Moderating Effect of Audit Committee Independence on the Relationship between Auditor Tenure and Stock Returns in Nigeria

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ABSTRACT

The study investigates the moderating effect of Audit Committee Independence on the relationship between Auditor Tenure and Stock Returns of Consumer Goods Firms that are listed on the Nigerian Stock Exchange. Data were gathered from the Annual Financial Reports of the Companies chosen for this study covering the period from 2008 to 2019. Panel Data Regression was employed for the purpose of analysis. It was discovered that Audit Tenure has a significant positive relationship with Stock Returns, and that, the interaction of the Audit Committee Independence with Auditor Tenure has no moderating effect on the relationship between Auditor Tenure and Stock Returns. Based on these findings, the study recommends to Investors and other capital market participants that in taking investment decisions, besides Financial Variables, they should pay attention to Auditor Tenure as a factor affecting Stock Prices, that Independent Directors who are not engaged with the Company in one way or the other should constitute the majority in the audit committee.

KEYWORDS*:* Auditor Tenure, Stock Returns, Audit Committee Independence, Firm Size, Growth Opportunities

1. Introduction

Stock Returns refer to the sum of all dividend yielded from the Stock and Stock Capital Gain less the Initial Cost of Investment (Davis, 2021). A return represents the change in the price of an asset, investment or project over time, which may be represented in terms of price change or percentage change. A positive return represents a profit, while a negative return marks a loss. Stock Returns are important to investor and hence, the investor expects to get returns from such an investment. Returns from stock enable an investor to take charge of his financial security and also allows him to grow his wealth.

In view of the importance of company's earnings, Managers of the Firm employ some strategies to

purposely manipulate earnings to align with their pre-determined target such as carrying out some activities that either manipulate or falsify income so that they can attain high level of earnings and push up the company's prices of stock (Schipper, 1989; Healy & Wahlen, 1999). Stock prices in turn convey to Financial Markets Firm specific information, to this end Roll (1988) maintain that, there are so much inconsistences in stock returns that are informed by Firm-SpecificInformation. Firm-Specific Information comprises both public and private information. A conveyance of both public and private information avails the stockholders the opportunity to adjust their expectations appropriately if such information is of significant relevance to analysts and other users of financial statements, they will also adjust earnings estimate and share prices for other companies in the industry. The reaction of shareholders to disclosed information most especially earnings is reflected in the Stock Returns (Ji & Yoon, 2020; Maggina, 2018). Stock Returns is used by researchers to theoretically explain how different investors and the market react to information of audit reports especially earnings information (Nelly & Apandi, 2018; Su, Zhao & Zhou, 2016).

Extant literature has inextricably linked Auditor tenure with stock returns. Auditor tenure is thought to be an Audit quality variable that prior studies have suggested that can impact on Stock Returns of Firms. Researchers are divided on this issue of Auditor Tenure. Some researchers such as Ghosh and Moon (2005); Hohenfels (2016) avail that, with the increase in Auditor tenure, there will be a good and better appreciation of the operations of the business, the accounting systems and good standard of reporting issues thereby enhancing the quality of audit reports, the firm's quality of financial reporting standard and the financial statements.

Consequently, the uncertainties that are associated with investment decisions and forecasting of returns will be minimised (Su, Zhao & Zhou, 2016). Other researchers maintain that, if auditors maintain a long term relationship with their clients, there is a tendency for them to become reluctant and complacent in using appropriate audit tools and procedures in performing their audit and they can become less sceptical in identifying financial errors and misstatements contained in the financial statements (Shockley, 1982; Mgbame, Eragbe, & Osazuwa, 2012; Gosh & Moon, 2005; Siregar, Amallurah, Wisowo & Angarraith, 2012). When this happens, it brings to question the quality of audit reports produced by these authors which may affect negatively the perception of investors resulting to negative changes in stock prices. Audit committee is another variable that affects stock returns. One of its basic functions is to supervise the financial reporting process by overseeing the internal control system of the firm to ensure that it complies with the laws and regulations. It further stands as a reinforcement agent to the independence of the external and internal auditors. As the Audit committee interacts with the external and internal auditors, they are able to influence the Firms internal control strength as well as financial reporting quality

