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Audit Report and Corporate Governance: Effect on Firms Performance in Nigeria

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Abstract: This study examines the effects of audit report and corporate governance on firm performance with particular reference to listed firms in Nigeria. The study adopts three corporate governance mechanisms and performance variables. The data used were collated over a period of five years spanning from year 2012 to 2016. The t-test technique was used to test the hypotheses. The study revealed that both variables of auditor's report and corporate governance have significant effect on the performance of a firm. Since corporate governance is essential in today's business world, we therefore recommend among others that a cost effective corporate governance system should be put in place and special audit procedures adopted to test the efficacy of the system adopted and its effect on corporate performance.

Key words: Audit report · Corporate Governance · Firm Performance

INTRODUCTION

In the corporate world, research has it that the audit report produces the final product of any audit process and also provides auditor's judgment of the quality of the financial statements of clients. The audit report connects the auditor and financial statements' end users; and displays the most important aspect of the auditors' activity which expresses the result of financial statements' assessment to all users [1].

In a case where the audit report is objective and comprehensible, the audit report becomes a communicative media between the auditor and the audit reports' users and due to its relevance it can make a significant difference in making and taking decisions, otherwise, end users of such financial statements will not be able to utilize the report in the process of making decisions [2]. Hence, the auditor's report must be clear and without any ambiguity providing a clear connection with user of the information. The auditor documents should, therefore, be properly documented for the purpose of the audit to be achieved. If goals are not achieved, worksheets must contain the documentation of failure. Experts' opinion can be used to gather audit evidence. The auditor must review and assess the conclusions derived from the audit evidence which was obtained as a basis for the expression of an opinion on the financial statements as quality audit reports and good corporate governance are important steps in building market confidence and encouraging stable investment flow [3].

Research studies on corporate governance have been much reviewed in organizational sciences and economics. According to [2], corporate governance is "the process and structure by which the business and affairs of institutions are directed and managed, in order to improve long-term shareholders value by enhancing corporate performance and accountability, while taking into account the interest of other stakeholders."

[4], contends that corporate performance is an important concept which relates to the ways and manner in which both financial and non financial resources available to an organization are prudently utilized to obtain the overall corporate goal of an organization. It sustains the organization and creates a higher prospect for future opportunities.

Different writers on the subject of corporate governance have used a number of corporate governance mechanisms capable of reducing the principal-agent problem between managers and their stakeholders. Some of these mechanisms include board size and board composition. This study employs number of board

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committees as an additional corporate governance indicator variable. Employing the number of board committees as a corporate governance variable is justified on the ground that as more and more members are added to the board of directors' committee, intense monitoring of the company's activities will likely increase, especially at the helm of affairs. [5] Thus, this study entails the variables of audit report and corporate governance variables of board size, board composition and number of board committee's members as well as performance variables of Return on Equity as they relate to listed firms in Nigeria.

Statement of Problem: Generally, most business failures in the recent past have been attributed to failure in corporate governance such as insider related credit abuse, poor risk appreciation and internal control system credit failure. This particular research study is been spurred due to increasing loss of confidence on the capital market by investors, the persistent and unending agency problems and insolvency issues of large companies as a result of financial improprieties. Or put differently, weak corporate governance is perhaps the most important factor that has been considered to be the bane of corporate failure as a consequence from economic and corporate crises. However, there is so much that can be done to improve the integrity of financial reporting in these corporate entities. These may include: greater accountability, restoration of resources devoted to audit function and better corporate governance policies. Concerns have also emerged about reduced audit quality.

Objectives of the Study: The key objective of this study is to examine the effects of audit report and corporate governance on the performance of listed firms in Nigeria. However, the specific objectives include:

- To find out the extent to which corporate governance mechanism affect firms' performance.
- To examine the effects of auditor's report on firms performance.

Research Hypotheses: To guide this study, the following hypotheses have been formulated:

Ho: Corporate governance has no significant effect on the performance of listed firms in Nigeria.

