

Audit Committee Diligence and Financial Reporting Quality of listed Non-Financial Firms in Sub-Saharan Africa

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Abstract

The study aims to address the inconsistency and unreliability of financial Reports among listed firms in Sub-Saharan Africa, attributed to insufficient audit committee diligence, lack of expertise, and limited oversight resources. By examining the impact of audit committee diligence on financial Reporting quality, the study seeks to enhance understanding of corporate governance mechanisms in the unique context of Sub-Saharan Africa. The main finding highlights the significant positive effect of audit committee diligence on financial Reporting quality. The study employed a panel dynamic regression analysis, using secondary data sourced from annual Reports of 235 non-financial firms listed on the Nigerian Exchange Group, Johannesburg Stock Exchange, and Nairobi Stock Exchange from 2013 to 2022. The Generalized Method of Moments (GMM) regression model was utilized to account for endogeneity and heteroscedasticity issues, ensuring robust and reliable results. The analysis reveals that audit committee diligence, particularly the frequency and effectiveness of meetings, significantly enhances the quality of financial Reporting. The results indicate a positive relationship between the number of audit committee meetings and financial Reporting quality, as measured by Jones Discretionary Accrual, with a significant coefficient (0.041, $p < 0.05$). This underscores the crucial role of diligent audit committees in improving financial transparency and reliability. This study contributes to the existing literature by providing empirical evidence on the importance of audit committee diligence in the context of Sub-Saharan Africa, a region that has been largely overlooked in previous research. The findings offer valuable insights for policymakers, regulators, and stakeholders, emphasizing the need for robust governance mechanisms to enhance financial Reporting quality and foster economic growth. The study also lays the groundwork for future research to explore other dimensions of audit committee effectiveness.

Keywords: Audit Committee Diligence, Financial Reporting Quality, Corporate Governance, Sub-Saharan Africa, Generalized Method of Moments (GMM)

1.0 Introduction

The quality of financial Reports is a critical aspect of corporate governance, especially in ensuring transparency and trust among stakeholders. Financial Reporting quality (FRQ) is fundamentally about the precision and reliability of financial information presented by firms. High-quality financial Reporting provides accurate and comprehensive insights into a company's financial health, aiding stakeholders in making informed decisions (Shuraki, Pourheidari, & Azizkhani, 2021). The significance of FRQ has been underscored by various financial scandals that have shaken investor confidence and market stability, emphasizing the

need for robust governance mechanisms (Namakavarani et al., 2021). Effective financial Reporting is essential not only for investor trust but also for the smooth functioning of financial markets and economic stability (IASB, 2018).

Audit committees play a pivotal role in enhancing the quality of financial Reports through diligent oversight and monitoring of the financial Reporting process. Audit committee diligence, characterized by frequent and effective meetings, is vital for maintaining the integrity of financial statements (Alqatamin, 2018). The effectiveness of these committees is often gauged by their ability to meet regularly, review audit processes, and ensure the implementation of robust internal controls (Abbott, Parker, & Peter, 2004). The presence of an active and independent audit committee can significantly reduce the likelihood of financial misReporting and fraud, thus enhancing overall financial Reporting quality (Emeh & Appah, 2013). Research indicates that diligent audit committees contribute to better financial Reporting by ensuring that management adheres to high standards of accuracy and transparency (Madawaki & Amran, 2014).

The relationship between audit committee diligence and financial Reporting quality is well-documented in academic literature. Diligent audit committees, which meet frequently, are more likely to identify and address issues in financial Reporting, thereby improving the quality and reliability of financial statements (Mutalib & Lawan, 2011). The regular meetings of audit committees facilitate continuous monitoring and timely intervention, which are crucial for maintaining high standards in financial Reporting (Mohd Naimi et al., 2010). This relationship underscores the importance of audit committee diligence as a key factor in ensuring robust financial governance and accountability.

In Sub-Saharan Africa, the quality of financial Reporting among listed firms faces several challenges, including weak governance structures and inadequate oversight by audit committees. The main problem is the inconsistency and unreliability of financial Reports, which undermine investor confidence and market stability. The root causes of this problem include insufficient diligence by audit committees, lack of expertise, and limited resources dedicated to financial oversight (Kabirib & Usman, 2021). The effect of poor financial Reporting is far-reaching, affecting not only investor decisions but also the overall performance and sustainability of businesses in the region (Musa, 2018). Despite the critical role of audit committees, there is a gap in literature focusing on their effectiveness in the context of Sub-Saharan Africa, necessitating further research to address these shortcomings (Majiyebo et al., 2018).

