using E-views 9). The results show that audit committee size does not significantly predict ROCE nor does audit committee financial skill and frequency of audit committee meetings. None of the independent variables have significant predictive power on the performance of Deposit Money Banks in Nigeria. Thus, instead of DMBs focusing on expanding the members of Audit committee, they should instead consider other things that can be done to have an effective audit committee, such as gender, religion, region, ownership, etc that could possibly influence the performance of banks in Nigeria.**

Keywords: **Audit Committee, Agency Theory, Financial Performance, ROCE.**

1. INTRODUCTION

Financial performance which assesses the fulfilment of firm's economic goals has long been an issue of interest in managerial researches. Firm financial performance relates to the various subjective measures of how well a firm can use its given assets from primary mode of operation to generate profit. Kothari (2001) defined the value of a firm as the present value of the expected future cash flows after adjusting for risk at an appropriate rate of return. To (Eyenubo, 2013) it is the success in meeting pre-defined objectives, targets and goal within a specified period. Qureshi, (2007), put forward four different approaches in which the value of a firm has been identified in corporate finance literature. These are: the *financial management approach* which focuses on the evaluation of cash flows and investment levels before identifying and assessing the impact of financing sources on firm value; the *capital structure approach* which studies the impact of capital structure changes on the value of firm and how different factors impact directly or inversely the debt and equity component of the firm capital structure; the *resource based approach* which explains the value of firm as an outcome of firm's resources; and finally, the *sustainable growth approach* which is a summary of the above three approaches to firm value, taking into account the firm's operating performance, its investment and financing needs, the financing sources, and its financing and dividend policies for sustainable development of firm's resources and maximization of firm value.

Financial performance could be affected by many factors, amongst them is Audit Committee. Abbott (2010) opined that understanding the characteristics of an audit committee is fundamental in determining its effectiveness and subsequent performance of a firm. Carcello (2012), emphasized that audit committees should comprise independent individuals, with some of the members having financial knowledge and experience. He gave emphasis on the frequent meetings of the audit committee members. Due to high level corporate failures experienced in the world, focus has been shifted to the corporate governance and the effectiveness of audit committees, boards, disclosures, internal controls and auditors and director's independence. In the world at large, corporate internal governance has been strengthened by audit committees.

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Previously, the audit committees were non-mandatory instruments that ensured accountability. Generally, audit committee characteristics have proved to necessitate success and financial health of an entity. Zábojníková, (2016), while investigating audit committee characteristics in the UK firms, unraveled that the characteristics of audit committees have an impact on UK financial performance. The findings implied that there is a significant positive relationship between the audit committee size, frequency of its meetings and its financial experience and firm financial performance. A review of previous studies in Nigeria (such as: Olayinka (2019), Yusuf, Bambale, & Abdullahi (2018), Shehu, (2017) and Ebere & Ibanichuka, 2016 show that there is scarcity in the level of studies carried out on audit committee characteristics and financial performance. This includes attributes of the audit committee such as; its independence; size, financial expertise and frequency of meetings. The characteristics of the audit committee are used in this study as a way of investigating how audit committee characteristics affect the financial performance of deposit money banks in Nigeria. In this essence, the primary question of this research is as follows: Do the characteristics of audit Committee enhance the financial performance of deposit money banks in Nigeria? Thus, in order to answer this predominant question, this study examines audit committee characteristics and performance of Deposit Money Banks in Nigeria.

2. LITERATURE REVIEW

2.1 Agency Theory

Agency theory is a theory that has been applied to many fields in the social and management sciences: politics, economics, sociology, management, marketing, accounting and administration. The agency theory a neoclassical economic theory (Ping & Wing 2011) and is usually the starting point for any debate on the corporate governance. The theory is based on the idea of separation of ownership (principal) and management (agent). It states that 'in the presence of information asymmetry the agent is likely to pursue interest that may hurt the principal' (Sanda,Mikailu, &Garba 2005).It is earmarked on the assumptions that: parties who enter into a contract will act to maximize their own self-interest and that all actors have the freedom to enter into a contract or to contract elsewhere. Furthermore, it is concerned with ensuring that agents act in the best interest of the principals. Audit committee plays a major role in ensuring that management (agent) is always acting in the best interest of shareholders (principal). From the point of view of Habbash (2010), the agency theory is the most commonly used of all corporate governance theories; more academics and practitioners have investigated it and given it more attention than any other theory. It is focused on the idea of separating ownership from management.