Ho: Auditor's report has no significant effect on firms' performance.

Overview of Related Literature: No audit can be termed such unless a report is made on the auditor's findings. In a few words the auditor has to commit himself to a high degree of responsibility. If he is qualified then he is expected to exercise due care, skill and diligence in the performance of his duties. Should he fail he may be held responsible and liable for damages. It is essential, therefore, that the report should be carefully prepared to reflect his own opinion within the limits of his examination and sufficiently clear as to leave no likelihood of misinterpretation by those whom it concerns.

In [6] an audit report is attributed to be the single factor that determines the timeliness of accounting information. [3], notes delay in the public disclosure of most listed companies in Nigeria capital markets is due to issues as regards to waiting for audit report. In another dimension, [7] defined audit report as the number of elapsed days between year-end and the date of audit report signature.

Corporate Governance: Following [8], corporate governance describes the way in which firms' credit suppliers assure themselves of getting a positive return on their investments. Looking at a broader perspective on the issues, [9], posit that the term corporate governance is a system of laws, rules and factors that permits the control of operations in an organization. As opined by [10], corporate governance actually entails "duties and responsibilities of a company's board of directors in managing the company and their relationships with the shareholders of the company and the stakeholder groups". To make it work effectively, such dealing should be appropriately governed, regulated, imposed and enforced.

Corporate Governance Mechanisms and Firm Performance: One of the key objectives of corporate governance mechanism and controls is to reduce the inefficiencies that emanate from the dual effects of moral hazard and adverse selection. For instance, to check manager's behavior, a third party (usually the external auditor) attests the accuracy of received information provided by management to investors. This implies that an ideal control system should regulate both motivation and ability. In the same vein, [11] emphasize that, discipline in modern corporations is induced by both internal and external factors which affects corporate governance system of a company.

Board of Directors' Role: A director of a company is a trustee or custodian of the organization's human and material resources duly appointed to direct and manage the business of the organization. The board of directors, possesses its legal authority to hire, fire and compensate management, safeguard invested capital resources. Regular board meetings allow potential issues to be resolved, discussed and avoided. Non-executive directors' decisions are deemed to be more independent and seem to be less effective in corporate governance and possibly will not increase performance. In the view of most regulatory framework a company's board of directors is expected to prepare financial statements reflecting a true and fair view of the operations of the company during the firm's financial year.

Diverse opinions have been maintained as to whether the board should be composed of more executive directors or more outside directors, who have no tie with firm management (non-executive directors). [12], suggest a significant linear relationship between corporate governance variable of board independence and firm value. They assert that outside directors may play the role of "professional referees" ensuring that competition among executives results in actions consistent with shareholder value maximization. Conversely, the study of [13] cited in [12] favors more inside directors on the board because the activities of the firm is much familiar to them and they act as monitors to top management, especially if the opportunity to advance into positions held by incompetent executives is perceived. [13] cited in [6]tends to support the existence of a negative relationship between firm performance and board independence. [14] have maintained that the effectiveness of a board depends on the optimal mix of inside and outside directors.

However, there is very little theory on the determinants of an optimal board composition [2] Studies which totally deviate from the above findings are: John and [3] and [4] [14], who find no significant relationship between board composition and firm performance. The study of [15] reveals no relationship between the proportion of outside directors and various performance variables measures of sales, number of employees and return on equity. [16], employed the performance variables of Tobin's Q, return on assets, asset turnover and stock returns in their study. Findings reveal no association between the proportion of outside directors and all performance variables. In contrast, [17] and [7] show that the market rewards firms for appointing outside directors. Anderson, [4], reveal that the cost of debt, proxy by bond yield spreads, is not directly related to board independence. Thus, the relationship between the proportion of outside directors, a proxy for board independence and company performance is mixed.