The lack of comprehensive studies on audit committee effectiveness in Sub-Saharan Africa highlights a significant gap in the literature. Most existing research has been conducted in developed countries with different regulatory environments, leaving a void in understanding how audit committees function in the unique context of Sub-Saharan African firms (Dabor & Adeyemi, 2009). The inconsistencies and inconclusive findings in previous studies further underscore the need for more focused research on the impact of audit committee diligence on financial Reporting quality in this region (Abbott et al., 2004). Addressing this gap is crucial for developing tailored governance mechanisms that enhance financial Reporting quality and foster economic growth in Sub-Saharan Africa.

This study contributes to the existing body of knowledge by providing an in-depth analysis of audit committee diligence and its impact on financial Reporting quality in listed firms in Sub-

Saharan Africa. By examining variables such as audit committee meetings, expertise, and resources, the study offers valuable insights into the factors that influence financial Reporting quality. The use of comprehensive data spanning multiple years allows for a robust analysis of trends and patterns, providing empirical evidence that can inform policy and practice (Alqatamin, 2018). The theoretical contributions of this study lie in its application of agency and stewardship theories to understand the dynamics of audit committees and financial Reporting. Empirically, the study fills a critical gap by focusing on a region that has been largely overlooked in previous research, offering practical implications for improving corporate governance and financial transparency in Sub-Saharan Africa.

2.0 Concepts and Hypotheses Development

2.1 Financial Reporting Quality

Financial Reporting Quality (FRQ) is a multifaceted concept that is critical for the transparency and reliability of a company's financial statements. According to Shuraki, Pourheidari, and Azizkhani (2021), FRQ refers to the extent to which financial information accurately reflects the economic events of a company. High-quality financial Reports should be free from material misstatements and present a true and fair view of the company's financial performance and position. The International Accounting Standards Board (IASB, 2018) emphasizes that FRQ is essential for providing useful information to stakeholders, enabling them to make informed economic decisions. Various authors have proposed different measures for assessing FRQ. For instance, Dechow, Ge, and Schrand (2010) suggest using accrual-based models to measure earnings quality, while Barth, Beaver, and Landsman (2018) advocate for value relevance models, which assess the correlation between stock prices and accounting figures. These measures help determine the reliability and accuracy of financial information disclosed in financial statements. Other approaches include the assessment of earnings management practices, timeliness of Reporting, and the presence of financial restatements, as indicated by Francis, LaFond, Olsson, and Schipper (2020). The implications of FRQ are significant for various stakeholders, including investors, regulators, and management. High-quality financial Reporting enhances investor confidence, reduces information asymmetry, and lowers the cost of capital (Pounder, 2019). It also helps regulators in monitoring and enforcing compliance with financial Reporting standards. For management, maintaining high FRQ can improve corporate reputation and stakeholder trust. For the present study, Financial Reporting Quality is defined as the degree to which financial statements accurately represent a company's financial performance and position, free from material misstatements, and provide reliable information for stakeholders' economic decision-making.

2.2 Audit Committee Diligence

Audit Committee Diligence is a crucial aspect of corporate governance, reflecting the committee's commitment to overseeing the financial Reporting process and internal controls. According to Alqatamin (2018), audit committee diligence is demonstrated by the frequency and effectiveness of meetings held by the audit committee to discuss and review financial Reporting and auditing processes. A diligent audit committee is proactive in its duties, ensuring that the financial statements are accurate and comply with regulatory standards. Different authors have measured audit committee diligence in various ways. Abbott, Parker, and Peter (2019) suggest that the number of audit committee meetings is a primary indicator of diligence,

with more frequent meetings implying higher diligence. Other studies, such as those by DeZoort et al. (2020), consider the quality of interactions during these meetings, including the depth of discussions on financial issues and the follow-up actions taken on audit findings. Additionally, the presence of members with financial expertise and their active participation in meetings are also considered crucial metrics of audit committee diligence (Emeh & Appah, 2019). The applications and implications of audit committee diligence are profound in enhancing the quality of financial Reporting and corporate governance. A diligent audit committee can identify and address financial irregularities early, thereby preventing financial misstatements and fraud (Mutalib & Lawan, 2020). This diligence not only protects the interests of shareholders but also upholds the company's reputation in the financial markets. For the present study, Audit Committee Diligence is defined as the proactive involvement of the audit committee in overseeing the financial Reporting process, characterized by frequent and effective meetings, thorough discussions on financial matters, and timely actions on audit issues.

