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# AUDIT COMMITTEE CHAIR FINANCIAL EXPERTISE AND AUDIT PRICING OF LISTED MANUFACTURING FIRMS IN NIGERIA

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## Abstract
Following the requirement of Section 404 (5) of Companies and Allied Matters Act, 2020 for the membership of audit committees of firms include at least one member belonging a professional accounting body in Nigeria, this study sought to determine the relationship between audit committee chair (AC chair) financial expertise and audit pricing of listed manufacturing firms in Nigeria from 2020 to 2022. The specific objectives of the study are (1) to investigate whether AC chairs with accounting expertise relative to their counterparts without accounting expertise are associated with lower audit fees and (2) whether the relationship is moderated by AC chair representation status. The study gathered data from annual reports of 32 manufacturing listed on the Nigerian Exchange Group and tested the formulated hypotheses by estimating fixed effect model of panel regressions. Findings revealed that AC chairs with accounting expertise have negative effect on audit fees. Further analysis showed that the relationship was not significantly moderated by the AC Chair representing shareholders and possessing accounting expertise. The study recommends that firms should ensure AC chairs are accounting experts irrespective of whether they are representatives of shareholders or directors. The major limitation of the study is the use of only membership of professional accounting body as the measure of accounting expertise. It is suggested that disclosure of biographical details of members of AC in annual reports should be made mandatory.
**Keywords:** Audit committee chair, accounting expertise, audit fees, audit committee chair representation status.

## Introduction
Separation of ownership from control which is the hallmark of modern firms gives rise to agency problem. Agency problems manifest in various ways including shirking of responsibility, excessive consumption of perquisites, managerial empire building, and manipulation of financial reports. To oversee the financial reporting process, corporate governance experts recommend that each firm should establish audit committee. Across the globe, audit committee is a key provision in corporate governance codes, corporate laws and listing requirements of many stock exchanges Indeed, the Companies and Allied Act, 2020 requires all limited liability companies to set up audit committee and appoint external auditor to examine their annual financial statements. External auditors examine the financial statements prepared by management and express opinion on whether the financial statements present a true and fair view of the financial performance of the firm thereby enhancing the credibility of financial reports. Section 404 (7e) of Companies and Allied Act, 2020 (CAMA, 2020) bestows on the audit committee the responsibility to make recommendations to the board with regard to the appointment, removal and remuneration of the external auditors of the company.

Following the wave of corporate accounting scandals, the effectiveness of audit committee to deliver on its mandate has remained questionable thereby triggering corporate governance reforms. One of such reforms is the enactment of Sarbanes-Oxley, 2002 in the US. One key reform is the requirement for all members of audit committee to be financially literate. This is seen as the best practice and Section 404 (5) of CAMA 2020 goes further to require at least one of the members should be a member of a professional accounting body in Nigeria established by an Act of the National Assembly. Though somestudies such as Abbot *et al.* (2003), Carcello *et al.* (2002), Chan *et al*. (2012), Ghafran, 2017, Krishnan and Visvanathan (2009), and Zaman *et al*. (2011) have investigated the impact of financial expertise of audit committee on audit fees. Studies on the effect of AC chair financial expertise on audit fees are quite scarce. This was corroborated by Carcello, Hermanson, and Ye (2011) their extensive review of audit committees stating thus:

> However, very little research separately examines the role of the audit committee chair in facilitating effective audit committee performance (Bédard and Gendron 2010). Given the role of the audit committee chair in driving the agenda, the meeting packet, the conduct of the meeting, and interactions between meetings, this is an unfortunate oversight. We believe that examining the role of the audit committee chair, including the chair's behaviors, characteristics, and personality traits, in ensuring audit committee effectiveness is worthy of future study. (p. 26).

The dearth of studies of the role of audit committee chair in audit pricing is very pronounced in Nigeria. The purpose of this study, therefore, is to investigate the relationship between audit committee chair expertise and audit fees. The study chose financial expertise because prior studies such as DeFond, Hann and Hu, 2005) have shown that the market valued financial expertise and auditors priced accounting expertise (Krishnan & Visvanathan, 2009).

The rest of the paper is as follows: Section 2 presents a review of related literature followed by Section 3 which highlights the methodology adopted to achieve research objectives. Section 4 contains test of hypotheses and the results while section 5 concludes the paper.