Furthermore, the agency theory was developed by Jensen and Meckling (1976) who defined the agency relationship as a contract where a person (the agent) is employed by the principal to execute several tasks on his behalf, which implies that authority has been delegated to the agent for some decision-making. Moreover, ensuring that the agent is acting in the best interest of the principal is a matter of concern. This is due to an inherent conflict of interest between the agent and the principal as explained by Fama and Jensen (1983): '*Control of agency problems in the decision process is important when the decision managers who initiate and implement important decisions are not the major residual claimants and therefore do not bear a major share of the wealth effects of their decisions. Without effective control procedures, such decision managers are more likely to take actions that deviate from the interests of residual claimants* (Fama & Jensen 1983, 77).'

The proponents of this theory, Jensen and Meckling (1976), assert that putting apart how entities are owned and managed could result into disagreement between managers and shareholders. Different people that have the same aspiration or schedule in doing a specific task and have varying motivations and these differences can manifest in different ways. Agency relationship arises when the management of firms is delegated by shareholders. The transfer of responsibilities by the principal and the resultant separation of responsibilities are necessary in enhancing an efficient and rewarding entity (Jensen & Meckling 1976). The agent in most cases has access to more information concerning the activities of the entity than the principal. These differences could occur as a result of financial rewards, labour market opportunities and relationship with other parties that may not be beneficial to the principal (shareholders).

The primary assertion of the agency theory is that managers' actions are not spawned out of anything except their own personal interest and self-benefit. This, as a result, gives less focus and attention to the needs and interests of the shareholders, which undermines the firm's overall value (Eisenhardt, 1989). As long as managerial (agent) and shareholder (principal) interests converge and harmonize, an agent problem wouldn't arise; however, as soon as their interests diverge, the agent will aim to maximize his own interests as against the interest of the principal.

Kyereboa-Coleman et al.(2007) suggested a couple of ways that tend to reduce opportunistic behaviour from an agent to the barest minimum. The first option is by having non-executive directors. To have an effective board of directors, agency theory proposes and expects that a large percentage of the board members should be non-executive directors. The theory asserts that it will guarantee the independence of the board, sustain a fair and unbiased judgment in its monitoring, thus reducing the conflict of interests between the agents and the principals. The second option is by what is known as a CEO duality. Agency theory stipulates that assigning the position of the CEO and the Chairman of the Board to different individuals will reduce the possibility of one individual dominating the firm's management and board members.

2.2 Empirical Review

Joseph (2020) studied the relationship between audit committee characteristics and financial performance of listed banks in Ghana. The study focused on 8 banks listed on the Ghana Stock Exchange using return on equity (ROE) and return on assets (ROA) as measures of financial performance. The study focused on a period of 5 years. The outcomes of the study include: audit committee size and the expertise and experience of audit committee members were found to be positively correlated with return on equity. However, independence of the audit committee members and gender divert of the committee had a negative correlation with return on equity. Similarly, audit committee size and the expertise and experience of audit committee members correlated positively with return on assets. However, audit committee independence and gender divert had a negative correlation with return on assets.

John (2020) investigated board audit committee characteristics and financial performance of selected commercial banks in Ghana during the period of 2008 to 2017. The sample size for the study was 13 commercial banks in Ghana. Data were analyzed using multiple regression analysis and Pearson’s Product Moment Correlation. The study used return on assets (ROA) and return on equity (ROE) as indicators of financial performance. It was found that when banks’ audit committee increase the number and quality of financial qualifications of members on total board membership; it will have a significant influence on the financial performance of the banks.

Dakhlallh (2020) examined the effect of audit committee on Jordanian companies’ performance. He proxied audit committee with audit committee size, audit committee independence, audit committee financial expertise, and stock owned by audit committee members, but firm performance was proxied with Tobin's Q, using a sample of 180 firms from the financial, industrial and service companies listed on Amman Stock Exchange (ASE)during the period of 2009 to 2017. He used a panel data analysis in his investigation. His study produced a result that showed that the size of the audit committee, the independence of the audit committee, and the financial expertise of the audit committee have a positive and significant relationship with firm performance. While the relationship between stocks owned by the audit committee members and firm performance is significantly negative.

Chijoke-Mgbame, Boateng, and Chijoke (2020) considered the effects of female representation and the proportion of female representation on corporate boards and audit committees on financial performance in an African context where institutions are weak. They employed a panel of 77 firms, and they found that female board representation exerts a positive and significant influence on firm financial performance. Their study also found that the performance effect of gender diversity is stronger for firms with two or more female directors, suggesting that building a critical mass of female representation enhances firm financial performance. Their study further indicated that the inclusion of females on the audit committee appears to have a positive impact on firm financial performance.

