The Relationship between Audit and Risk Management Committees on Financial Performance of Non-financial Companies in Nigeria: A Conceptual Review

Adejoh Edogbanya
School of Accounting, College of Business, Universiti Utara Malaysia
adejoh17@yahoo.com

Hasnah Kamardin
School of Accounting, College of Business, Universiti Utara Malaysia
hasnahk@uum.edu.my

Doi:10.5901/mjss.2015.v6n3p206

Abstract

In recent years, cases of dissatisfaction from shareholders in reflection and recording of corporate financial activities, this has given rise to establishments of Audit and risk management committee and inclusion in the governance code as one of the governance mechanism for companies. It has become very serious issues of fraudulent practices by management, hence the need for audit system to signal any form of information asymmetries. This paper is purely conceptual review of past articles on corporate governance mechanism, board committees and Corporate Governance Code in Nigeria. The code defines what is needed for establishment of audit Committee by Corporations. The conceptual framework on audit and risk management committee is proposed for further study looking at Tobin q and ROA as measure of accounting and market performance respectively.

Keywords: Audit Committee, Corporate Governance, Risk Management Committee, Nigeria, Financial performance.

1. Introduction

The Board of Directors (BOD) of organization has generated focus of stakeholders in business in the past few decades (Daily & Dalton, 1994; Ellstrand, Tihanyi, & Johnson, 2002; Finegold, Benson, & Hecht, 2007). There have been disagreements in regards to director’s role in business management as stipulated by agency theory (Jesen & Meckling, 1976). The duties and functions of directors are classified into three; Shaker,( 1989) namely; Appointment and removal of Chief Executive Officers (CEOs) and top management of the company; Executive pay determination; and Managerial and executive issues by the top management. Other functions of the board committees are the formulation and establishments of board committees such as independent audit committees and risk management committee. Other role of company’s directors were identified by Lorch and Maclver (1989) in Brickley et al., (1997) are resources independent labeled control and services. The control role is that managers are monitored by directors as fiduciaries of stockholders, the services includes the advice by BOD to CEOs and to top management on their activities. The recourses independence role entails BOD critically facilitating the acquisitions of resources needed by the firm to perform. The objective of this paper is to critically examine the relationship or association between various dimensions of audit committee characteristics and financial performance and to access the relationship between risk management committee and financial performance. These objectives mentioned above motivated this research article.

1.1 Importance of Board Committees

1. To receive and deliberate reports and recommendations from management of the firm and to make necessary recommendations to the board of directors in respect of the financial reporting, accounting policies, internal control system, internal and external audit processes.
2. To assist the board of directors in fulfilling its oversight duties and responsibilities on risk management policies as approved by the board in respect of the risks inherent in the businesses of the firm and the control processes with respect to such risks; the risk profile of the firm and the risk management, compliance and control activities of the companies.
3. To monitor the compliance systems in place by which management renders and discharges its regulatory and legal obligations in respect of the firm's business and to review compliance systems and procedures within the bank to monitor that there is appropriate disclosure to the board of areas of operating and non-financial risk.

The need for detailed review of day to day economic activities, and ensuring accountability and transparency in the management of company funds led to the start of the legitimacy of the audit (Guxholli, Karapici, & Dafa, 2013). According to many researchers of audit origin, the first traces and testimony about the audit area were found in the form of commercial laws and accounting reports so many centuries back. With the increasing number and size of companies and growth, auditing has become very important (Guxholli et al., 2013).

It is adequate to bring attention to some of the numerous examples of insolvency and bankruptcy of large companies such as “Enron” (2001), World-Com’s”. “Parmalat” Scandal, Collapse of some notable banks in Nigeria in 2008 and so many other examples are reason for audit committee (Guxholli et al., 2013; Lin & Hwang, 2010; Stewart & Munro, 2007).

2. Literature Review and Development of Hypotheses

The study will review literature in the area of corporate governance structure in Nigeria and relevant areas of board committees

2.1 Corporate Governance Code in Nigeria

It is generally agreed that corporate failures in Nigeria is as a result of weak corporate governance mechanism. In order to increase the corporate governance systems, the SEC in Nigeria issues a corporate governance code to regulate the activities of board of directors. The board of SEC reveals the 2003 and 2008 corporate governance code weaknesses and came up with the 2011 codes which is believed will ensure highest standards of transparency accountability and good governance mechanism. The code is only applicable to the public companies but the board of SEC implores other companies like the private and small and medium scale entities to adopt the set code or principles. The board committees should determine the extent to which its duties and responsibilities should be undertaken as stipulated by SEC code through her committees. The board may in addition to audit committee as required by CAMA 1990 may also establish governance/remuneration committee and risk management committee and all other committees as deemed by the board depending on the size of such organization.