## Review of Related Literature

### Conceptual Review

### Audit Committee Chair

Section 404 (5) provides that audit committee should be composed of five members with three members representing shareholders and two members representing the directors. Though CAMA (2020) is silent on the chairmanship of the audit committee, members elect a member amongst themselves as the chairman of the committee. The AC chair is the leader and chief executive of the audit committee. Tanyi and Smith (2015) consider AC chair as the member of audit committee with the greatest responsibility relative to other members. The AC chair drives the agenda of the AC and influences the information flow between AC and key stakeholders (Khemakhem & Fontaine, 2019) and leads the AC in mediation over accounting disputes between the chief finance offices and external auditor (Free, Trotman & Trotman, 2021).

### Audit Committee Chair Financial Expertise

Financial expertise refers to a special skill or knowledge in financial, accounting, auditing and related matters. The extant literature identifies two categories of financial expertise. These are accounting financial expertise and nonaccounting financial expertise (Dhaliwal *et al.*, 2010; Defond *et al*., 2005; Krishnan & Visvanathan, 2008). Accounting financial expertise or accounting expertise refers to experience, skill and professional accounting certification in preparing or auditing financial statements. Non-acounting financial expertise includes work experience and skill as an investment banker, financial analyst, or any other financial management role; and supervisory expertise as chief executive officer. By requiring that at least one member of the audit committee should be a member of a professional accounting body in Nigeria established by an Act of the National Assembly, Section 404 (5) of CAMA 2020 recognizes accounting financial expertise.

**Audit Pricing**

It is the responsibility of audit committee to make recommendations to the board with regard to the appointment, removal and remuneration of the external auditors of the company. The remuneration of the external auditor is the audit fee. Audit fees are the fees paid to the external auditor for statutory audit and non-statutory audit services. It is always arrived at after negotiations between the audit committee and the external auditors taking into consideration the complex nature of the services provided, the expertise required to conduct the audit work, the cost configuration of the firm concerned, litigation risks, audit task complexity, and negotiation skill of the parties, auditor brand names and industry specializations amongst others (Bédard & Johnstone, 2004; Choi, Kim & Zang, 2010; Craswell, Francis, & Taylor, 1995, Simunic, 1980).

**Theoretical Review**

The study is anchored on Upper Echelon Theory. The Upper Echelons Theory credited to Hambrick and Mason (1984) posits that organizational outcomes can be partially predicted from observable managerial characteristics such as age, gender, tenure, and expertise of powerful actors like upper-level executives. Since AC chair has responsibility for providing effective leadership for the AC and since AC activities are interactive in nature (Abernathy, Beyer, Masli & Stefaniak, 2014; Beattie, Fearnley & Hines, 2014; Turley & Zaman, 2007; Khemakhem & Fontaine (2019), the effectiveness of audit committee significantly reflects that of a person who is in charge of steering the audit committee – the AC chair. Therefore, Upper Echelon Theory is considered appropriate to this study.

**Empirical Review**

Azizkhani, Hossain and Nguyen (2023) investigated the association between the characteristics of audit committee (AC) chairs, and audit fees and audit quality using a sample of 11,328 firm-year observations of non financial firms listed on the Australian Securities Exchange in the period 2004 to 2017. The results of multivariate analysis showed that AC chairs with higher business qualifications were more likely to hire a Big 4 auditor, pay higher audit fees and have lower discretionary accruals, while AC chairs with professional qualifications were more likely to hire a Big 4 and/or industry specialist auditor. Big 4 and/or industry specialist auditor are noted for providing higher quality audits (Choi et al. 2008; Craswell *et al*. 1995. Al-Qublani, Kamardin and Rohami Shafie (2020) analyzed a sample of 139 companies in the Malaysian capital market in 2015 to ascertain the relationship between AC chair expertise, AC chair tenure and the audit report lag of companies. Findings revealed that AC chair accounting expertise improved timeliness in financial reporting in Malaysia. Appointing top-rated auditors and paying high audit fee could lead to a reduction in material misstatement and restatement. Indeed, Schmidt and Wilkins (2013) found that an AC chair who has experience in financial accounting was negatively and significantly associated with restatement dark periods. Abernathy, Beyer, Masli, and Stefaniak (2014) (2014) and Baatwah, Salleh and Stewart (2019) provided evidence that an AC chair with public accounting expertise was significantly associated with financial reporting timeliness.