therefore enhancing high audit quality (Godwin & Seow, 2000). Most studies on Audit quality have been examining the direct relationship between Audit quality and stock returns on one hand and also Audit committee and stock returns on the other hand. We therefore have in this study used Audit committee to interact between Audit quality and Stock returns to see whether it will strengthen their relationship or weaken it. According to Larcker and Richardson, (2004); Sun and Liu, (2013), Internal Corporate Governance mechanisms do not work as substitutes but work to complement each other in impacting on the quality of reported earnings hence high audit quality. In Nigeria, researchers in this area are yet to look at the moderating role of the Audit committee independence on the relationship between auditor tenure and Stock Returns thereby living a gap in literature in the area of auditing and accounting which now serves as a motivation for this study.

The main objective of this study is therefore to investigate the moderating effect of Audit Committee on the relationship between auditor tenure and Stock Returns. The Nigerian stock exchange is experiencing same steady growth in terms of trading volume, listed firms and market capitalisation, it is still very clear that the Nigerian economy is a developing economy with the full characteristics of a developing economy (Mgbame, Eragbe & Obazuwa, 2012; Omotosho, Okpanachi, Yahaya & Aniete, 2017). It is therefore very revealing to examine the relationship between auditor tenure and stock returns with audit committee Independence moderating the relationship in the context of Nigerian economy using the consumer goods firms listed on the Nigerian Stock Exchange. The findings of our study contribute to literature in this area and also add to the frontiers of knowledge of the theories of previous researchers. Additionally, the findings will also contribute to policy formulation, professional practice and many others that normally use of accounting information. Accordingly, the rest of the paper is presented as follows; Literature review, Methodology, Results & discussion, Conclusion and recommendations.

2.0 Literature Review

Under this section, the concept of Auditor tenure as well as Stock Returns and Audit committee independence will be discussed. The section will also discuss the baseline theory and how this theory is related to this work.

2.1 Auditor Tenure

This is the length of the period an audit firm has audited his client. The question of whether stock returns increases or decreases when an auditor maintains a long-term relationship with their clients has been one of the major issues that has engaged the attention of researchers. Some researchers maintain that, because of the long-term relationship maintained by the auditors and their clients, they become less interested in applying appropriate audit tools and proper procedures in performing their audit work and they usually become less sceptical (Safari, et al 2012).

On the other hand, some researchers are of the opinion that, maintaining long term auditor tenure relationship increases the knowledge and compe tence of the auditor (Su, Zhao & Zhau, 2016; Ji & Yoon, 2020). The second argument favouring long term auditor tenure suggests that auditor tenure is most likely to be associated with high quality audit which has a significant relationship with Stock Returns (Maggina, 2018). Based on the above stand point of view, Gull, Fing and Jaggi (2009) posits that, the quality of earnings in the early years of the tenure of an Auditor is low, equally, Nelly and Apandi (2018) show that, the risk of fraudulent reporting in the early years of the tenure of an auditor is higher. Similarly, Nekoueizadeh and Shahbazi (2016) found that, the discretionary accrual figures during the early years of the tenure of an auditor are higher than what is observed towards the end of the tenure of an auditor. In the same vain Khodamiepoor, Delfan and SabrojooWalker, (2014) discovered that, the possibility of increasing lawsuits against auditors' is most probable in the early years of their audit work. We therefore develop the following hypothesis:

Ho_1: There is no significant relationship existing between Auditor Tenure and Stock Returns of Consumer goods firms in Nigeria

2.2 Stock Returns

These refers to the income that investors are able to get from the stock market where they have invested in Stock. Such returns may be in form of the dividend paid to its shareholders by a firm from time to time. Stock Returns are not fixed income but lend themselves to market risk fluctuations which could be either positive or negative. However, market characteristics and the firm specific information content impacts directly on the magnitude in which the participants in the market reflect this new information of accounting numbers to bear on the prices of stock (Maggina 2018). Stock returns have been used in positive accounting research to theoretically analyse the reaction of the markets to different information events (Ahmadi & Jamali 2014). It has also been used to analyse how different investors react to unfolding information events. Prior studies suggest that auditor tenure could have significant effect on stock returns (Nekoueizadeh & Shahbazi 2016; Nelly & Apandi 2018; Safari Gerayeli & Jorjani 2018; Ji & Yoon 2020). Emphasis on the possible significant effect of auditor tenure on stock returns from developing countries such as Nigeria could bring out a positive impression on the firms listing requirements and enforcement with respect to the quality of auditors.