2.3 Theoretical Foundation

The Agency Theory, proposed by Jensen and Meckling (1976), is central to understanding the dynamics between audit committee diligence and financial Reporting quality. This theory posits that there is a fundamental conflict of interest between the principals (shareholders) and the agents (management) due to the separation of ownership and control. The primary assumption of Agency Theory is that agents, acting in their self-interest, may not always act in the best interests of the principals, leading to agency costs. This theory suggests that mechanisms such as audit committees are established to monitor and mitigate these conflicts, ensuring that management's actions align with shareholder interests. However, one of the weaknesses of Agency Theory is its overly simplistic view of human behavior, assuming that all agents are primarily motivated by self-interest and may ignore other motivational factors such as professional ethics or stewardship (Donaldson & Davis, 1991).

Stewardship Theory, introduced by Donaldson and Davis (1989), offers a contrasting perspective by proposing that managers, when given trust and autonomy, are motivated to act in the best interests of the organization and its stakeholders. This theory assumes that managers are inherently trustworthy stewards who seek to achieve organizational goals rather than pursue personal gain. One key limitation of Stewardship Theory is its idealistic view of managerial behavior, which may not always hold true in practice, especially in diverse organizational contexts (Hernandez, 2012). Despite these limitations, Stewardship Theory connects to the variables of this study by suggesting that diligent and committed audit committees can enhance financial Reporting quality through their inherent motivation to ensure accuracy and integrity in financial Reporting. This theory supports the notion that audit committee diligence, characterized by frequent and effective meetings, can lead to higher quality financial Reporting by fostering a culture of accountability and transparency within the organization.

2.4 Hypothesis Development

Few studies examine the relationship between audit committee diligence and financial Reporting quality. In Africa, Asiriwuwa et al. (2018) analyzed the attributes of audit committees and audit quality among listed firms in Nigeria from 2010 to 2018. They found that the

frequency of audit committee meetings positively influences the quality of financial Reportings using a regression analysis. Similarly, Chukwu and Nwabochoi (2019) in Nigeria observed that regular audit committee meetings improve the timeliness of corporate financial Reporting in the Nigerian insurance industry through an ex-post facto research design. In Asia, Medhat et al. (2018) explored the impact of audit committee characteristics on financial statement comparability in Chinese firms. Their findings suggest that frequent meetings and the presence of financially knowledgeable members enhance financial Reporting quality. In a similar vein, Safari, Rezaei, and Abdollahi (2021) documented that diligent audit committees with frequent meetings improve financial Reporting quality in Iranian firms.

Conversely, some studies have reported negative findings. For instance, Chukwu and Nwabochoi (2019) also found a negative but insignificant relationship between audit committee meeting frequency and the timeliness of financial Reporting. Similarly, Odjaremu and Jeroh (2019) discovered that while audit committee size and independence positively influence financial Reporting timeliness, the frequency of meetings has an insignificant effect in Nigerian firms. Other studies like those by Bedard et al. (2004) and Lin et al. (2006) Reported no significant correlation between audit committee meeting frequency and financial Reporting quality. In contrast, Zhang and Zhou (2007) found a favorable association between the number of meetings and the quality of financial Reporting in U.S. firms. Beasley et al. (2000) observed that fraudulent firms have fewer audit committee meetings compared to their non-fraudulent counterparts, suggesting that meeting frequency could serve as a deterrent to financial misreporting. Hence, the following hypothesis is stated:

H1: There is no significant relationship between audit committee diligence and financial Reporting quality in listed firms in Sub-Saharan Africa.