Ghafran and O'Sullivan (2017) investigated the impact of audit committee expertise on audit fees paid by non-financial FTSE350 firms in the period 2007 to 2010. The analysis of a sample of 991 firm-year observations found that audit committees possessing greater levels of financial expertise were associated with higher audit fees. When financial expertise was segregated into accounting and non-accounting financial expertise, it found that the positive impact identified was driven by non-accounting expertise. Haq, Smith and White (2019) employed a sample of 1,729 US companies in 2009 toexamine the relationship between an audit committee chair change and external audit fees. The study used a final. The results suggested that a change in the audit committee chair was positively associated with higher audit fees in the year of change.

Using a sample of 801 firm-year observations of S&P 500 firms, Krishnan and Visvanathan (2009) explored the relation between audit fees and the financial expertise of the audit committee. It was found that audit fees were negatively associated with audit committee accounting or financial expertise, inconsistent with the notion that audit fees increase in audit committee quality. The authors argue that audit pricing reflects the effectiveness of audit committees in overseeing the financial reporting process thereby resulting in a lower supply of audit effort and by extension lower audit fees. Myers, Schmardebeck and Slavov (2021) investigated whether new audit committee chairs provided more effective monitoring of the financial reporting process based on 13,871 US firm-year observations in the period 2005 through 2017. It was documented that firms are less likely to misstate their financial statements when new AC chairs have firm-specific knowledge. Lisic, Myers, Seide and Zhou (2019) examined whether audit committee accounting expertise helped to promote audit quality by motivating auditors to conduct diligent internal control audits and make appropriate internal control assessments. The analysis of 12,002 firm-year observations, 1,611 firm-year observations, and 847 firm-year observations of US firms from 2004 t0 2013 showed that among clients with existing and likely internal control material weaknesses, there was a greater likelihood of adverse internal control audit opinions and lower likelihood of subsequent auditor dismissal following an adverse internal control audit opinion when the audit committee has greater accounting expertise.

Based on a sample of over 13,840 observations of U.S. public companies, Krishnamoorthy, Bruynseels, De Groote, Wright and Van Peteghem (2023) evaluated the effect of accounting financial expertise (AFE) of the audit committee chair on oversight effectiveness of audit committee. Findings indicated that AFE of the AC chair was associated with lower levels of earnings management, reduced misstatement risk and enhanced monitoring of the audit process.

**Hypotheses Development**

From the foregoing and since AC chair with accounting expertise understands complex accounting and auditing issues as do the external auditors and provides effective monitoring of the financial reporting process, this study argues that such AC chair would lead the negotiation of audit price in such a manner that will result in lower audit fees without compromising audit quality. This leads to the following hypothesis:

Ho1: AC chair with accounting expertise does not have significant effect on audit fees of listed manufacturing firms in Nigeria.

AC chair could be a representative of shareholders or directors. AC chair representing shareholders is not responsible for the preparation of financial statements and so is likely to be more effective in monitoring the financial reporting process than AC chair representing directors. Given that both AC chairs possess accounting expertise, this study posits that AC chair with accounting expertise and representing shareholders will moderate the relationship between AC chair with accounting expertise and audit fees of listed manufacturing firms in Nigeria. This formally stated thus:

Ho2: There is no significant moderating effect of AC chair with accounting expertise and representing shareholders on the relationship between AC chair with accounting expertise and audit fees of listed manufacturing firms in Nigeria.

**METHODOLOGY**

The study employed ex post facto research design. The population of this study consists of all consumer goods and industrial goods manufacturing firms listed on the Nigerian Exchange as at 31st December, 2022. The website of Nigerian Exchange Group showed a total of 45 manufacturing firms in the Agriculture sector, Consumer Goods sector, Industrial Goods sector, and the Healthcare sector. as 31st December 2022. Using judgmental sampling technique, the selected only firms that have required data in their annual reports in the sample period and arrived at a sample size of 32 firms. The annual reports were downloaded from the websites of sampled firms.