2.3 Audit Committee Independence

An audit committee is a selected number of members of a company board of directors whose respon sibilities include helping auditors to remain inde pendent of management. The audit committee plays a critical role in providing oversight and serving as a check and balance on a company's financial reporting system. It is imperative that an audit committee should ensure that the management of a firm are accountable to shareholders (Blue RC, 1999; Cadbury Report, 1992; Treadway Commission, (1987). The code of

corporate governance (2011) by SEC provide that, the majority of audit committee members should be independent while the chairman of the committee must be a non-executive director. Equally section 11(4) (2) of the Nigeria code of corporate governance (2018) states that, all members of the audit committee must be financially literate and should be able to read and understand financial reports. According to Bala and Kumai (2015), the higher the independence of an audit committee, the more the degree of oversight functions, the more likely that members will show objectively in evaluating the propensity of firms accounting internal control and reporting practices thereby enhancing the quality of audit reports which has an impact on the stock returns of firms. Previous studies such as Azzoz and Khamees (2015), Velnampy, Sivatha Thavanika and Sinthuju (2014) showed Auditor tenure and stock returns giving inconsistent results with some showing positive relationship while others yet show a negative relationship. The main objective of the study is therefore to investigate the moderating effect of Audit committee independence on the relationship between Auditor tenure and Stock Returns. Audit committee independence as a moderating variable is expected to improve the efficiency of the model and its relationship with Auditor tenure and Stock Returns.

We therefore propose second hypothesis as follows:

Ho_2: Audit committee independence does not significantly moderate the relationship between Auditor tenure and Stock Returns of consumer goods firms in Nigeria.

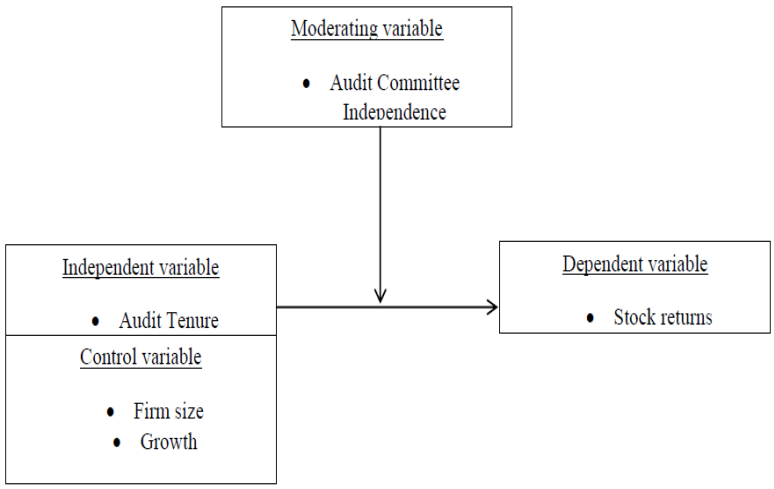

Figure 2.1: The conceptual framework of the study

Figure 2.1 presents the framework of the current study within the existing research and also explaining how Auditor tenure affects Stock Returns.

Figure 2.1 of the expected relationship between Auditor tenure and Stock Returns is divided into four parts, Auditor tenure (independent variable) Stock Returns (dependent variable), Audit Committee Independence (moderating variable).

2.4 Theoretical Framework

The theory that is used to support the analysis of this work is the Agency theory which is considered appropriate to explain the model of the study.