3.0 Data and Method

The study's population encompasses all listed non-finance companies in Nigeria, South Africa, and Kenya. As of December 2022, there were 109 non-finance companies listed on the Nigerian Exchange Group (NGX), 243 on the Johannesburg Stock Exchange (JSE), and 45 on the Nairobi Stock Exchange (NSE). This brings the total population to 397 non-finance firms across these three countries. To ensure a comprehensive analysis, the study covers the period from 2013 to 2022, allowing for a detailed investigation of the trends and dynamics over a significant timeframe. The sampling technique employed in this study involves a straightforward filtering process based on specific selection criteria. The criteria are limited to companies listed on the NGX, JSE, and NSE from 2013 to 2022 that have publicly accessible annual financial Reports. Companies that operate subsidiaries in Nigeria, South Africa, and Kenya but are not listed on the relevant stock exchanges, as well as recently listed and delisted firms, will be excluded. This approach ensures that only non-financial companies with complete and continuous data are included in the sample. Consequently, the final sample size comprises 75 non-finance companies from Nigeria, 135 from South Africa, and 25 from Kenya, totaling 235 non-finance firms. Secondary data will be utilized for this study, sourced from the annual Reports of the listed firms from 2013 to 2022. This approach is justified by the reliability and comprehensiveness of secondary data, as highlighted by Jayeola, Agbatogun, and Akinrinlola (2017). The data collected will encompass various financial and governance-related variables necessary to test the study's hypotheses and achieve its objectives. In order to

test the hypotheses formulated in the study and to achieve the objectives of the research, the study adopted and modified the model of Umobong and Ibanichuka, (2017). Hence, the econometric model of the study is expressed as;

$$FRQT_{it} = \beta_0 + \beta_1 AUCD_{it} + \beta_2 CFOA_{it} + \mu_{it} .$$

Where:

- FRQT = Financial Reporting Quality
- AUCD = Audit Committee Diligence
- CFOA = Cashflow from Operations
- β_1 - β_2 = Slope Coefficient
- μ = Stochastic disturbance
- i = ith firm
- t = time period

4.0 Results and Discussion

In order to achieve the objectives of this study, the pool least square regression was conducted before proceeding to check for inconsistencies with the basic assumptions of the OLS regression. Succinctly, these diagnostics tests include test for multicollinearity as well as test for heteroscedasticity. The researcher also performs preliminary pre-regression analysis such as descriptive statistics and correlation matrix.

4.1 Descriptive Analysis

In this section, the researcher examines the descriptive statistics for both the explanatory or independent and dependent variables of interest. Each variable is examined based on the mean, standard deviation, maximum and minimum. Table 4.1 below displays the descriptive statistics for the study.

Table 4.1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
frqt	2350	-.392	2.833	-51.15	83.81
aucd	2350	3.995	1.253	1	15
cfoa	2350	.065	.396	-17.98	1.48

Source: Authors Computation (2024)

In Sub-Saharan Africa, where non-financial firms operate amidst unique economic and regulatory landscapes, understanding the descriptive statistics offers valuable insights into audit committee practices and financial Reporting quality. The result from the descriptive statistics presented in table 4.1 shows that the mean financial Reporting quality (FRQT) of -0.392 suggests on average, a slight negative discretionary accrual, indicating that firms tend to slightly underestimate their performance thus impairing their financial Reporting quality. However, the wide standard deviation of 2.833 indicates considerable variability in financial Reporting quality across firms, highlighting potential discrepancies in transparency and reliability. In the case of the independent variables, the result shows that the mean audit

committee diligence (AUCD) of 3.995 signifies that, on average, audit committees exhibit moderate to high levels of diligence in terms of meetings. This suggests a generally robust oversight mechanism in place, which could contribute to enhanced financial Reporting accuracy and integrity. This would imply that firms with more diligent audit committees are more proactive in their financial oversight. In the case of the control variable, the result shows that the mean of cashflow from operations (CFOA) ratio of 0.065 implies a generally positive cashflow from operations, indicating firms' ability to generate operational cash to sustain their business activities. However, the wide standard deviation suggests significant variability in cashflow performance, which could reflect diverse economic conditions and operational challenges across firms in Sub-Saharan Africa.

4.2 Correlation Analysis

In examining the association among the variables, the study employs the Pearson Correlation Coefficient (correlation matrix), and the results are presented in the table below.

