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Effect Of Audit Committee Attributes On Earnings Opacity Of Quoted Manufacturing Companies In Nigerian Exchange Group Between 2015 And 2019.

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ABSTRACT
This study examined the effect of audit committee attributes on earnings opacity of quoted manufacturing companies in Nigerian exchange group between 2015 and 2019. The study adopted the ex-post facto research design. Panel data used were sourced from CNB statistical bulletin and the firm financial statement. The data collected were analyzed using descriptive statistics and multiple regression. Audit committee attributes was proxy using audit committee resourcefulness, audit from the analysis, result showed that audit committee attributes significantly affect earnings opacity among the manufacturing companies in Nigeria. The result also shows that Audit committee resourcefulness, and audit committee effectiveness has positive but insignificant effect on earnings opacity. These results indicate that audit committee resourcefulness and effectiveness can positively drive the level of earnings opacity among manufacturing companies in Nigeria. Based on the findings the study recommends that both audit committee resourcefulness and audit committee effectiveness should not be given major consideration when setting up audit committee that can enhance the reporting quality based on financial reporting principles. Rather, Transparent reporting should be a since it boasts stakeholder's confidence and investment in the company.
Keywords*:* Earning Opacity, Audit Committee, Audit Attributes, Earning Aggressiveness, Income soothing, Disclosure level

1.0 INTRODUCTION

The audit committee is a body of executive members appointed by the board of directors to carry out unique aspect of the board functions. The committee most often is made up of members who are non-executive directors (Emeh & Appah, 2013), and they carries out unique function which promote good corporate governance and enhance the integrity of financial reporting. Those functions includes: act as a liaison between the board of directors and the external auditors, overseeing the companies accounting and financial reporting policies, process and practices, to ensure the quality and credibility of audited financial reports, and finally by guaranteeing the financial report, internal control and management risk. This makes the audit committee an integral part of corporate governance structure. According to Ayemene and Elijah (2015), the audit committee is a subcommittee of the board that specializes in, and is responsible for, ensuring the accuracy and reliability of the financial statements provided by management.

Audit committee is a committee under the board of directors which mainly comprise of non-executive directors. The committee is saddle with the responsibility of overseeing the firm accounting preparation and reporting, interface between the board and the external auditor, implement the external auditor's recommendation, review of internal audit and external audit report. The committee is therefore seen as an effective tool for improving board oversight function in ensuring integrity and transparency in the financial reporting thereby helping to maintain investors' confidence. Thus an effective and efficient audit committee can be a basic tool for improving the company's financial report quality and minimize the incident of fraud.

According to Ghafran and Yasmin, (2018) there are attributes necessary for the success of the committee. For the audit committee to discharge their responsibilities effectively, the committee is required to have the required size, be independent, diligent, and highly competent (expertise and experience).

Earnings opacity is a deliberate alteration of a firm's reported economic performance to mislead some stakeholders. An opaque earnings means that company earnings do not reflect economic real earnings. A firm's earnings may not be transparently presented for many reasons ranging from managerial incentives to flexibility in accounting. Earnings opacity has capacity of negatively influencing investors' decision by weakening the link between reported accounting earnings and unobservable economic earnings, may increase the level of asymmetric information. Asymmetric information can affect equity markets in the following way. An increase in asymmetric information would lead to an increase in the adverse selection problem a liquidity provider faces when trading with insiders.

Many manufacturing companies in Nigeria are usually faced with challenges of reporting negative earnings (net) probably due to the presumed stakeholder's reaction. Opaque activities in firms can be successfully done when with the direct or indirect support of the audit committee. The weaknesses of audit committee enhance the chances of earnings opacity in firm which can impact negatively on investors' confidence as the informational risk caused by earnings opacity is an important factor relative to the other factors that affect equity markets, and value of stock. Despite the importance of the audit committee on earnings opacity empirical studies in Nigeria context is still scarce.

The contribution of this paper to the literature is that it is the first paper to my knowledge that measures earnings opacity at industry level by using a panel data to assess the effect of audit committee on earnings opacity. The main objective of this study is to evaluate the effect of audit committee attributes on earnings opacity among listed manufacturing companies in Nigeria. The specific objectives includes to: Examine the effect of audit committee resourcefulness size, Audit committee effectiveness, Audit committee independence and audit committee expertise on earnings opacity in Nigeria.