Board of Directors Size: The size of boards is believed to impact on the performance of the corporation. In this regard, [1] cited in [11] argue that the market penalizes large boards i.e., those with membership between 4 and 10, beyond which no systematic relationship appears to exist. In a Nigerian study, [18], report that firm performance is positively correlated with small, as opposed to large boards. However, [19], reveal that companies with board members between six and fifteen obtain higher net profit margins and higher returns on equity than do firms with other board sizes.

The research study of [18], employed data from 93 Nigerian quoted firms and found similar results with [20] and [21]. Their results revealed that firm performance is directly related with small boards, as opposed to larger boards. In the study of [12] and [5], they recommend that larger boards are best fits for corporate performance since they possess a wide range of expertise that proffer better solutions making it difficult for powerful CEO to dominate. Nevertheless, [20] as cited in [18] and [21] contend that larger boards are far less effective and are easier for a CEO to control. Their arguments stems from the fact that when the number on the board of directors' gets too much, it becomes difficult to coordinate and creates numerous problems The view of [21] is in consonant with [20] who found a positive relationship between small board size and profitability, having used sample of small and midsize Finish firms.

Internal Accounting and Financial Audit: Internal control procedures are policies implemented by an organization's Board of Directors, Audit committee, Management and other personnel in order to provide reasonable assurance of the entity achieving its goals related to reliable financial reporting, operating efficiency and compliance with laid down laws and regulations. The audit committee plays a vital role in financial and operational controls in the whole system of corporate governance, by making recommendations to the board concerning the appointment and remuneration of external auditors, reviewing auditors' evaluation of the system of internal

control and accounting and considering and making recommendations on the conduct of any aspect of the business of the company which should be brought to the notice of the board, among others. The internal audit is an integral element of corporate governance and is carried out by an internal auditor who tests the design and implementation of the entity's internal control procedures and the reliability of its financial reporting.

Board of Committee Size: [8] have stressed the role of committee structure as a means of increasing the independence of the board. They argue for the need to set up specialized committees on audit, remuneration and appointment. This is also in line with the submission made by [22] that there should be a system of independent sub-committees of the board, especially the finance and audit and remuneration committees of companies. However, there is dearth of empirical research that seeks to establish the relationship between the number of board committee set-up by a firm and such firm's performance. This study seeks to adopt this dimension to bridge the knowledge gap in this area of study.

External Auditors: The main object of the external audit is to give a report on the view presented by the financial statements prepared by the managers. The detection of fraud and errors are incidental to this main object. The audit may also prevent the commission of fraud and errors by reason of the deterrent and moral check that it imposes. Regulators' reliance on external auditors is based on the belief that the auditors will act on behalf of either the public or the state and that auditors are independent of the management. To engender public confidence in the integrity of the external auditor, he/she must be skilful, careful, diligent, faithful and honest. Such an auditor supports the perception of corporate governance. If the external audit firm provides this support then the most critical consideration must be whether the internal audit department is staffed by different personnel from the external audit and also headed by a partner not involved in external audit activities.

Laws, Rules and Institutions: Laws, rules and institutions provide a competitive playing field and discipline the behavior of insiders, weather managers or shareholders. In developed market economies, some of the institutions that discipline corporations are the legal framework for enforcing shareholders rights, systems for accounting and auditing, a well-regulated financial system, the bankruptcy system and the market for corporation control. However, there is new increasing momentum internationally towards implementing more laws and government regulations that impose obligations on companies, their directors and officers. Failure to do so may lead to legal and criminal sanctions being imposed on them. [23], is of similar view, when he asserts that "the quality of governance is directly linked to the policy framework." The role of the governments is vital here, since they stand a better chance of shaping the legal, institutional and regulatory framework within which governance systems are developed. Therefore, if the framework conditions are not in order, the governance system will not be effective.

Theoretical Framework

Agency Theory: The Agency theory has been commonly adopted in literature to examine the information asymmetry that lies between principals (shareholders) and agent (management). This theory emanates as a result of the difference between the owners (shareholders) of the company (principal) and the executives who are hired to manage the organization (agent). Following [22] & [23], agency theory provides that the goal of the agent is at variance with that of the principal creating conflicts at all times. Furthermore, [24], states that a firm consists of a combination of linked contracts between both the shareholders (owners of economic resources: the principals) and managers (the agents) charged with the responsibilities of employing and controlling these scarce resources.

