

Audit Committee Independence and Corporate Financial Reporting Quality in Aluminum Corrugating Companies in Rivers State

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Abstract

This study examined the relationship between Audit Committee Independence of and Corporate Financial Reporting Quality in Aluminium Corrugating Companies in Rivers State. The study dimensions of independence were used and reliability, timeliness and relevance are the measures. A total population of 70 employees was drawn from six Aluminium Corrugating companies in Rivers State and sample size of 60 was determined using Taro-Yemen statistical instrument at 0.05 level of significant. Survey design was adopted and questionnaire was used to elicit information. The instruments were validated with reliability above 0.70 co-efficient using Cronbach Alpha. Also, 60 copies of questionnaire were distributed to respondents while 55 copies of questionnaire were completed and retrieved. Hypotheses were tested using Pearson's Product Moment Correlation Coefficient (r) and Multiple Regression Analysis (Ordinary Least Square Method) using statistical package for social sciences version. Our findings at 0.05 level of significance reveals that independence was found to have stronger relationship with reliability and a strong relationship with timeliness but moderate relationship with relevance of the surveyed Aluminium Corrugating companies. Based on our findings, we conclude with a model which shows that audit committee independence significantly relate with corporate financial reporting quality in Aluminium Corrugating companies in Rivers State. Hence, we recommend that the entire legal and regulatory framework together with the necessary institutional and environmental architecture for proper constitution and operation of an efficient audit committee should be over hauled and maintained at all times to enhance corporate governance and improve financial reporting quality of selected Aluminium Corrugating companies in Rivers State. Corporate governance regulation should be improved in order to strengthen financial reporting quality in the selected aluminium companies. Finally, regular meetings of audit committees are also recommended for effective performance. Companies should adopt the international standard which recommends that the audit committee should meet at least four times a year in order to be effective.

Keywords: *Audit Committee Independence, Corporate Financial Reporting Quality, Aluminum Corrugating Companies*

Introduction

The establishment and development of public limited companies brought about changes in the organizational and ownership structures. These changes in the ownership structure resulted in a complete divorce between ownership and control. The latter prompted shareholders of company to employ professional managers to carry-out oversight functions in managing the affairs of the company. Corporate financial reporting is a major corporate obligation and a center component of the corporate framework. This is on the grounds that,

the money related detailing fills in as the real medium of correspondence amongst organizations and partners by lessening the level of data asymmetry between the chiefs, who approach administration data and suppliers of back who are outer to the organization (Whittington, 1993). Corporate money related detailing is characterized as the accuracy with which monetary revealing passes on data about the association's operations, specifically its normal money streams. Bartons (2005) assert that existing and potential shareholders use corporate financial reports to evaluate the investment potential of a company's shares, creditors and lenders to assess the creditworthiness and liquidity, government to administer the company law.

In Nigeria the formation of audit committee is traced to the promulgation of Companies and Allied Matters Act of (1990) as amended in (2004) that replace companies Act of (1968). Section 359 (3) requires public companies to establish audit committee to examine and review reports of auditors and make adequate recommendations to the members of the company in Annual General Meeting (AGM). DeZoort (2002) state that a compelling audit committee has qualified individuals with the specialist and assets to secure partner's interests by guaranteeing dependable money related revealing, inside controls, and hazard administration through its steady oversight endeavors. Audit committees make recommendations to the board of directors on the selection of an external auditors, liaise with senior financial managers and external auditors on issues such as the financial statements, audit process and internal controls, as well as oversee internal auditors, external auditors, and management to ensure that they act on the best interest of the shareholders. Lindsell (1992) assert that one of the mechanisms that have been widely used by corporate organizations to monitor the effectiveness and efficiency of financial statement is the audit committee. Baxter and Cotter (2009) indicated that the audit committees assist corporate governance in the improvement of financial reporting quality. Hence, Ojo (2009) pointed out that, the aim of establishing audit committee is to overhaul the financial system and uphold the integrity of financial statements to reflect economic substance and present a true and fair financial statement. The existence of audit committee provides and oversight financial reporting and auditing process.

Statement of the Problem

Audit committee has been in existence for decades (Krushan, 2005). In Nigeria, Companies and Allied Matters Act CAMA (1990) as amended in (2004) created the audit committee. The audit committee created by this Act comprises equal number of directors and representatives of shareholders which shall not exceed six (6). However, despite the relevance and glamour to establish audit committee for public companies in Nigeria, their functions, responsibilities and practices have been criticized; this criticism resulted from the fact that, the audit committee might not be capable to handle the expected responsibilities, since the same law is silent to their professional capability and qualification (Enofe, Arontuwan & Abadua, 2013).