The findings from this study are of importance to stakeholders of firms in Nigeria (managers, investors, policy makers and researchers. This paper is structured as follows: introduction, reviews of related literature, methodology, data analyses and interpretation, conclusion and recommendations.

2.0 Review of Related Literature

Conceptual Framework

Earnings Opacity is a measure of how little true information about an entity's economic activities is disclosed in the financial statement. Earnings opacity is the earnings reported by firms that fail to provide information on the real economic earnings distribution. Earnings can become opaque due to at least 3 factors: managerial motivation, accounting standard, and compliance with accounting standards. Firms' earnings opacity may result from an incident where managers are motivated to manipulate earnings.

Audit Committee Attributes: The uniqueness which made the audit committee different from every other board set up in the firm. The uniqueness ranges from the frequency of meeting, the number of professional, size of the board, independency of the board, effectiveness, expertise etc members. The audit committee is a sub set of the corporate board of directors which is appointed by shareholders to monitor management and oversee the affairs of the company on their behalf.

Audit Committee and Earnings Opacity

The audit committee to effectively discharge its responsibilities, the committee needs to have the required numbers of directors (Raweh, Kamardin & Malik, 2019). An effective audit committee minimizes the errors in the financial statement and increases the probability of detecting management fraud. As part of its role, the audit committee helps to minimize the information asymmetry, and consequently reduce and solve agency problems. Furthermore, it was elucidated that the effective observation of the audit committee protects the interests of shareholders in light of the annual financial reporting, external auditing efficiency and internal control. According to the study of Bédard and Gendron (2010), the audit committee independence, size, competency, and meetings have highest impact on financial reporting quality. Similarly, the study of Dellaportas, Leung, Cooper, Rochnah and Moh (2012) finds that corporations with experienced members, independence members and large audit committees are more likely to provide clear reports about the quality of financial information on time. Some researchers assert that audit committee features (independent members and audit committee financial experts) are positively associated to aspects expected to improve the financial reporting procedure.

Audit Committee Resourcefulness and Earnings opacity

Audit committee size is the measure of the resourcefulness of the audit committee. Generally, it is believed that a large audit committee provides more effective monitoring and thus improves the quality of the financial report than smaller audit committee. However, some researchers argued that larger audit committees may lead to inefficient governance, and may suffer from the problem of free rider and difficulties in co-ordination. On the other hand, a small team is believe to help facilitate the exchange of information that can be useful is monitoring management and ensure glassy financial report, to assist management identify potential errors in financial reporting and reduce the incidence of restatement of the minimum size requirements.

H_{01}: Audit committee resourcefulness has no significant effect on earnings opacity in Nigeria.

Audit Committee Effectiveness and Earnings Opacity

Audit committee effectiveness is a measure of how the Audit committee is meeting with their responsibility. The effectiveness of the board is reveals by the number of times the Audit committee meet to discuss and formulate policy for the firm. According to Ntim and Oser (2013), audit committee meeting is the number of times that the corporate board of director meets to deliberate on issues regarding the firm. Since the committee is saddled with oversea of accounting and internal control, the meeting of the audit committee will deliberate on issues relating to accounting, accounting policy, accounting report and review of report. Since the audit committee is likely to perform their duties in the best interest of the shareholders. The routine meeting avail the committee opportunity to exercise control over the management. Based on the above argument, the study hypothesizes as follows:

H_{02}: Audit committee effectiveness has no significant effect on earnings opacity in Nigeria.

Audit Committee Independence and Earnings opacity

Audit committee independence is the proportion of independent directors over the total number of directors audit committee. Hence audit committee with larger proportion of independent audit committee members is more likely to monitor the firm’s reporting process effectively.

The independence of the audit committee has been argued to facilitate more effective relationship between the external auditor and the board, strengthens the internal audit and monitors the financial reporting process. On the other hand, being completely separate from management could mean that the independent audit committee members see less industry issues and are more likely to side with the auditor requiring less negotiations and deliberations and thus fewer meetings. This can have negative impact on the level of monitoring (Sharma et al., 2009). Based on the above argument, the study hypothesizes as follows:

H_{03}: Audit committee independence has no significant effect on earnings opacity in Nigeria.