Ala Hussein, A. et al (2020) investigated the effect of board of directors and audit committee characteristics on company performance in Jordan. The approach of panel data was adopted between 2015 to 2019, with listed samples of 140 non-financial industries under the Amman Stock Exchange (ASE). Performance was measured using return on assets (ROA). It was indicated from the results that, the following variables (independent board of directors, expert in auditing committee) positively had impact on the performance ability of selected firms. It was also shown that, independent auditing committee and board size of smaller capacity could enhance the performance potential of the firms. However, no significant difference was found on the performance of firms in terms of frequency of board meetings and structure of leadership.

Armstrong and Gyimah (2019) studied the impact of audit committees meetings and audit fees on the financial performance of listed banks in Ghana. Financial performance was measured using return on assets (ROA), and return on equity (ROE). The study adopted panel data regression analysis. The study found that listed banks financial performance with respect to return on assets (ROA) was positively influenced by audit committee size and audit fees. However, return on equity (ROE) was negatively skewed by audit committee meetings.

Oroud (2019) investigated the relationship between audit committee characteristics (size, independence, meeting and financial expertise) and the profitability of industrial companies listed on the Amman Stock Exchange (ASE) for the years 2013 to 2017, utilizing the fixed effect approach of the panel data regression analysis on the data from 51companies which amounted to 255 observations, and also using company size and leverage as control variables. His dependent variable, profitability, was measured with return on investment and return on equity. He found that audit committee characteristics have a significant effect on profitability of the industrial companies listed in Jordan.

Awinbugri and Prince (2019) researched the impact of audit committee on financial performance of banks listed on the Ghana Stock Exchange; the Audit committee variables used were: Audit Committee Meetings, Audit Committee Size, and Audit fees. On the other hand, they measured financial performance using return on asset and return on equity; using regression model; they found that listed banks financial performance with respect to return on assets was positively influenced by audit committee size, and audit fees, while frequency of audit committee meetings negatively influenced return on assets as well as return on equity. Their results indicated that over 60% of variability in financial performance of the listed banks in Ghana was due to Audit committee and fees.

Ali et al (2018) studied board of directors, audit committee and the financial performance of listed companies in Malaysia. The study used a sample of 150 non-financial listed companies in Malaysia for the year 2014. The dependent variable was measured using return on equity (ROE). Regression analysis was conducted using statistical package of social science version 22 (SPSS 22). The results of the study showed significant and positive relationships between all the independent variables (board independence, board size, board expertise, audit committee independence, and audit committee expertise) and financial performance (ROE) of companies listed on Bursa Malaysia.

Yusuf, Bambale, and Abdullahi (2018) tested the effect of corporate governance on financial performance of money deposit banks in Nigeria; measuring corporate governance as audit committee, board size, and board composition, while financial performance was measured as return on assets; they carried out their data analysis using both partial correlation and regression. They found that audit committee size have insignificant positive effect on financial performance, while board size and board composition have an insignificantly negative impact on financial performance of deposit money banks in Nigeria. It also revealed that small board size (board of director) contributes positively and significantly to the financial performance of deposit money banks in Nigeria.

Abu-Zraiq and Bt-Fadzil (2018) examined the relationship between audit committee and firm performance of the Jordanian firms. Their study used multiple regression, the OLS method to test the relationship between audit committee and firm performance; obtaining data from 228 Jordanian firms. Their findings showed that a positive relationship exist between audit committee size and return on assets, while audit committee size and earnings per share had a positive and significant relationship. Furthermore, their result showed that audit committee meetings had a significant and positive relationship with return on assets. They also found a positive, but insignificant relationship between audit committee meetings and earnings per share.

3. RESEARCH METHODOLOGY

3.1 Population and Sample

The population for the study comprises all deposit money banks in Nigeria, from 2009 to 2018, which are 21 banks. The sample for this study comprised the 13 deposit money banks in Nigeria whose annual financial report contained complete data for all the variables under investigation. Quantitative data from secondary source, which are audited financial statements of the deposit money banks from 2009 to 2018, were used in this study.

3.2 Methods of Data Analysis

The data collected by the researcher was analyzed using: Panel data analysis approach of Panel multiple regression technique with the aid of E-views 9 Package. The data for the banks were pooled together to form a panel data

.