**Empirical Model**

To test Ho1, the study employed the following empirical model:

$LAF_{i,t} = \beta_o + \beta_1 ACEP_{i,t} + \beta_2 ACREP_{i,t} + \beta_3 FSZ_{i,t} + \beta_4 LEV_{i,t} + \varepsilon_{i,t}$ ……………………………[1]

To test Ho2, the study expanded Model 1 as follows

$LAF_{i,t} = \beta_o + \beta_1 ACEP_{i,t} + \beta_2 ACREP_{i,t} + \beta_3 FSZ_{i,t} + \beta_4 LEV_{i,t} + \beta_5 ACEP{*}ACREP_{i,t} + \varepsilon_{i,t}$ ……..[2].

Where for firm I in year t;

LAF = natural logarithm of audit fees, ACEP = AC chair financial expertise coded 1 if AC chair is a member of either ICAN or ANAN, and 0 otherwise, ACREP = AC chair representation = coded 1 if AC chair is shareholders' representative, 0 if AC chair is directors' representative, FSZ = firm size measured as natural logarithm of total assets, LEV = leverage which is total liabilities divided by total assets ACEP*ACREP = interaction between ACP AND ACREP. $\varepsilon$ = Error term. $\beta_0$ = Intercept. $\beta_1$- $\beta_5$ = Regression coefficients. The a priori expectation is that $\beta_1$ and $\beta_5$ will be negative and significant. The level of significance is 0.05.

The study includes FSZ and LEV in the Models as control variables. Larger firms require greater time and effort to audit due to the size and scope of their business operations (Simunic, 1980). Firms with high financial leverage may be vulnerable to high insolvency risks, thus leading to high audit fees (Simunic, 1980; Craswell *et al*. 1995).

## RESULTS AND DISCUSSION

### Univariate Analysis

Table 1 displays the descriptive statistics of the study.

Table 1. Descriptive Statistics

| Variable | Obs | Mean | Median | Std. Dev. | Min | Max |
|---|---|---|---|---|---|---|
| Audit-fee(N'000) | 96 | 71601.6 | 25500 | 137039.7 | 2000 | 724000 |
| laf | 96 | 10.28262 | 10.14624 | 1.293006 | 7.600903 | 13.49255 |
| acep | 96 | 0.5104167 | 1 | 0.5025156 | 0 | 1 |
| acrep | 96 | 0.8958333 | 1 | 0.3070802 | 0 | 1 |
| fsz | 96 | 17.7211 | 17.70526 | 1.878658 | 14.47747 | 21.68478 |
| lev | 96 | 0.5695764 | .5836885 | 0.2152757 | 0.0583205 | 1.299719 |

Source: Author's Computation, 2024

Table 1 shows that on average, firms paid N71601600 as audit fees. Audit fees range from N2,000, 000 to N724,000,000. The median suggests that 50% and above paid N25,500,000. The standard deviation of the audit fees suggests wide dispersion justifying the log transformation of the audit fee in the test of hypotheses. While on average 51% of AC chair possessed accounting expertise, over 90% were shareholders' representatives.

**Table 2: Correlation Matrix**

| | laf | acep | acrep | fsz | lev | acep*acrep |
|---|---|---|---|---|---|---|
| laf | 1.0000 | | | | | |
| acep | -0.0330 | 1.0000 | | | | |
| acrep | -0.1290 | -0.0611 | 1.0000 | | | |
| fsz | 0.8807* | -0.0022 | 0.0262 | 1.0000 | | |
| lev | -0.1251 | -0.2119* | 0.0787 | 0.0304 | 1.0000 | |
| acep*acrep | -0.0647 | 0.8822* | 0.3071* | 0.0171 | -0.1611 | 1.0000 |

Source: Author's Computation, 2024

* denotes 5% level of significance

Table 2 presents the result of correlation analysis. It shows a negative and insignificant correlation between ACEP and LAF (r = -0.0330). It also shows negative and insignificant correlation between ACREP and LAF (r = -0.1290). The interaction term ACEP*ACREP equally indicates a negative and insignificant correlation with LAF (r = -0.0647). The correlation coefficients are generally low implying absence of serious multicollinearity.