Audit Committee Expertise and Earnings Opacity

The audit committee expertise refers to the number of or the extent to which members of the audit committee have the relevant qualification and experience. Having directors in the audit committee who are competent and experienced in financial aspects, can enhance the audit committee monitoring process of the Board. The recent study by Krishnan and Visvanathan, (2008), has shown that audit committee members with accounting expertise are likely to contribute to greater monitoring, which may leads to glassy financial report. An audit committee that has members with some financial and/or corporate background would better serve as a financial monitor in ensuring glassy report. The expertise of the audit committee help infuse confidence in financial statements, as the committee create for the external auditor an environment enabling the auditors to act as modulating forces against earnings opacity practices. Based on the above argument, the study hypothesizes as follows:

H_{04}: Audit committee expertise has no significant effect on earnings opacity in Nigeria.

Theoretical Framework

Inspired Confidence Theory

The study is anchored on inspired confidence theory developed in the late 1920s by Theodore (Hayes, Schilder, Dassens & Wallage, 1999). Limperg's theory addresses both the demand for and the supply of audit services. The theory posit that the demand for audit services is the direct consequence of the participation of outside stakeholders in the company and that stakeholders demand accountability from the management, in return for their contribution to the company. Since information provided by management might be biased, there is the possibility of divergence between the interest of management and outside stakeholders; hence an audit of this information is required. With regard to the level of audit assurance that auditor should provide, (the supply side), Limperg adopts a normative approach. The auditor's job should be executed in such a way that the expectations of a rational outsider are not thwarted. So, given the possibilities of audit technology, the auditor should do everything to meet reasonable public expectations. The auditor accomplishes the professional task through his judgment in form of reports. In the past, it is claimed that the auditor is responsible for searching, discovering and preventing fraud in his client company which was an early 20th century perception. More recently, the focus of auditors has been to provide reasonable assurance and verify the truth and fairness of the financial statements, though detection of fraud as the auditor's responsibilities has not diminished.

Empirical Review

Myers, Schmidt, and Wilkins (2014) investigate whether audit quality resulted in a change in auditor behavior with respect to going concern reporting. The authors find that non-Big N auditors became more conservative while Big N auditors became more accurate. Specifically, the results of the logistic regression techniques show that non-Big N auditors issued more going concern opinions to both failing and non-failing clients post-2001, reducing their Type II misclassifications at the expense of increased Type I misclassifications. However, Big N auditors decreased their Type I misclassifications with no corresponding increase in Type II misclassifications.

Feng and Li (2011) examine whether auditors exercise professional skepticism about management earnings forecasts when making going-concern decisions. Using publicly issued management earnings forecasts as a proxy for earnings forecasts provided by managers to auditors, the authors find that management earnings forecasts are negatively associated with both auditors' going concern opinions and subsequent bankruptcy. The weight auditors put on management forecasts in the going-concern decision is not significantly different from the weight implied in the bankruptcy prediction model. The authors concluded that the evidence is consistent with auditors being professionally skeptical about management earnings forecasts when making going-concern decisions.

Gallizo and Saladrigues (2016) sought go in-depth into the relationship between going concern audit opinion and certain characteristics of the company and auditor, including financial decline. A logit analysis was carried out in order to enable them discover the probability of receiving a going concern audit opinion and the analysis indicates that it is not financial decline, but rather registering losses and being audited by a small-scale auditor, that increase the likelihood of a company receiving a going concern audit opinion.

William and Ari (2016) examine prior audit reports for a sample of 401 U.S publicly held companies that filed for bankruptcy during the period 2002–2008. Using a quadratic model to control for potential nonlinearity in the relationship between auditor tenure and audit reporting, the authors find no significant association between auditor tenure and Type II errors for Big 4 audit firms. In contrast, for non-Big 4 audit firms they find evidence of a significant association that is nonlinear. Specifically, auditor tenure appears to adversely influence non-Big 4 firms' audit reporting for bankrupt clients in the initial years of an audit engagement and has no discernible effect in the later years. Thus, they provide evidence that long auditor tenure in itself, is not associated with Type II reporting errors.