2.4.1 Agency Theory

Auditing is regarded as a mechanism for mitigating information asymmetries among related parties. This position is supported by the Agency theory. The demand for audit of companies' accounts is created by the agency problems which are related to the separation of corporate ownership from control

(Gerayeli, 2011). The agency problem arises from the existence of asymmetric information in the principal agent contracts (Jenson & Messier, 2000). Some studies Wild and Wild (1995) have shown that the existence of information asymmetry between management and shareholders is a necessary condition for an easy perpetration of earnings misreporting and financial statements manipulations. The audit of a company's accounts is a monitoring or control mechanism that diminishes information asymmetry and protects the interests of the principal. The duration of the audit engagement improves the quality of audit reports making the company's stock to become more competitive because the existing shareholders are not ready to pull out their invest ments while the potential investors clamour to enter the market through the purchase of the company's shares.Clamour for more of the company's shares will now create a demand for the company's shares resulting into the rise in prices of these shares which

3.0 Methodology

The research approach adopted for this paper is the *Ex-p* is carried out after events have taken place and the data i is a systematic empirical study in which the researcher because the situation for the study already exist or has al made up of all the consumer goods firms listed on the Ni

Stock Exchange as from 2008-2019 covering 21 firms. Out of this number, a sample of 16 firms was chosen using the following criteria: i) The firms should have complete financial statement for the period under review; ii) The firm must not have ceased operations during the period under review. iii) Firms must have been listed on the Nigeria Stock Exchange as at the beginning of the study period.

3.0 Variables of Study and their Measure ments.

The study uses four sets of variables, that is, dependent variable, the Independent variable, moderating variable and the control variables in order to study the hypothesised moderating effect of Audit committee Independence on the relationship between Auditor tenure and Stock Returns.

3.0.1 Dependent Variables (Stock Returns)

Stock return is the appreciation in the price of stock plus any dividend by the original price of the stock. The measurement of the stock returns is done using the following equation:

Where: RET = Stock Returns

$$\mathrm{RET} = \frac{(P_{1it} - P_{oit}) + D_{it}}{P_{oit}}$$

Where: RET = Stock Return

P_{0it} = Initial Stock Price at the beginning of the year.

P_{1it} = Ending Stock price at the end of the year

D_{it} = Dividend paid

Table 3. 1 Variables and their Measurements

Symbol	Variable	Measurement	Source
Dependent Variable			
RET	Stock Returns	Price of Stock at the end of the year minus Price Stock from the beginning of the year plus Dividend Divide b Prices of Stock at the beginning of the year	Bhattacharya, (2011); Perotti and Wagenhofer (2014)
Independent Variables			
AUT	Auditor Tenure	Measured by the period the Audit Firm has spent as the Auditor of the Firm.	Heydari,(2015)Hohenfels,(2016)
ModeratingVariable			
ACI	Audit Committee Independence	Measured by the proportion of Independent Directors sitting on the audit Committee	Omotosho, Okpanachi, Yahaha and Aniette, (2017); Reid, Carcello, Li and Neal, (2017
Control Variables (Firm Characteristics)			
FSZ	Firm Size	Measured using the log of Assets of the Firm.	Khostinant & Barari, (2006); Chaney & Jeter, (1992)
GRT	Growth Opportunities	Measured using the Market Value of Equity to book Value of Equity	Scott, 2011; Bolo & Mirzaeei, (2011)

Source: Authors Compilation, 2021

3.1 Model for the Study

A multiple regression model is used to test the moderating effect of Audit Committee Indepen-dence on the relationship existing between Auditor tenure and Stock returns. The model is structured as follows:

$$RETit = \beta0 + \beta1\ AUTit + \beta2\ ACIit + \beta3\ AUTit\ ^{*}ACIit + \beta4\ FSZit + \beta5\ GRTit + e_{it}$$

Where:

RETit = Stock Returns of Firm 'i' in year 't'

AUT_{it} = Auditor Tenure of Firm 'i' in year 't'

ACI_{it} = Auditor Committee Independence of Firm 'i' in year 't'

FSZ = Firm size of Firm 'i' in year 't'

GRT = Growth Opportunities of Firm 'i' in year 't'

$\beta_0 - \beta_5$ = Regression Model Coefficient of Independent Variables

* = Interaction between Independent and Moderating Variable

e_{it} = error term of firm 'i' in year 't'

4. Results and Discussion

In this section, statistical results are presented and discussed.