Corporate governance deal with the manner the custodian of finance of corporation guarantees themselves of getting returns on their investments (Morck, Shleifer, & Vishny, 2001; Voeller, Bremert, & Nicole, 2013) corporate governance has been designed to explain the mechanism that ensures management performance in an efficient and effective manner. This governance mechanism are designed to reduce agency problem between actors in business (Kamardin & Haron, 2011; Latif, Kamardin, Nisham, Mohd, & Adam, 2013). Corporate governance may also be defined as a system consisting of all the persons steps and activities to ensure stewardship over an entity’s assets (Lin & Hwang, 2010). Absentee’s owners’ interests are protected normally with the presence of good strong and good corporate governance as a result; resources available will be utilized to the best knowledge of the top management and board of directors. Therefore, the role of corporate governance is to comply with the relevant code in financial reporting process and compliance with the Generally Accepted Accounting principles (GAAP), International Financial reporting Standards (IFRS) and maintain the credibility of corporate financial statement (Lin & Hwang, 2010). However, governance mechanisms are supposed to increase financial performance because they provide good quality in ensuring financial reporting process.

2.2 Audit Committee

Auditing is very important in any business line-up. Apart from compulsory or regulatory requirements, it could be considered a way to mediate and moderate agency conflicts and information asymmetries (Cohen, Holder-Webb, Nath, & Wood, 2011; Voeller et al., 2013; Watts & Zimmerman, 2014). Internal audit function is one of the pillars of corporate governance (Abiola, 2012), he found out that is significant relationship between audit committee and performance. In a similar research conducted in Malaysia by (Ismail, Iskandar, & Rahmat, 2008) on corporate reporting, audit committees and its quality stipulates a positive relationship and financial performance. This result is also in line with the result of Song & Windram, (2004) who states that the existence of audit committee will reduce and solve agency problem. However, the role of corporate governance in a developing economy is to ensure that board committees such as audit committees are
established to ensure the quality of corporate financial reporting (Rehman, 2012; Xiaoyan, 2013). They found out there is positive relationship between audit committee and financial performance. Other studies that found significant positive relationship are follows (Ismail et al., 2008). However, there are also contrary views about audit committees (Leng, 2004) states that is negative significant relationship between the variables in the research “the impact of corporate governance practices on performance” He further states that the role of the audit committee has nothing to do with the financial performance of any enterprise. Similar to the study above, a study on the relationship between audit committee independence and earnings management shows negative result (Saibaba & Ansari, 2013) and this finding is consistent with the idea that a lack of independence impairs the ability of boards and audit committees to monitor management Absence of corporate law in any nation and different accounting regime can also deteriorate the performance of the auditors and create financial instability in developing market (Xu & Wang, 1999). Menon & Williams, 2001 also states that the existence of the audit committee is for cosmetic reason as it has no significant association with performance. The agency theory is good in explaining the relationship because the existence and presence of audit committee is a good way of reducing information asymmetry and agency problem (Jesen & Meckling, 1976). The corporate governance code of Audit committee is also to ensure that the new IFRS is complied with (Edogbanya & Kamardin, 2014). The Audit committee meeting is another corporate governance code of importance to firm in Nigeria. There are no principles concerning the Frequency meeting of audit committee meetings, with corporate governance code acknowledging that the meetings should be as frequent as possible to effectively carry out the committee’s duties, functions and responsibilities (SEC, 2011). Researches that shows positive relationship between audit committee are as follows (Aldamen, Duncan, & Kelly, 2012). On the contrary, other results shows negative relationship as (Sharma, Naiker, & Lee, 2009). The frequencies of the audit committee indicate seriousness and effectiveness of the audit committee. Based on the above explanation, theoretical and empirical justification, the below hypotheses is developed.

H1. There is a positive Relationship between Audit size and financial performance of non-Firm Company in Nigeria

H2. There is a positive Relationship between Audit independence and financial performance of non-Firm Company in Nigeria

H3. There is a positive Relationship between Audit committee meeting and financial performance of non-Firm Company in Nigeria