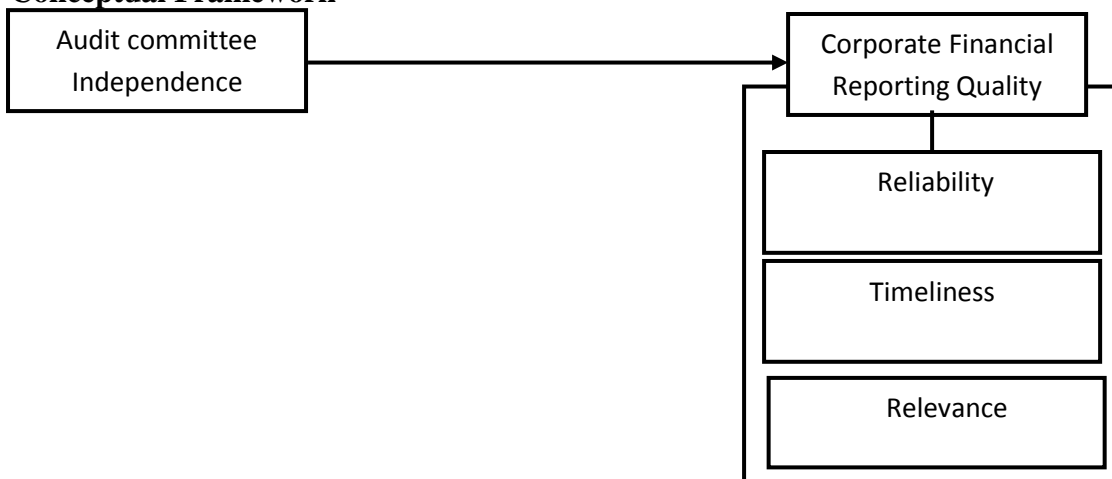
The inclination of poor corporate money related announcing quality is quick turning into a key test for partners in the Nigerian corporate setting. The instances of African Petroleum PLC which indicate money related explanations of the organization did not genuinely display the organization's monetary position (Oyejide and Soyibo, 2001), Cadburv Nigeria Plc (Itsueli, 2006) and the saving money division which saw the Economic and Financial Crimes Commission (EFCC) summoning the best administration of a portion of the banks because of false budgetary revealing are works of art cases of budgetary detailing challenges in Nigeria. The later propose to us that the risk of poor corporate money related detailing quality as of

now sneaks around. The suggestion is that there would be a continuous rise of doubts in the brain of speculators, investors and different partners on the validity of monetary reports of organizations in Nigeria. Hence, this study fills these gaps by examining the relationship between audit committee characteristics and corporate financial reporting quality of Aluminium Corrugating companies in Rivers State.

The general Purpose of this study is to determine empirically the relationship between Independence of audit committee and corporate financial reporting quality in Aluminum Corrugating companies in Rivers State with the following specific objectives:

- i. To determine the extent of relationship between Independence of the audit committee and reliability of corporate financial report in Aluminum Corrugating companies in Rivers State.
- ii. To investigate the extent of relationship between independence of the audit committee and Timeliness of corporate financial report in Aluminum Corrugating companies in Rivers State.
- iii. To determine the extent of relationship between independence of the audit committee and Relevance of corporate financial report in Aluminum Corrugating companies in Rivers State.

Conceptual Framework



Source: Conceptualized from Desk Research 2017

Review of Literature

Theoretical Framework

Institutional Theory

The principle of institutional theory is defined by the facts that an organization consists of social and symbolic structures that constitute its broader institutional environment. This theory places emphasis on the adoption and operations of audit committee that measures the independence of audit committee members. Bradbury (2006) state that the composition of audit committee is mostly and exclusively by outside directors that are more independent than other committee members. Requirement of at least three directors for listed companies. Bryan, Liv and Tiras (2004) noted that the independence of the audit committee is a positive influence on the quality of earnings. Hence, the independence of member of audit committee is the most significant criterion with the effect on reliability of financial statement. Institutional theory place emphasis that audit committee considers changes in organizational process overtime, and how governance fulfill ritualistic roles that helps legitimize the international among the various actors within the corporate governance.

