

# A Comparative Analysis of Corporate Governance Attributes and Audit Quality

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## ABSTRACT

The objective of this study is to investigate the results of relationship between corporate governance attributes and audit quality with empirical evidence from the consumer goods and financial services sectors. Board diligence and independence were the two board attributes used against audit quality to establish the relationships. Based on the use of historical data for the study, an ex-post facto research design was adopted. Thirty-four (34) firms quoted on the Nigerian Stocks Exchange were used for the study. For our hypotheses testing, descriptive and Logistic Regression statistics were applied for the dataset covering four (4) years from 2015 to 2018 – a post- corporate governance and IFRS-adoption period. In the consumer goods sector, the result shows that the independence of the board has positive and significant relationship with audit quality. While board independence and diligence have both negative and no significant relationship with audit quality for firms in the financial services sector. The study therefore recommended that adequate attentions should be paid to the enhancement of board independence and there should be increase in the number of Board meetings especially in consumer goods sector in line with SEC code of 2018 directive which call for at least 4 board meetings annually.

**Keywords:** Corporate governance, board independence, board diligence, Audit quality, Nigeria.

## INTRODUCTION

Poor and inaccurate audit outputs have become a worldwide occurrence in recent times and have recently taken frightening dimensions with corporate scandals that lead to collapse of both Enron in America and Cadbury (Nigeria) Plc. Auditors are not exempted either as their reputation was also compromised (Okaro & Okafor, 2014a). Nawal et al. (2016) hammered on lawsuit costs and reputational loss as the twins' essential drivers for audit quality. The desires of auditors to avoid litigation costs and reputation loss have been the compelling forces to improve and not compromised on the quality of audit reports. Adebayo et al. (2014) concluded their study with emphasis on the nexus between company operational transparency and good corporate governance practices. Therefore, implementation of robust corporate practices is synonymous to a vehicle for attraction of investment capital, minimize the investor's risks and improve both audit quality and corporate performance (Hussain et al. 2015).

The demand for quality audit report is directly linked to the fact that professional managers (the agents) are saddled with responsibility of preparing financial statements, which is primarily on the basis of costs. Research scholars such as Adeyemi and Fagbemi (2010), Ejeagbasi et al. (2015), Okaro and Okafor (2014b) and Motavassel et al. (2013) have studied correlation between corporate governance and audit quality, but these studies did not investigate the outcomes of audit quality in two business environments while applying the same variables. This research gap forms the basis of this study. For instance, Okaro and Okafor (2014a) studied drivers of audit failure in Nigeria with evidence from Cadbury (Nigeria) Plc (i.e. from a consumer goods sector) while Ahmodu (2017) examined similar subject matter with attention on the listed non-

financial firms. However, similar variables were not considered for the studies. This study, therefore, contributes additional empirical evidences on what would be the impact of the board independence and diligence on quality of audit applying the same attributes but in two different sectors (the consumer goods and financial service sectors).

### **Research Objectives**

The main aim of the research is to examine comparatively the link between audit quality and corporate governance attributes in two business environments with the same variables. The specific objectives are:

1. To determine the effect of board independence on audit quality
2. To ascertain the effect of board diligence on audit quality

### **Research Questions**

The formulated questions for the study are:

1. Does board independence affect audit quality?
2. Is there a relationship between board diligence and quality of audit?

### **Research Hypotheses**

The tested null hypotheses are as follows:

1. There is no significant relationship between independence of the board and audit quality
2. There is no significant relationship between audit quality and diligence of the board.

## **REVIEW OF RELATED LITERATURE**

### **Corporate governance and its attributes**

Corporate governance and audit quality have become of a frequent interest in research works. Thus, this section of the study looks at those essentials in the literature that offer explanations on audit quality, corporate governance and its attributes.

It has been established that most of corporate successes are traced to effective and efficient corporate governance practices and this fact has led to rolling out of several corporate governance codes worldwide since 1990s (Alhababsah 2018). Corporate governance is better defined as a sequence of relationship amongst stakeholders especially board of directors and other concerned players. It is a platform where firm's goals are set, attained and monitored including evaluation of performance (OECD, 1999). Corporate governance drives corporate strategies, accountability and business success. There are claims that regulation of corporate governance in Nigeria is not very pronounced as there are no strict enforcement and consequences over non-compliance. However, Nigerian Code of Corporate Governance (NCCG) 2018 calls for institutionalization of corporate governance best practices in Nigerian firms. The code alerts the public of essential corporate ideals and ethics that will boost the uprightness of the business environments.