Hossain, Chapple, and Monroe (2018) investigate whether an audit partner's gender is associated with the likelihood of issuing a going-concern opinion for a financially distressed client. The analysis is based on data for a sample of Australian listed companies for the period 2003–2011. The result from unrestricted and propensity score-matched samples and a Heckman two stage model indicate that female audit partners are less likely to issue a going-concern opinion for financially distressed clients. The findings provide evidence of differential audit outcomes depending on the gender of the audit partner, thus implying that audit partner gender affects the decision-making processes used when making the audit reporting decision. In conclusion, the authors held that these behavioral differences have the potential to influence perceptions of financial reporting and audit quality.

Chae, Nakano, and Fujitani (2020) examine the effect of financial reporting opacity and audit quality on stock price crash risk using listed firms in Japan. The authors use a logistic regression and linear regression model to test whether financial reporting opacity and audit quality affect crash risk using listed firms in the Japanese stock exchange market during the fiscal years 2015 January through 2017 February. The results of this study suggest that financial reporting opacity variable shows a positive relationship with CRASH, which suggest that a firm with more opaque financial reporting increases crash risk. The results suggest also that firms audited by Big4 auditors experience less crash risk, implying that the audit quality in Japan can be one of the factors mitigating firm's crash risk.

3.0 METHODOLOGY

Research Design

Ex-post-facto research design was used in this study. The study used panel data collated from the financial report of twenty quoted manufacturing companies in Nigerian exchange group between 2015 and 2019 financial years. In analyzing the data, the study adopted multiple linear regressions. Explanatory variables used in this study are audit committee resourcefulness (AUCRE), audit committee effectiveness (AUCEF), audit committee independence (AUCIN), and audit committee expertise (AUCEX). The response variable is earnings opacity (OPACITY).

Audit committee effectiveness (AUCEF)	Number of times the audit committee member attends meeting within the accounting year (Sharma, Naiker, & Lee 2009).
Audit committee resourcefulness (AUCRE)	Number of director in the audit committee (Anderson, 2004, Sadiq & Emmanuel 2017).
Audit committee members expertise (AUCEX)	Expertise of audit committee measured by number of audit committee member with accounting, finance or economic qualification or had experience in finance related area (Krishnan & Visvanathan, (2008).
Audit committee independence (AUCIN)	Proportion of non executive directors on the audit committee to total board size (Gul, Srinidhi & Ng, 2011).

Earnings opacity is measured by an earnings opacity index established by Bhattacharya, Hazem and Michael (2003). The index established from three measures: earnings aggressiveness, income smoothing, and the number of footnotes (Zuhrohtun, & Baridwan (2015). Hence, earnings opacity is measured using earning aggressiveness, income smoothing and disclosure level through notes on financial report in income statement.

Earnings Aggressiveness: is calculated using scaled accruals. Scaled accruals are defined as:

$ACC_{it} = (\Delta CA_{it} - \Delta CL_{it} - \Delta CASH_{it} + \Delta STD_{it} + \Delta DEP_{it} + \Delta\ TP_{it}) / TAk_{it}\text{-}1$ - - - - - - (1)

Where: ACC_{it} = scaled accrual company i period t; ΔCA_{it} = total change of assets company i period t; ΔCL_{it}: = change of current debt company i period t; $\Delta CASH_{it}$ = change of cash of company i period t; ΔSTD_{it} = change of long-term debt proportion included in short-term debt company i period t; DEP_{it} = depreciation and amortization cost company i period t; ΔTP_{it} = change of taxable income company i period t; $TAk_{it}\text{-}1$ = total asset company i period t-1

Income Smoothing, which is calculated using the correlation change in the accrual and cash flow from operation (Leuz et al., 2003), is as follows:

$PL_{it} = \rho[\Delta Acc, \Delta CFO]$ ----------------------------------- (2)

Where: PL_{it} = income smoothing of company i period t; ΔACC_{it} = accrual change of company i period t; ΔCFO_{it} = change of operational current cash of company i period t P = correlation level

Data sources and Analytic Method

Data used were sources from CBN statistical bulletin and the firms published financial statement. The panel data were analyzed using descriptive statistics and multiple liner regression.