Development of Audit Committee

McKee (1979) “claimed that prior to the rise of the auditing profession in the United States committees such as the audit committee of the East Tennessee (ET) and Western North Carolina Railroad WNCRR) frequently handled the auditing task in 1870, On 28 February 1870, shareholders of the ET and WNCRR appointed a special committee, which was required to inspect the accounts of the offices of the Board of Directors of the company and report at the next meeting (McKee, 1979)”. The authors commented this may be one of the soonest recorded occasions in the United States of a review advisory group answering to the governing body of an organization.

Audit committees were first proposed by the American Institute Certified of Public Accountants (AICPA) as right on time as 1937 and have been supported by the SEC since 1940. One intriguing pattern revealed amid a survey of applicable writing recommends that, in the greater part of the nations where they have turned out to be built up, review boards have been animated by startling organization disappointments and additionally corporate misbehavior (Vanasco, 1994). In addition, Green (1994) noted that “corporate audit committees have developed and evolved as a result of dissatisfaction with methods of corporate governance”. “Audit committees have been under pressure to accept increasingly higher levels of responsibility over the past decade because of the increasing public pressure for greater corporate accountability.

Audit Committee Characteristics

In relation to audit committee composition, we focus on the gender composition of audit committees and its purported influence on corporate financial reporting quality. There is increasing emphasis for audit committees to be composed of both male and female members and such integration could influence the effectiveness of the audit committee. Psychology and management theories have long acknowledged that significant gender-based differences exist, for instance, in leadership styles, communicative skills, risk averseness, and decision-making. Given these differences and their potential implications for corporate governance, the issue of gender composition has begun to receive increasing attention in corporate governance and especially in investigating the link between audit committee composition and corporate financial reporting quality.

Independence

The concept independence was primarily of British origin in the 19th century, where auditors doubled as book keepers (Baker, 2005). According to Izedonmi (2000) asserted that independence is a state of the mind characterized by objectivity and integrity on the part of the auditor. It implies the performance of the auditor work without being biased. Aderibigbe (2005) viewed independence as an emotive word that portrays freedom, integrity and all that is good. Kirk (2000) stated that one of the primary objectives of the audit committee is to give unbiased reviews on corporate financial information, and audit committee independence contributes to the corporate financial reporting quality of companies.

Corporate Financial Reporting Quality

Corporate financial reporting quality has been generally recognized as a vital area in accounting. Numerous accounting professional institution world over have made attempts to define the objectives of financial statement and financial reporting which is vital to the development of financial accounting theory and practice (Cyert, 2009 & Kirk, 2010). The term financial reporting refers to accounting information that is prepared by management to meet the needs of various users. Ball (2006) noted that corporate financial reporting is an

important economic activity. Healy and Palepu (2001) state that the demand for corporate financial reporting results from the data asymmetry between the administrators and proprietors of the organization.

Audit Committee and Corporate Financial Reporting Quality

Audit committee plays significant parts in strengthening the corporate financial reporting quality. Hence, Studies have analyzed the link between audit committee and corporate financial reporting. According to Abbott and packer (2000) stated that audit committee particularly active and independent committees are less likely to experience fraud and other reporting irregularities. Audit committee is effective in reducing misleading financial statements. Accordingly, Simnett (1993) pointed that; audit committee is expected to promote the effectiveness of both the internal and external auditors. Cardbury (1992) opines that, audit committee to be effective majority, if not all should be in dependent and they should have adequate comprehension of bookkeeping, inspecting and control issues. Carcello and Neal (2000) opines that, reviewers are probably going to issue going concern reports within the sight of more autonomous sheets and are less to be terminated by the organization following the issuance of a going concern review report.

Reliability/Faithful Representation

FASB states that with a specific end goal to be helpful, money related data must speak to applicable marvels, as well as must reliably speak to the wonders that it implies to speak to. To be a flawlessly devoted portrayal, data must be finished, nonpartisan and free from blunder. A total delineation incorporates all data fundamental for a client to comprehend wonder being portrayed, including every single important depiction, clarifications and points of interest. Besides, keeping in mind the end goal to accomplish unwavering portrayal, a nonpartisan delineation is obligatory. Nonpartisan data does not mean data with no reason or no impact upon conduct. Despite what might be expected, as it was at that point said some time recently, pertinent data is fit for having any kind of effect in clients choices. A nonpartisan portrayal isn't controlled keeping in mind the end goal to adjust or change clients' choices, to impact them. Steadfast portrayal is a term that is utilized additionally when endeavoring to clarify what unwavering quality means. It is essential to see that in the past IASB utilized the term unwavering quality to portray what is presently called dedicated portrayal.