**Test of Hypotheses**

To test the formulated hypotheses, the study estimated Models 1 and 2 using panel data methods. The study opted for panel data methods to control for unobserved heterogeneity in the sample. Cameron and Trevid (2010) identify three panel data estimation methods viz: Pooled regressions, Fixed Effect Method (FEM) and Random Effect Method (REM). To select the appropriate method, the study conducted LM test and Hausman specification test. In the LM test, the null hypothesis that Pooled Regression Method is a better estimator than the REM is rejected if the p-value of the Chi squared statistics is less than or equal to 0.05 and REM is accepted. To selected between REM and FEM, the Hausman specification test was conducted. The null hypothesis that REM is a better a better estimator than REM is rejected if the p-value of the Chi squared statistics is less than or equal to 0.05 and FEM is accepted. Table 3 shows the results of LM Test while Table 5 and Table 5 contain the results of Hausman Specification Test. Table 3, Table 4, and Table 5 shows the p-value of Chi-Squared statistics are less than 0.05. Consequently, the study employed FEM to test the hypotheses.

**Table 3: Results of LM Test**

| | Model 1 | | Model 2 | |
|---|---|---|---|---|
| | Var | sd = sqrt(Var) | Var | sd = sqrt(Var) |
| laf | 1.671864 | 1.293006 | 1.671864 | 1.293006 |
| e | 0.0199303 | 0.1411748 | 0.0198677 | 0.1409529 |
| u | 0.2967832 | 0.5447782 | 0.306753 | 0.5538529 |
| chibar2(01) | | 66.62 | | 66.35 |
| Prob > chibar2 | | 0.0000 | | 0.0000 |

Source: Author's Computation, 2024

Table 4: Results of Hausman Test for Model 1

| | Coefficients | | | |
|---|---|---|---|---|
| | (b) fe | (B) re | (b-B) Difference | sqrt(diag(V_b-V_B)) S.E. |
| acep | -0.1089012 | -0.1212656 | 0.0123643 | 0.0174151 |
| acrep | -0.1041976 | -0.1619766 | 0.057779 | 0.0298874 |
| fsz | 0.4269431 | 0.4537254 | -0.0267823 | 0.0077893 |
| lev | -0.6217134 | -0.6919404 | 0.070227 | 0.0787735 |
| chi2(4) = (b-B)'[(V_b-V_B)^(-1)](b-B) | | | | |
| chi2(4 = 13.82 | | | | |
| Prob>chi2 = 0.0079 | | | | |

Source: Author's Computation, 2024

Table 6 displays the results of estimating Model 1 and Model 2 to test the hypotheses. The Model Summary shows that the Models have good fit (p-value of F statistics = 0.0000). About 81% variation in the audit fees in both Models were jointly explained by the independent variables. The study reports the regression results to mitigate heteroskesdasticity concern.
Ho1 states that AC chair with accounting expertise does not have significant effect on audit fees of listed manufacturing firms in Nigeria. Model 1 in Table 6 reveals a negative coefficient on ACEP ($\beta_1$ = -0.10890 and a p-value of 0.015. Since the p-value is less than 0.05, Ho1 is rejected and the study concludes that AC chair with accounting expertise has a significant effect on audit fees of listed manufacturing firms in Nigeria.

Table 5: Results of Hausman Specification Test for Model 2

| | Coefficients | | | |
|---|---|---|---|---|
| | (b) fe | (B) re | (b-B) Difference | sqrt(diag(V_b-V_B)) S.E. |
| acep | -.2390541 | -.228286 | -.0107681 | .0265886 |
| acrep | -.1546739 | -.204728 | .0500541 | .0241088 |
| fsz | .4269818 | .4529397 | -.0259579 | .0076267 |
| lev | -.631931 | -.6973454 | .0654144 | .0773139 |
| acep*acrep | .1690955 | .1373158 | .0317797 | .0391131 |
| chi2(5) = (b-B)'[(V_b-V_B)^(-1)](b-B) | | | | |
| chi2(5) = 14.00 | | | | |
| Prob>chi2 = 0.0156 | | | | |

Source: Author's Computation, 2024

Ho2 states that there is no significant moderating effect of AC chair with accounting expertise and representing shareholders on the relationship between AC chair with accounting expertise and audit fees of listed manufacturing firms in Nigeria. Model 2 in Table 6 shows that the interaction term has a positive coefficient ($\beta_5$ = 0.16910) and p-value of 0.209. Since the p-value is greater than 0.05 (not significant), Ho2 is accepted. It is therefore concluded that there is no significant moderating effect of AC chair with accounting expertise and representing shareholders on the relationship between AC chair with accounting expertise and audit fees of listed manufacturing firms in Nigeria.