Model Specification

This study uses multiple regression analysis to test the hypotheses. The regression model is:

$OPACITY_{it} = \alpha + \beta_1 AUCRE_{it} + \beta_2 AUCEF_{it} + \beta_3 AUCIN_{it} + \beta_4 AUCEX_{it} + e$ ---------------- 3

Where:
OPACITY = Earnings Opacity Index
AUCRE =Audit Committee Resourcefulness,
AUCEF =Audit committee effectiveness,
AUCIN = Audit Committee Independence,
AUCEX = Audit Committee Expertise's.

4.0 DATA ANALYSIS AND INTERPRETATION

Descriptive Statistics

The descriptive statistics result shows the mean (average) for each of the variables, their maximum values, minimum values, and standard deviation. Table 4.1 below, is the descriptive statistics result of the data covering the period of five years (2015 – 2019) of the quoted companies in used for the study.

Table 4.1: Descriptive Statistics

	OPACITY	AUCRE	AUCEF	AUCIN	AUCEX
Mean	***0.3229***	***0.2932***	***0.4695***	***0.4962***	***0.2932***
Maximum	***0.6100***	***0.5000***	***0.8000***	***0.7500***	***0.5000***
Minimum	***0.0300***	***0.0000***	***0.1300***	***0.3300***	***0.0000***
Std. Dev.	***0.1144***	***0.1527***	***0.2453***	***0.1325***	***0.1527***
Observations	***100***	***100***	***100***	***100***	***100***

The descriptive statistics result reveals the mean value of 0.3229, maximum value of 0.610 and minimum value of 0.03. This shows that on the average the firms used are high level of earnings opacity. The difference between the mean and the maximum reveals a considerable skewed nature, suggesting the existence of large percentages of earnings opacity.

Regression Analysis

To evaluate the effect of audit committee attributes on earnings opacity and to test our formulated hypotheses, we used regression analysis. The result obtained is presented in table **Fixed and Random Effect Test**

The summary result of multiple regression analysis is presented below. However, the study takes into cognizance the heterogeneous nature of the manufacturing firm data. The study used Hausman effect test to select between fixed and random effect that is best to be adopted in the study. The result is in table 4.2 below.

Table 4.2: Regression Analysis

	AUCRE	AUCEF	AUCIN	AUCEX
Coefficient	0.4846	0.0471	-0.6428	-0.0456
P. value	0.1349	0.9647	0.0526	0.0211

R= 0.541;**R^2=** 0.483; **F- stat =**3.425 ; **F-stat(Porb) =**0.004**; D. Watson =**2.031

The result shows that audit committee resourcefulness (AUCRE) has positive (48%) but insignificant effect on earnings opacity, audit committee effectiveness (AUCEF) has weak positive (47%) but insignificant effect on earnings opacity. These results indicate that audit committee resourcefulness and effectiveness can positively drive the level of earnings opacity among manufacturing companies in Nigeria. Audit committee independence and audit committee expertise have negative (-64% and -45%) but significant effect on earning opacity respectively. This means that audit committee independence and audit committee expertise negatively and significantly drives earnings opacity among manufacturing companies.

DISCUSSION

Results of this research indicated a significant relationship between audit committee independence and audit committee expertise and earning opacity of the company. This means the more independence and expertise audit committee members are, the less opaque earnings of the companies would be.

The results of this study can be considered by board executive in appointing members for the audit committee. To ensure transparent reporting, the independence of the audit committee should be sacrosanct and only members with financial expertise should be selected into the audit committee.

CONCLUSIONS AND RECOMMENDATIONS

Based on the findings of this research, the study concludes that both audit committee resourcefulness and audit committee effectiveness cannot determine opacities of reported earnings. Therefore, transparent earning report cannot be achieved with audit committee resourcefulness and audit committee effectiveness. Hence, it recommended that both audit committee resourcefulness and audit committee effectiveness should not be given major consideration when setting up audit committee that can enhance the reporting quality based on financial reporting principles. Rather, transparent reporting should be since it boasts stakeholder's confidence and investment in the company.

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