Timeliness

Timeliness of financial reporting is an important qualitative characteristic of financial information (Beest, Braam & Boelens 2009).The Conceptual Framework for Financial Reporting 2010 identified timeliness as one of the four characteristics of useful information (IASB 2010).Exposure Draft, 'An improved Conceptual Framework for Financial Reporting' of the US Financial Accounting Standard Board (FASB) and the International Accounting Standard Board (IASB) defined timeliness as "having information available to decision makers before it loses its capacity to influence decisions" (IASB 2008: 40).

Relevance

Relevance is referred to as the ability of having any kind of effect in the choices made by clients in their ability as capital suppliers (IASB, 2008). Drawing on earlier writing, pertinence is operationalized utilizing four things alluding to prescient and corroborative esteem. As talked about before, scientists tend to concentrate on profit quality rather than on money related detailing quality. This definition is constrained in scope since it disregards non-monetary data and it bars 'future' budgetary data effectively accessible to the clients of

the yearly report, for instance on future exchanges (Jonas and Blanchet, 2000; Nichols and Wahlen, 2004). To enhance the breadth of the quality evaluating estimation device, this investigation will consider a more extensive point of view on prescient esteem including both money related and non-budgetary data. Numerous analysts have operationalized prescient incentive as the capacity of past income to anticipate future profit (e.g. Francis et al., 2004; Lipe, 1990; Schipper and Vincent, 2003).

Empirical Reviews

Madawaki & Amran (2013) examined whether audit committees are related with enhanced monetary revealing quality for a specimen of Nigerian recorded organizations preceding and after a corporate administration code ordered new controls for review panels in 2003. Utilizing an example of 70 organizations recorded on the Nigerian Stock Exchange, the investigation utilized documented information as organizations' yearly reports to quantify the relationship between review boards of trustees and enhanced budgetary revealing quality. Dechow and Dichev (2002's) show was likewise used to gauge profit as an intermediary for monetary detailing quality.

Methodology

Cross-sectional method was used in this study. The study also adopted the use of quantitative, statistical or regression techniques in testing and evaluating research questions and hypotheses. The population size of this study consists of 70 staff from six selected Aluminium Corrugating companies operating in Rivers State, Nigeria, namely, East Chez Aluminum Co. Ltd, Alo Aluminum Manuf. Company Ltd, Asaba Aluminum Company Ltd, Best Aluminum, Delta Aluminum Company Ltd and Ifeco Aluminum Company Ltd. For the sample size of the study, the Taro Yamen's sample size determination formula was adopted in determining the sample independence of 60 respondents. In obtaining the data for this study, the primary and secondary methods of data collection will be employed. In this study, Pearson correlation coefficient statistical tools with the aid of statistical package for social sciences. Pearson was adopted because it is one of the appropriate techniques for examining the relationship between variables (Gujarati & Porter, 2009). The use of regression was also adopted to avoid the problem of multi co linearity, aggregation bias and endogeneity problems (Greene, 2002).

Results and Discussion

Test of Hypothesis 1

Table 1: Correlation Analysis on the Extent and Direction of the Relationship between Independence and Reliability

		Independence	Reliability
Independence	Pearson Correlation	1	.944**
	Sig. (2-tailed)		.000
	N	55	55
Reliability	Pearson Correlation	.944**	1
	Sig. (2-tailed)	.000	
	N	55	55

** . Correlation is significant at the 0.01 level (2-tailed).

Source: SPSS, data output 2017

Table 1 shows the correlation analysis on the extent and direction of the relationship between independence and reliability. The table showed a correlation coefficient of $r = 0.944^{**}$ with a correspondent significant/probability value of 0.000, from the classification of r value in table 1, the value is very strong. Also the correlation coefficient is positive which indicate that an increase in reliability is associated with an increase in independence of audit committee. Thus the analysis from table 1 shows that there is a strong significant relationship between independence and reliability.

Table 2 Correlation Analysis on the Extent and Direction of the Relationship between Independence and Timeliness

		Independence	Timeliness
Independence	Pearson Correlation	1	.625 ^{**}
	Sig. (2-tailed)		.000
	N	55	55
Timeliness	Pearson Correlation	.625 ^{**}	1
	Sig. (2-tailed)	.000	
	N	55	55

^{**}. Correlation is significant at the 0.01 level (2-tailed).