**Table 6: Regression Results of Model 1 and Model 2**

| | Model1 | | | | Model 2 | | | |
|---|---|---|---|---|---|---|---|---|
| laf | Coef. | Robust Std. Err. | t | p-value | Coef. | Robust Std. Err. | t | p-value |
| acep | -0.1089 | 0.0423 | -2.58 | 0.015 | -0.2391 | 0.1193 | -2.00 | 0.054 |
| acrep | -0.1042 | 0.1130 | -0.92 | 0.364 | -0.1547 | 0.0916 | -1.69 | 0.101 |
| fsz | 0.4269 | 0.0370 | 11.55 | 0.000 | 0.4270 | 0.0369 | 11.57 | 0.000 |
| lev | -0.6217 | 0.3165 | -1.96 | 0.058 | -0.632 | 0.3070 | -2.06 | 0.048 |
| acep*acrep | | | | | 0.1691 | 0.1317 | 1.28 | 0.209 |
| cons | 3.21976 | 0.6818 | 4.72 | 0.000 | 3.261 | 0.6741 | 4.84 | 0.000 |
| Model Summary | | | | | | | | |
| Number of obs | | 96 | | | | 96 | | |
| Number of groups | | 32 | | | | 32 | | |
| Obs per group: min | | 3 | | | | 3 | | |
| : avg | | 3 | | | | 3 | | |
| : max | | 3 | | | | 3 | | |
| F(4,31) | | 34.57 | | | | 8.51 | | |
| Prob > F | | 0.0000 | | | | 0.0000 | | |
| R-sq: within | | 0.8750 | | | | 0.8775 | | |
| between | | 0.8200 | | | | 0.8151 | | |
| overall | | 0.8116 | | | | 0.8073 | | |

Source: Author's Computation, 2024

**Discussion of Findings**

The negative coefficient on ACEP implies that audit fees of listed manufacturing firms in Nigeria decrease by 11% as the number of AC chair with accounting expertise increases by 1. This is in agreement with Krishnamoorthy *et al*. (2023) and Krishnan and Visvanathan (2009). This is not surprising because AC chair with accounting expertise understand complex accounting and auditing issues as do external auditors and provide effective leadership to the audit committee to oversee the financial reporting process. It was found that AC representing shareholders has a negative effect on audit price implying that representative status of the AC chair did not matter in audit pricing. It was also found that AC chair was a shareholders' representative and possessed accounting expertise, a positive association with audit price was observed. But this is not significant, again suggesting that AC chair with accounting expertise and representing shareholders did not matter in audit pricing. This is not in agreement with the alignment hypothesis of Jensen and Meckling (1976) that a shareholder would be more effective in advancing shareholders' interest by mitigating agency cost than directors since their wealth is at stake. In respect of the control variables, while firm size has a positive and significant effect on audit fees consistent with (Simunic, 1980), leverage has negative and significant effect on audit fees. This runs contrary to findings in prior studies (Simunic, 1980; Craswell *et al*. 1995).

**Conclusion**

This study investigated the effect of AC chair financial expertise on audit fees of listed manufacturing firms in Nigeria. Regressing accounting expertise of AC chair and control variable on log of audit fees for sample of 32 firms in the period 2020 to 2022, the study found evidence that AC chair with accounting expertise was associated with lower audit fees. The also sought to determine if AC chair representing shareholders and possessing accounting expertise would moderate the relationship between AC chair with accounting expertise and audit fees. It found no evidence. Based on the findings, the study recommends that chair of AC should should possess accounting expertise irrespective of whether such AC chair is a representative of shareholders or directors.

The study contributes to the literature by showing another channel through which AC effectiveness can be enhanced. this should be of interest to policy makers and regulators in fashioning policies and regulations to strengthen AC. Shareholders will find the outcome of this study in electing AC members in annual meetings and choice of AC chair.

One limitation of this study is that it non availability of data on expertise as well as work experience on all members of the AC in annual reports. Policy makers and regulators should mandate full disclosure of biographical details of AC members.

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