2.3 Risk Management Committee

According to the Nigerian Code Corporate Governance NCCG (2011) The Board of any organization may form a Risk Management Committee to assist it in its oversight of the risk function or profile, risk management framework and the risk-reward system to be determined by the Board of Directors (BOD). This is one the BOD committee as required by the Corporate Governance code. It is important but not mandatory for firm to have one. Risk is a day to day activity of any business entity. Scholars postulate that organizational performance could be enhanced if there is good management committee in place. Performance of company largely depend on the risk management mechanism (Akindele, 2012). Business failures is also as a result of risk management mechanism (Davies, 2013; McShane, Nair, & Rustambekov, 2011). The following studies also shows positive relationship between RMC and firm performance (Gordon, Loeb, & Tseng, 2009; Graham & Rogers, 2002; Hoyt & Liebenberg, 2011).on the contrary, the following studies states that risk management committee have a negative relationship with performance (Bartram, S. M., Brown, G. W., & Conrad, 2009; Beasley, Clune, & Hermanson, 2005; Hoyt & Liebenberg, 2011). Because of the above inconclusive results, there may be need for re-investigation of risk management committee and performance. The signaling role of Chief Executive Officer (CEO) characteristics is important in reporting information asymmetry (Daily & Dalton, 1994). Based on the above explanation, theoretical and empirical justification, the below hypotheses is developed.

H3. There is a positive Relationship between the presence of risk management committee and firm performance of non-Financial Company in Nigeria

2.4 Theory

Signaling theory is appropriate to explain the variables. The theory states the important of behavior when two parties are involved. This theory is crucial in raising alarm when there is information asymmetry (Connelly, Certo, Ireland, & Reutzel, 2010; Spence, 1973). Signaling is always important as a method of diversifying investments of the owners are usually communicated to the capital market (Brandes, Hadani, & Goranova, 2006). Another theory which can explain the below framework is the agency theory Jesen and Meckling (1976)and Watts and Zimmerman (2014).
3. Conceptual Framework and Methodology

This paper adopts signaling theory to explain the model. The Relationship between Audit and Risk Management Committees on Financial Performance of non-financial Institution in Nigeria. This Theory is good in explaining two behaviors in an Organization in order to explain how firm uses Board of directors to Communicate to the Shareholders on the financial activities of the company (Spence, 1973). In practical terms, companies with excellent operating performance usually disclose information to the public to promote public image of the business firm (Bhattacharya, 2007; Chiang, 2005). The Corporate governance variables include in the proposed framework is as follows; Audit Committee characteristics and risk management committee. The study will also look at Return on Accounting and Tobin q as proxy for performance measurement (Brickley et al., 1997; Haniffa & Hudaib, 2006).

Fig 1.1. Proposed Conceptual framework, 2014.

Table 3.1 Proposed Measurement for the sampled variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Proposed measurement</th>
<th>Author</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Accounting (ROA)</td>
<td>Earning before tax divided by the total assets of the firm</td>
<td>Haniffa and Hudaib (2006) Kamardin and Haron (2011)</td>
</tr>
<tr>
<td>Tobin Q</td>
<td>common shares plus the total debt divided by the book value of asset</td>
<td>Haniffa and Hudaib (2006) Kamardin and Haron (2011)</td>
</tr>
<tr>
<td>Independent Audit Committee</td>
<td>the percentage of Non-executive committee on the Audit Committee</td>
<td>Karamanou and Vafeas (2005)</td>
</tr>
<tr>
<td>Audit size</td>
<td>the total numbers of audit members serving in the Audit committee</td>
<td>Karamanou and Vafeas (2005)</td>
</tr>
<tr>
<td>Audit meeting</td>
<td>the number of meeting held by the members of Audit committee</td>
<td>Sharma, Naiker and Lee (2009)</td>
</tr>
<tr>
<td>Risk Management committee</td>
<td>proxy as 1 for presence and 0 otherwise for risk management committee</td>
<td>Hoyt and Liebenberg (2011)</td>
</tr>
</tbody>
</table>

4. Methodology

To address the issue of board committees, in the context of the transformation of financial reporting and corporate governance, the paper adopts review approach. The research presented here holds on an analysis of discourses within the range of documentary evidence and is based upon an examination of some publications and materials emanating from academic research carried out in the past. This study proposes multiple linear regressions using STATA statistical tool for the sampled variables. The proposed sample represents 100 non-financial companies listed on Nigeria Stock exchange out of the population of 136. This sampling frame is according to Krejcie and Morgan (1970). This method is adopted because it will take care of the following test; homoscedasticity, linearity, multi-collinearity and normality assumption (Haniffa & Hudaib, 2006). This paper is purely a conceptual review.

5. Conclusion

The paper examines the conceptual review of relevance of the audit committee and risk management committee.
Signaling theory is in support of the establishment of audit committee and all other committee as prescribed by the corporate governance code. The important of board committee cannot be over emphasized. That is why the corporate governance code of Nigeria made it mandatory as one of the committee to be established by the Board of Directors. The function of this committee is to oversee the financial reporting process and ensure that the all relevant and material information are disclosed.

References


Bhattacharya, S. (2007). Imperfect information, dividend policy, and “the bird in the hand” fallacy, 10(4), 259–270.


SEC. (2011). code of Corporate Governance in Nigeria.