Table 2 shows the correlation analysis on the extent and direction of the relationship between independence and timeliness. The table showed a correlation coefficient of $r = 0.625^{**}$ with a correspondent significant/probability value of 0.000. The r value shows a strong correlation. Also the correlation coefficient is positive which indicate that an increase in timeliness is associated with an increase in independence of audit committee. Thus the analysis shows that there is a strong significant relationship between independence and timeliness. Table 1 showed that the probability/significant value is 0.000, < 0.05 level of significance hence the researcher rejects the null hypothesis and conclude that there is significant relationship between independence and timeliness.

Table 3: Correlation Analysis on the Extent and Direction of the Relationship between Independence and Relevance

		Independence	Relevance
Independence	Pearson Correlation	1	.535 ^{**}
	Sig. (2-tailed)		.000
	N	55	55
Relevance	Pearson Correlation	.535 ^{**}	1
	Sig. (2-tailed)	.000	
	N	55	55

^{**}. Correlation is significant at the 0.01 level (2-tailed).

Table 3 shows the correlation analysis on the extent and direction of the relationship between independence and relevance. The table showed a correlation coefficient of $r = 0.535^{**}$ with a correspondent significant/probability value of 0.000. The r value indicates a moderate

correlation. Also the correlation coefficient is positive which indicate that an increase in relevance is associated with an increase in independence of audit committee. Thus the analysis shows that there is a positive significant relationship between independence and relevance.

Discussion of Findings

The test of hypotheses was done using primary data obtained from the respondents and the extent and direction of the relationship between the predictor variables (independence) and the measures of corporate financial reporting quality (reliability, timeliness and relevance) and also the effect of audit committee characteristics and its dimensions on corporate financial reporting quality and its measures of reliability, timeliness and relevance were determined.

The study findings show that there is a strong relationship between independence and reliability, also independence statistically affect reliability and timeliness. The implication of the findings is that an expansion in unwavering quality of money related report is related with the expansion in autonomy of review board of trustees. The Framework (1989) said that data has the nature of unwavering quality when it is free from material mistake and predisposition and can be relied on by clients to speak to loyally that which it either implies to speak to or could sensibly be required to speak to. The study finding is in line with the views of Aderibigbe (2005) who stated that independence is an emotive word that portrays freedom, integrity and all that is good. Kirk (2000) stated that one of the primary objectives of the audit committee is to give unbiased views on corporate financial information, and audit committee independence contributes to the corporate financial reporting quality of companies. Furthermore our finding corroborates the findings of Kibiya, Ahmad and Amran (2016) whose results show that control variables; company age and company size are statistically significant. Audit committee share ownership, and financial expertise are positive and statistically significant, indicating that audit committee monitoring mechanisms influence the financial reporting quality of listed nonfinancial firms in Nigeria.

Conclusion and Recommendations

Financial reporting is an exceptionally central corporate obligation and a center component of the corporate framework. This is on the grounds that the money related detailing fills in as the significant medium of correspondence amongst organizations and partners by decreasing the level of data asymmetry between the chiefs who approach administration data and other invested individuals who are outside to the organization. Given these improvements, the part of the review advisory group has been distinguished as being basic in guaranteeing believability of the budgetary detailing. Utilizing the office hypothetical system, the examination hypothesizes in accordance with earlier investigations that review board of trustees attributes can affect essentially on dependability, auspiciousness and significance and accordingly enhance the nature of corporate money related detailing. To support our contentions, review board estimate, autonomy was relapsed on corporate budgetary announcing quality measured by unwavering quality, convenience and significance. The investigation discoveries propose that review advisory group attributes are vital in enhancing the level of money related announcing quality in Rivers State.

In the light of this research work, the following recommendations are made:

- i. The entire legal and regulatory framework together with the necessary institutional and environmental architecture for proper constitution and operation of an efficient Audit Committee should be over hauled and maintained at all

- times to enhance corporate governance and improve financial reporting quality of selected Aluminum Corrugating companies in Rivers State.
- ii. Corporate governance regulation should be improved in order to strengthen financial reporting quality in the selected Aluminum Corrugating companies in Rivers State.
 - iii. Security and Exchange Commission (SEC) ought to guarantee that the greater parts of the individuals in the review council are monetarily proficient with a specific end goal to guarantee the trustworthiness of money related revealing.

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