4.1 Descriptive Statistics

The descriptive statistics of the data for the study is presented in table 4.1

Table 4.1 Descriptive Statistics

Variable	No.	Min.	Max.	Mean	Std. Dev.
RET	192	-1	1,435	115.28	172.11
AUT	192	1	12	5.43	3.08
ACI	192	0.17	0.57	0.39	0.11
AUTACI	192	0.2	6	2.06	1.29
FSZ	192	9.09	11.59	10.53	0.63
GRT	192	-16.92	27.48	4.89	6.21

Source: STATA output results

Table 4.1 shows a minimum of -1 and a maximum of 1.435 for RET which means that the minimum annual returns on stock prices of firms under study is negative (-1), and the maximum stock returns for the same period for the same set of firms is ₦ 1,435 with a mean value of ₦115.28 and a standard deviation of ₦172.11. Auditor tenure show a minimum of 1 year and a maximum period of 12 years meaning that the minimum period an auditor has stayed with his client is one year and the maximum period an auditor has stayed with his client is 12 years for the firms under study. It also shows a mean of five years and a standard deviation of 3 years.

Audit committee independence has a minimum value of 0.17 representing 17% and a maximum value of

0.57 representing 57%. This shows that some of the sampled companies have about 17% of the composition of their audit committee members to be non-executive directors while some of the sampled companies have about 57% composition of their audit committee members to be non-executive directors. The mean value of the audit committee independence is 0.39 representing 39%. This implies that the sampled firms have an average of 39% of the composition of their audit committee members to be non-executive directors whereas the rest of the members of the committee ie 61% comprising of shareholders and executive directors with a standard deviation of 11%. From table 4.1, the minimum value of -16.92 and maximum value of 27.48 represents -1,692% and 2,748% growth rate respectively. The firms also have a mean value of 4.89 representing an average growth rate of 489% and a standard deviation of 6.21 representing 621%

4.2 Correlation Matrix of the Study Variables

The Pearson correlation results showing the relation ship between the dependent and the independent variables are presented in table 4.2. It also shows the relationship among all pairs of variables in the regression model.

Table 4.2 Correlation matrix of the Dependent, Independent and Control Variables

Variable	RET	AUT	ACI	FS2	GRT
RET	1.0000				
AUT	0.2029	1.0000			
ACI	-0.0608	-0.0869	1.0000		
FSZ	0.2881	0.1052	0.0449	10000	
GRT	0.4610	0.1572	-0.0583	0.2506	1.0000

Source: STATA output results

Table 4.2 shows the highest correlation coefficient of 0.4610 between Stock Returns and Growth meaning the variables have no correlation problems. The rest of the variables have correlation coefficients of less than 0.4610 meaning that the data used for this study has no correlation problems.

4.3 Assumptions for Multiple Regression Tests

Here the results of regression analysis showing the relationship between the Dependent and Independent variables and the moderating effect of the audit committee independence on the relationship existing between Auditor tenure and Stock Returns will be discussed.

Table 4.3 Breusch-Pagan/Cook Wersberg Test for Heteroscedasticity

Chi2(1)	Prob>chi2	Null (Ho)
175.17	0.0000	Rejected

Table 4.3 Shows a P Value of less than five (P<0.05) meaning that the data used for this study has heteroscedasticity issues. Panel Corrected Standard Error (PCSE) was used to correct the heterosce dasticity presence in the data (Beck and Katz,1995).

Table 4.4 VIF and TV for Multicollinearity Test

Variable	VIF	TV ( )
GRT	1.09	0.916452
FSZ	1.08	0.928552
AUT	1.04	0.963770
ACI	1.01	0.985906
MEAN VIF	2.04	

Table 4.4 shows the variance inflation factor (VIF) The Hausman specification test results show a preference for fixed effect model as can be seen in table 4.6 for Hausman specification test. This study however cannot use the fixed effect model for analysis of this work because the data set contains heteroscedasticity and Autocorrelation issues. According to Moundigbaye, Rea and Reed, (2018) Panel Corrected Standard Error was established as a superior tool for Panel data with the problems of heteroscedasticity and autocorrelation.

with Tolerance values. The independent variables for the model are all below the bench mark of ‘’10’’ which is considered harmful for regression analysis. The VIF mean of 2.04 supports this.

Table 4.5 Wooldridge Test for Autocorrelation

F (1.15)	Prob> f	Null Ho
27.049	0.0001	Rejected

In table 4.5 the Wooldridge Test for Auto-correlation show the result of P value of less than 0.05 (P<0.05) meaning that the data set used for this study has autocorrelation issues. Panel Correlation Standard Error (PCSE) regression as suggested by Beck and Katz (1995) was used to correct the autocorrelation issue.