Table 4.3: Correlation Analyses

Variables	(1)	(2)	(6)
(1) frqt	1.000		
(2) aucd	-0.056	1.000	
(6) cfoa	0.334	0.011	1.000

Source: Authors Computation (2024)

In the case of the correlation between audit committee diligence and financial Reporting quality, the above results show that there exists a negative association between the independent variable of audit committee diligence (-0.056) and the dependent variable of financial Reporting quality when measured in terms of Jones Discretionary Accrual during the period under study. Finally, in the case of the control variable, the result shows that there exists a positive association between cashflow from operations (0.334) and the dependent variable of financial Reporting quality when measured in terms of Jones Discretionary Accrual during the period under study. But, to test our hypotheses a regression results will be needed since correlation test does not capture cause-effect relationship.

4.3 Regression Analyses

Specifically, to examine the cause-effect relationships between the dependent variables and independent variables as well as to test the formulated hypotheses, the study used a panel dynamic regression analysis since the result reveal the presence of heteroscedasticity and endogeneity across.

Variables	(1) OLS-FRQT	(2) GMM I-FRQT	(3) GMM II-FRQT
aucd	-0.092** (0.042)	0.087 (0.088)	0.041*** (0.002)
cfoa	2.401*** (0.000)	3.487*** (0.000)	3.421*** (0.000)
L.frqt		0.499*** (0.000)	0.499*** (0.000)
Intercept	0.973***	-0.597	-0.547***

	(0.009)	(0.187)	(0.000)
Observations	2350	1878	1878
R ²	0.121		
F-stat	64.13 {0.000}	1940.12 {0.000}	816173.26 {0.000}
VIF	1.04		
Hettes:	368.76 {0.0000}		
endo:	1 {0.000}		
Sargen Test			chi2: 1.39 {0.322}

Source: Authors Computation (2024)

The table above represents the results obtained from the estimation of the models of this study. The results show that the dependent variable of financial Reporting quality has an R-Square value of 0.121 when measured in terms of Jones Discretionary Accrual. This implies that the independent and control variables of the study could explain about 12% of the systematic change in the dependent variable of financial Reporting quality when measured in terms of Jones Discretionary Accrual. However, the unexplained part of the changes in financial Reporting quality has been captured by the error term. The result of the F-statistics of the pool OLS regression model for the sample non-financial firms in Sub-Sahara Africa with the associated p-value of 0.000 indicates that the pool OLS regression model on the overall is statistically fit at 1% level of significance and can be employed for statistical inferences. However, to further validate the estimates of the pool OLS results for the combined regression results, this study also tests for multicollinearity, heteroscedasticity, and endogeneity. In the present analysis, the mean VIF of the model is Reported as 1.04. This value is well below the commonly accepted threshold of 10, as suggested by Gujarati (2004) and other statistical guidelines. A mean VIF below 10 indicates that multicollinearity is not a significant concern in the model under consideration. Specifically, the mean VIF being within the benchmark of 10 suggests that the independent variables included in the regressions are not highly correlated with each other. Consequently, there is no evidence to suggest that multicollinearity is distorting the estimation of coefficients or compromising the validity of the regression results. In the context of the study, the assumption of homoscedasticity is tested using the Breusch-Pagan module in Stata 14. This test assesses whether there is evidence of heteroscedasticity in the errors of the OLS regression model. The significant p-values obtained, particularly on the variable representing financial Reporting quality, indicate that the assumption of homoscedasticity has been violated. This suggests that the variability of errors is not consistent across different levels of total assets, potentially compromising the reliability of the standard errors and, consequently, the accuracy of the regression estimates. In response to this violation, the study opts to re-specify the model to address the issue of heteroscedasticity. One recommended approach to mitigate heteroscedasticity in panel data analysis is to employ panel dynamic regression, as advocated by Greene (2003). Panel dynamic regression models allow for the incorporation of both time-series and cross-sectional variations in the data, providing a more robust framework for analyzing dynamic relationships while accounting for heteroscedasticity. This study test for the endogeneity by generating the error term, and then regressing the error term against the dependent variables only and the results return a 1% significant level indicting the violation of the endogeneity assumption which also implies that there is a strong correlation between the error terms and the dependent variables. In lieu of conventional methodologies, the study implemented a sophisticated technique of dynamic panel data estimation by means of the two-step system GMM with robust standard errors to

control for the endogeneity bias in the results. The GMM employed in this study addresses various statistical concerns, including the temporal correlation of errors, heteroscedasticity across firms, simultaneity, and measurement errors.