3.3 Model Specification

ROCE= β_0+ β_1ACS + β_2ACFE + β_3FACM + β_4FSize + β_5FLev + ε

Where:

ROCE = Return on Capital Employed

ACC = Audit Committee Characteristics

ACS = Audit Committee Size

ACFE = Audit Committee Financial expertise

FACM = Frequency of Audit Committee Meeting

FSize = Firm Size

FLev = Firm Leverage

ε = Error Term

While the study focuses on Audit committee characteristic, it is understood that performance may not be solely dependent on audit committee. Hence, the addition of firm size and firm leverage as control variables for this study.

4. RESULTS AND DISCUSSION

The table below presents the panel data regression result for the effect of audit committee characteristics and the performance of firms measured by the return on capital employed of firms.

Table 1: Model 1: Estimation results

Dependent Variable: ROCE
Method: Panel Least Squares
Date: 09/23/20 Time: 15:10
Sample: 2009 2018
Periods included: 10
Cross-sections included: 13
Total panel (balanced) observations: 130

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.535958	1.110362	0.482688	0.6302
ACS	-0.007132	0.172819	-0.041268	0.9671
ACFE	0.086848	0.085422	1.016696	0.3113
FACM	-0.045303	0.060686	-0.746525	0.4568
FSIZE	-0.013026	0.021314	-0.611161	0.5422
FLEV	-0.014871	0.010659	-1.395110	0.1655

R-squared	0.038577	Mean dependent var	0.114734
Adjusted R-squared	-0.000190	S.D. dependent var	0.731482
S.E. of regression	0.731552	Akaike info criterion	2.257758
Sum squared resid	66.36085	Schwarz criterion	2.390105
Log likelihood	-140.7542	Hannan-Quinn criter.	2.311535
F-statistic	0.995088	Durbin-Watson stat	1.359627
Prob(F-statistic)	0.423647		

Source: Output results from E-view

From the above, the results show that the coefficient of ACS is -0.007132, and this suggests a negative relationship between ACS and ROCE, but the associated p-value which is 0.9671 is more than 0.05 level of significance, which essentially indicates an insignificant negative effect. The result also shows that ACFE has a coefficient of 0.086848, suggesting a positive relationship, but the associated p-value is 0.3113, which in fact reveals that no significant effect of ACFE ion ROCE. Likewise, the result shows that the coefficient of FACM is -0.045303, implying a negative relationship between FACM and ROCE. Nevertheless, the associated p-value indicates that this relationship is not significant at 0.05 significance level. Similarly the result showed that the coefficient of the control variables FSIZE and FLEV are -0.013026 and -0.014871 respectively indicating negative relationship but with associated p-values of 0.5422 and 0.1655, there is no significant relationship.

The results of this study showed that audit committee characteristics and financial performance measures do not have statistically significant relationship. The panel data results showed that audit committee characteristics chosen in this study have no significant effect on the performance of Deposit Money Banks in Nigeria. This might be due to the fact that banks generate good return, in this case, return on capital employed, based on the efficient lending policies and strong maintenance of assets quality by decreasing assets quality ratio. Most banks that profit are not necessarily those that have strong internal control but those that are able to maximize lending to its fullest. The business of lending and at the same time, minimizing non-performing loans or loan impairments (decreased assets quality ratio) is what generate performance in the banking sector. This result supports the findings of Al-Matari and Al-Swidi (2014), Ojeka, Iyoha, & Obigbemi (2014), Ebere & Ibanichuka (2016),Yusuf, Bambale, and Abdullahi (2018), Zhou,Owusu-Ansah, and Maggina (2018) as well as Olayinka (2019). The implication is that whether you have many or few directors on the board's audit committee in a bank is irrelevant for the financial performance of the bank. This implies that, there should be no focus on the size of audit committee, when a bank is considering what to do in order to increase bank's performance, perhaps the focus should be on the quality of the committee.

5. CONCLUSION AND RECOMMENDATION

Several past investigations suggest that audit committee size, financial expertise, and frequency of audit committee meetings influence financial performance (Oroud 2019; Awinbugri & Prince, 2019; Dakhlallh et al, 2020). This study had deviated from norm and seems to suggest that the assertions doo not hold through in Nigeria banking sector. In spite of this, the outcome of this study point toward the fact that size, financial expertise and frequency of meetings of the audit committee have no predictive power on the financial performance of deposit money banks in Nigeria in agreement with the findings of Olayinka (2019) who also studied the Nigeria banking sector. The three audit committee characteristics investigated in this study such as audit committee size, audit committee financial expertise and audit committee meeting frequency exhibited inability to predict the two financial performance indicators employed in the study. In conclusion, factors which could predict performance in other economy may not do so in the Nigerian context, raising the concern that Audit committee characteristics might be country specific. Thus, there would be need for further studies to clarify this area.

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