Table 4.6 Hausman Specification Test

Chi2 (5)	Prob>chi2	Null Ho
45.82	0.0000***	Rejected

Note: The *** Indicates Significance at 1 percent (P<0.10)

4.3.1 Multiple Regression Tests

4.7 Summary of the Panel corrected Standard Error Regression

Variable	Coef.	Z Values	Prob> z
AUT	36.65483	2.06	0.040**
ACI	311.7953	1.43	0.152
AUTACI	-77.27413	-1.79	0.074

FSZ	48.23864	5.05	0.000***
GRT	10.44596	3.34	0.001***
R^2			0.2760
Prob.>f			0.0000***

NOTE: The *** indicates significance at 1% (P<0.01) ** indicates significance at 5% (P<0.05)

4.3.2 Regression Summary

From Table 4.7, the results show that the coefficient of determination R^2 stands at 0.2760 meaning that 27.60% of the variations in stock Returns over the period under study was jointly explained by the independent variables. The unexplained part of the dependent variable which is 72.40% can be explained to come from the exclusion of some important independent variables that could also explain the changes in the dependent variable but are however not within the scope of this study. The P Value of 0.0000 shows that the PCSE regression model overall is statistically significant at 1% level. From the table the interaction between Auditor tenure and Audit committee Independence is negatively and insignificantly related to Stock Returns (= - 77.27, P=-1.79) On the other hand the coefficient of Auditor tenure (=36.65, P= 0.040) is positive and significantly associated with Stock Returns. Audit Committee Independence has a positive but insignificant relationship with Stock Returns (=311.80, P= 0.152). Both firm size and growth have a positive and significant relationship with Stock Returns (= 48.24, P= 0.000;

=10.45, P =0.001 respectively).

4.3.3 Hypotheses Testing

From table 4.7, the results show that, Auditor tenure has a significant and positive effect on the Stock Returns for the firms under study (= 36.65, P=0.040). Therefore, Hypothesis Ho_1, is rejected meaning that, Auditor tenure has a significant positive effect on stock returns. The implication of this result is that, longer Auditor tenure helps to improve the quality of the stock returns of firms selected for this study. These findings are supported by the works of Nekoueizadeh and Shahbi (2016); Ji and Yoon (2020)

From table 4.7 the results reveal that the Audit Committee Independence do not moderate significantly the relationship between Auditor tenure and Stock Returns (= -77.27, P= 0.074), therefore hypothesis $H0_2$ is accepted. The implication of this result is that, Audit Committee Independence do not moderate the relationship existing between Auditor tenure and Stock Returns. The insignificant outcome of the moderating result means that the external auditors with their long stay in the firms and the Audit committee are not complementing the efforts of each other in improving the effectiveness of each other in producing quality reporting that will impact positively on the Stock Returns.

5.0 Conclusion and Recommendations

From the findings of the study, it is concluded that, with prolonged Auditor Tenure, the auditors will have a better understanding of the operations of the clients business. The Auditor will also be more familiar with the accounting systems and reporting issues leading to improvement in Audit quality and the quality of the firm's financial reports and audited financial statements. This will improve the Investors decision making process as the level of uncertainties in investment decisions and forecasting returns. This will in turn impact positively on Stock Returns. That the interaction between the moderator Audit committee independence and Auditor tenure cannot automatically lead to higher stock returns.

The study therefore recommends to investors and other capital market participants that when taking investment decisions, consideration should not only be given to financial variables only but they should also pay attention to the tenure of the auditor as a factor affecting stock prices. Furthermore the financial reporting council of Nigeria, (FRC) Securities and Exchange Commission (SEC) and other policy makers of the provision of the audit market are advised to recommend that, a mandatory period of 10 years that is permitted by statute in Nigeria be increased to 15 years or more, as this will ensure that the audit quality improves thereby increasing the Stock Return of firms. We also recommend that, the FRC and SEC in their next review of their codes should make a provision for Independent directors who are in no way committed or involved in one way or the other with the firm should form the majority of the Audit committee members, this will ensure their total independence from management.

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