The theory argue that agents have much more information than principals which creates an asymmetry capable of adversely affecting the principals' ability to monitor whether or not their interests are being properly served by the agents. [25]

Stewardship Theory: According to the Stewardship theory, the relationship that exists between the board of directors' and the executives involves training, monitoring and shared decision making [5]. This further substantiates the opinion of [6] who suggests that the role of the board of directors' may not be too controlling, as implied by agency theory. Shareholders should play a supportive role and also empower the executives which will in turn increase the potentials for higher performance. Following

[26] stewardship theory states that managers or executives are stewards of the owners and they both share common goals.

Resource Dependence Theory: In the views [5], [7], [4] this theory provides that the board of directors' exists in order to provide resources to executives enabling them maximize organizational goals and objectives. This theory, recommends that the board of directors should intervene in aspect of advocating for strong human, financial and intangible support to the executives. For example, board members with professional expertise may groom and mentor members of the executives in a direction that adds to organizational performance. Board of directors' may also connect into their network of support mobilize useful resources into the organization. Hence, this theory advocates that most corporate decisions be made by the executives while approval of the board is been sorted.

Stakeholders' Theory: The basic assumption of the Stakeholder Theory is that a company's shareholders are not the only group with a stake in the company. Stakeholders theory advocate for corporate social responsibility, identified as a duty which needs to be operated in an ethical manner, even if it requires a reduction of long term profit for a company [5].

This theory argues that clients or customers, suppliers and the surrounding communities also have a stake in a business organization. They are capable of been affected by the success or failure of the company. The theory therefore recommends that managers have special obligations to ensure that all stakeholders (not just the shareholders) receive a fair return from their stake in the company. [26]

From the theories listed above, this study will be anchored on the agency theory to achieve the general and specific objectives of this study.

MATERIALS AND METHODS

The research design for this study is the survey research. Due to the impossibility to cover the general population of this study which is the entire listed firms in Nigeria, an assessable population was collected based on the availability of their financial report. The number of selected firms from the survey of the listed firms is a total of 50. This is made up of ten (10) firms selected from each of the four key sectors of the Nigeria, namely banking, conglomerates, manufacturing, Agriculture (Agro-allied) and petroleum. For the purpose of this study, the primary and secondary sources of data were used. The data analysis technique employed was the simple percentages and the Students T-test.

Data Presentation and Analysis

Q1: Board of Directors influences the performance of firms

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	25	50.0	50.0	50.0
	A	25	50.0	50.0	100.0
	Total	50	100.0	100.0	

Table above indicates that 50% strongly agreed, 50% Agreed that the Board of Directors can influence the performance of the firms

Q2: Quality of audit committee affects the performance of firms

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	7	14.0	14.0	14.0
	A	35	70.0	70.0	84.0
	N	3	6.0	6.0	90.0
	S.D	5	10.0	10.0	100.0
	Total	50	100.0	100.0	

The table indicates that 14.0% strongly agreed, 7.0% agreed, 6.0% were neutral and 10% strongly disagreed that the quality of audit committee can affect the performance of the firms.

Q3: A qualified Audit Report reduces the earnings in the next financial year

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	3	6.0	6.0	6.0
	A	38	76.0	76.0	82.0
	N	3	6.0	6.0	88.0
	D	3	6.0	6.0	94.0
	S.D	3	6.0	6.0	100.0
	Total	50	100.0	100.0	

Table above indicates that 6.0% strongly agreed, 76% agreed, 6.0% were neutral, 6.0% disagreed, 6.0% strongly disagreed that a qualified audit report reduces the earnings in the next financial year.