4.4 Discussion of Findings

The results obtained from the GMM Step-II regression model presented in table 4.4 revealed that audit committee diligence [coef. = 0.041 (0.002)] has a positive significant effect at 5% on the financial Reporting quality of listed non-financial firms when measured in terms of Jones Discretionary Accrual. The result implies that an increase in audit committee meetings will significantly increase the financial Reporting quality when measured in terms of Jones Discretionary Accrual during the period under investigation. Hence, the null hypothesis that audit committee diligence has no significant effect on the financial Reporting quality of listed non-finance firms in Sub-Sahara Africa is rejected. The finding shows that audit committee diligence has a positive and significant effect on the financial Reporting quality of listed non-financial firms, as measured by Jones Discretionary Accrual. This result, significant at the 5% level, suggests that an increase in audit committee meetings correlates with a notable enhancement in financial Reporting quality during the period under investigation. The findings underscore the pivotal role of audit committee diligence in fostering transparency, reliability, and integrity in financial Reporting processes. The findings follow the studies of Leng (2023) who highlights the significance of robust governance mechanisms in ensuring the accuracy and credibility of financial disclosures. Similarly, Qader et al. (2023) emphasizes the positive impact of effective audit committee oversight on financial performance and stakeholder trust. Moreover, the findings resonate with the assertions of Juwita (2023) and Waris and Din (2022), who underscore the critical role of audit committees in upholding corporate governance standards and mitigating agency conflicts. Additionally, the observed relationship aligns with the conclusions drawn by Tan and Taufik (2022) and Feng (2022), who emphasize the importance of governance structures in enhancing firm value and mitigating information asymmetry. Furthermore, the findings corroborate the assertions of Jamhuri et al. (2022) and Ngo and Nguyen (2022) regarding the positive association between audit committee effectiveness and financial Reporting quality. Similarly, Hsu and Yang (2022) and Al-Qadasi et al. (2022) underscore the role of audit committee diligence in promoting accountability and transparency in corporate disclosures. The implications of the finding extend beyond governance literature to encompass broader implications for stakeholders, including investors, regulators, and policymakers. The positive relationship between audit committee diligence and financial Reporting quality underscores the importance of robust governance mechanisms in safeguarding investor interests, enhancing market efficiency, and fostering confidence in financial markets. Moreover, the findings underscore the imperative for regulatory authorities to promote best practices in corporate governance and ensure adequate oversight of audit committee activities to uphold financial Reporting standards.

5.0 Conclusion and Recommendations

The study addressed in this study is the inconsistency and unreliability of financial Reports among listed firms in Sub-Saharan Africa, primarily attributed to insufficient diligence by audit committees, lack of expertise, and limited resources dedicated to financial oversight. The primary aim of this study was to examine the impact of audit committee diligence on the

financial Reporting quality of listed non-financial firms in Sub-Saharan Africa, spanning the period from 2013 to 2022. The key findings of the study reveal that audit committee diligence, characterized by the frequency and effectiveness of meetings, has a significant positive effect on the quality of financial Reporting. The results obtained from the Generalized Method of Moments (GMM) regression model demonstrate that an increase in audit committee meetings is associated with a notable enhancement in financial Reporting quality, as measured by Jones Discretionary Accrual. This finding underscores the crucial role of diligent audit committees in ensuring accurate and reliable financial Reporting. The study's key takeaways emphasize the importance of robust governance mechanisms in fostering transparency and trust among stakeholders. The positive relationship between audit committee diligence and financial Reporting quality highlights the need for frequent and effective audit committee meetings to monitor and review financial Reporting processes rigorously. This diligence helps in identifying and addressing financial irregularities early, thereby preventing misstatements and fraud, and upholding the company's reputation in financial markets. Moreover, the study highlights the broader implications for stakeholders, including investors, regulators, and policymakers. High-quality financial Reporting, driven by diligent audit committees, enhances investor confidence, reduces information asymmetry, and lowers the cost of capital. It also supports regulators in monitoring and enforcing compliance with financial Reporting standards, contributing to overall market stability and economic growth in Sub-Saharan Africa. These findings underscore the imperative for regulatory authorities to promote best practices in corporate governance and ensure adequate oversight of audit committee activities to uphold financial Reporting standards.

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