Q4: Firms with large shareholders have better competitive advantage

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	7	14.0	14.0	14.0
	A	32	64.0	64.0	78.0
	N	5	10.0	10.0	88.0
	D	3	6.0	6.0	94.0
	S.D	3	6.0	6.0	100.0
	Total	50	100.0	100.0	

Table above indicates that 14.0%strongly agreed, 64.0% Agreed, 10.0% were neutral, 6.0% disagreed while 6.0 strongly disagreed that firms with large number of shareholders have better competitive advantage.

Q5: The size of a firm has an effect on its life span

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	8	16.0	16.3	16.3
	A	33	66.0	67.3	83.6
	N	3	6.0	6.1	89.7
	D	3	6.0	6.1	95.8
	S.D	2	4.0	4.2	100.0
	Total	49	98	100.0	
Invalid		1	2		
Total		50	100.0		

The table indicates that 16.4% strongly agreed, 67.3% agreed while 6.1% were undecided, 6.1% disagreed and another 4.2% strongly disagreed that the size of a firm has an effect on its life span.

Q6: Continuous inability to express an opinion by an auditor can lead to failure of the firm

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	7	14.0	14.0	14.0
	A	28	56.0	56.0	70.0
	N	10	20.0	20.0	90.0
	S.D	5	10.0	10.0	100.0
	Total	50	100.0	100.0	

Table above indicates that 14.0% strongly agreed, 56.0% Agreed while 20% we disagreed that continuous inability to express an opinion by an auditor can lead to failure of the firm

Q7: Audit reports adds credibility to the financial statement

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	3	6.0	6.0	6.0
	A	32	64.0	64.0	70.0
	D	12	24.0	24.0	94.0
	S.D	3	6.0	6.0	100.0
	Total	50	100.0	100.0	

Table above indicates that 6.0% strongly agreed, 64.0% agreed while 24.0% disagreed, while 6.0% strongly disagreed that audit reports adds credibility to the financial statement

Q8: Ineffective internal control system can lead to firm failure

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	11	22	22	22
	A	24	48	48	70
	D	12	24	24	94
	S.D	3	6	6	100.0
	Total	50	100.0	100.0	

The table indicates that 22% strongly agreed, 48% agreed while 24% disagree 6% strongly disagreed that ineffective internal control system can lead to firm failure

Q9: Frequent Statutory audits are needed in the corporate entity

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	6	15.0	15.0	15.0
	A	22	55.0	55.0	70.0
	D	10	25.0	25.0	95.0
	S.D	2	5.0	5.0	100.0
	Total	40	100.0	100.0	

Table 4.2.1 indicates that 15.0% strongly agreed, 55.0 %Agreed while 25.0% disagreed, 5.0% strongly disagreed that Frequent Statutory audits are need in the corporate sector

Q10: Statutory reports are more reliable than management reports

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	SA	2	4.0	5.0	4
	A	39	78	77.5	82
	N	4	8	7.5	90
	S.D	5	10	10.0	100.0
	Total	50	100.0	100.0	

Table above indicates that 4.0%strongly agreed, 78% agreed while 8% were neutral while 10.0% strongly disagreed that statutory reports are more reliable than management reports.

Test of Hypotheses

Hypothesis 1:

H_o: Corporate governance has no significant effect on firms' performance.

H_i: Corporate governance has significant effect on firms' performance.

One-Sample Statistics

	N	Mean	Std. Deviation	Std. Error Mean
Q1	50	1.5000	.50637	.08006
Q2	50	2.2000	1.04268	.16486
Q3	50	2.2500	.83972	.13277
Q4	50	2.2000	.93918	.14850
Q5	49	2.1538	.93298	.14940

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	T	Df	Sig. (2-tailed)	Mean Difference	Lower	Upper
Q1	18.735	49	.000	1.50000	1.3381	1.6619
Q2	13.344	49	.000	2.20000	1.8665	2.5335
Q3	16.946	49	.000	2.25000	1.9814	2.5186
Q4	14.815	49	.000	2.20000	1.8996	2.5004
Q5	14.417	48	.000	2.15385	1.8514	2.4563

Level of significance (X) = 5% = 0.05
Degree of Freedom (df) = (R-1)(C-1)
Where R = Row total =(5), C = Column total = (5)
Df = (5-1) (5-1)= 4 x 4 = 16
Critical Value $X^2_{tab} = X^2_{0.05}$df 16
$X^2_{tab} = 1.7459$

From the t-test result above, the mean of 10.30385 is obtained and accepted because it falls under the Acceptance region of the Likert Scale. This shows that corporate governance has effect on firm performance. Though there is an effect; the significance on firm performance can be ascertained with the one-sample t-test (X^2) calculated, by applying the decision rule.

Decision Rule:

Reject Null hypothesis if, $X^2_{Cal} > X^2_{tab}$, otherwise do not reject Null hypothesis

Result: $X^2_{Cal} = 71.435$

X^2_{tab}, = 1.7459

The X^2_{tab} is tested on 5% significant level; Since X^2_{Cal} is greater than X^2tab, the Null hypothesis is therefore rejected and the Alternative hypothesis Accepted that states that corporate governance have effect on firm performance of a company.

Hypothesis 2:

H_0: Auditor's report does not have any effect on firm's performance

H_i: Auditor's report has an effect on firm's performance.

One-Sample Statistics

	N	Mean	Std. Deviation	Std. Error Mean
Q6	50	2.3500	1.07537	.17003
Q7	50	2.6000	1.08131	.17097
Q8	50	2.4250	1.23802	.19575
Q9	50	2.5000	1.17670	.18605
Q10	50	2.3250	.97106	.15354

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	T	Df	Sig. (2-tailed)	Mean Difference	Lower	Upper
Q6	13.821	49	.000	2.35000	2.0061	2.6939
Q7	15.207	49	.000	2.60000	2.2542	2.9458
Q8	12.388	49	.000	2.42500	2.0291	2.8209
Q9	13.437	49	.000	2.50000	2.1237	2.8763
Q10	15.143	49	.000	2.32500	2.0144	2.6356

Level of significance (X) = 5% = 0.05
Degree of Freedom (df) = (R-1)(C-1)
Where R = Row total =(5), C = Column total = (5)
Df = (5-1) (5-1)= 4 x 4 = 16
Critical Value $X^2_{tab} = X^2_{0.05}$df 16
$X^2_{tab} = 1.7459$

From the t-test result above, the mean of 12.2 is obtained and accepted because it falls under the Acceptance region of the Likert Scale. This shows that Auditor's report has effect corporate performance. Though there is an effect; the significance on firm performance can only be ascertained with the one-sample t-test (X^2) calculated, by applying the decision rule.

Decision Rule:

Reject Null hypothesis if, $X^2_{Cal} > X^2_{tab}$, otherwise do not reject Null hypothesis

Result: $X^2_{Cal} = 71.435$

X^2_{tab}, = 1.7459

The X^2_{tab} is tested on 5% significant level; Since X^2_{Cal} is greater than X^2tab, the Null hypothesis is therefore rejected and the alternative hypothesis accepted that states that auditor's report has effect on firms' performance.

CONCLUTION AND RECOMMENDATIONS

Most of our findings were consistent with the findings of other researchers. Therefore, it can be stated that most of the companies in Nigeria do not adhere to the corporate governance code. It was discovered that companies with larger number of board members performed better than companies with smaller number of board members, this is evidence from the fact that companies with larger board members is likely to have people who are experts in different fields of life than companies with smaller board members. Non executive board members exact more influence than executive board members of the company. We conclude that audit report and corporate governance have significant effect on the performance of listed companies in Nigeria.

Since corporate governance is essential in today's business world, we carefully recommend that a cost effective corporate governance system should be put in place and special audit procedures adopted to test the efficacy of the system adopted and its effect on corporate performance. Again, companies should be good corporate governance citizens. In doing so, the risks of fraud and corporate collapse are reduced. Furthermore good corporate governance processes are likely to create an environment that is conducive to success.

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