### **Board Independence**

Research scholars such as Amran et al. (2009) and Cornett et al. (2008), as cited in Bakare (2019) have evidently made claims that success of board is linked with independence of Board. Fama and Jensen (1983) maintained that the primary responsibility of the board of directors is to review and monitor decisions of management. They concluded that having a higher percentage of external directors leads to objective

supervision and diminished managerial dominations. DeAngelo (1981) as cited in Lorenzo and Antonella (2014) articulated the connection between likelihood of identifying irregularity and objectivity of auditor. Auditor Independence is assumed to have major influence on the quality of audit work (DeAngelo, 1981; Nelson et al., 2002; Alim et al., 2007; Windsor & Warring-Rasmussen, 2009 as cited in Ilaboya & Ohiokha, 2014). Independence of Board is emphasized because the equity-holders are not always available for the daily running of firm and managers are professionally saddled with the operations of firms that may not have substantial stake in the firm (Fama, 1980). The necessity for auditor services is as a result of the agency issues which originated from ownership separations from firm's administrations (Fama & Jensen, 1983). For the reliability of financial disclosures to be assured, it is usually imperatives for it to be objectively verified by a certified auditor. Mohammed and Ibrahim (2018) justified with proof the sustenance of hypothesis that possibility of fraud and audit quality is negatively linked to the presence of non-executive directors. The correlation between Independence of Board and quality of audit is expressed as:

$$AQ=f(BI)$$

### **Board Diligence**

Frequency of Board meetings is used to determine the Board of director's diligence; rate of recurrence of meetings is used as the time voted to evaluate and monitor management activities. Studies have shown significant improvement in Board of director's performance when they meet frequently (Rizzotti & Greco, 2013; Vafeas, 1999). John et al. (2015) concluded that financial crisis of most of companies could be traced to poor attendance at the board meetings while reverse is the case for the company with regular attendance (Francis et al., 2012). Board diligence is an important factor that plays crucial roles in boosting audit quality. Regular meetings provide adequate protection against financial scandals and safeguarded firm's assets in accordance with the best practices. The nexus between Board diligence and audit quality is shown below:

$$AQ=f(BD)$$

### **Overview of Audit Quality**

Audit Quality essentially has different meanings to different people. It is defined as the capability of auditor to detect material misstatements especially fraud; while others adjudged it in terms of conformity with audit procedures, guidelines, standards and frameworks. Lorenzo and Antonella (2014) examined essential view of related literatures and further studied the proposed ethics on quality of audit work. Both PCAOB (2013) and IAASB (2013) released its proposed set of qualitative yardsticks that must be discussed with the board's advisory groups, other regulators, academics and key players in order to identify quality audit framework. In "agency theory", auditor's opinion is an essential assurance for third parties, who are using the financial statements (Hosseinnikani et al., 2014). Audit carried out in line with set standards will compel companies to exhibit commitment to good governance practice and raise their height of honesty, probity, trust, integrity and established atmosphere for continuous business activities.

### **Empirical Framework**

The perceptions of the auditor's independence (objectivity) affect the confidence of investors in financial statements and affect users taking informed decisions (SEC, 2000). As such, the desires for audit quality become more essential. One area of study which has gained global emphasis in both developing and developed countries is the impact of corporate governance attributes on quality of audit work (Okaro & Okafor, 2014b). Central Bank of Nigeria (CBN) reports on the backward development in some of Nigerian Banks; stressed weaknesses in the internal control systems and poor audit work as factors.

Ejeagbasi et al. (2015) examined relationship of Corporate Governance on quality of audit with emphasis on

banking sector in Nigeria and discovered that composition of Board has a negative and no significant effect on quality of audit outputs. Board size, separation of CEO from chairman of Board and Audit committee compositions has positive and significant nexus with the Audit Quality. Correlation method was used for data analysis with Big 4 Audit firms as proxy for measuring dependent variable. But he did not make use of board diligence and independence as added variables to further strengthening their findings. This forms basis for further empirical study.

Wan Zanani et al. (2008) studied impact of board composition, ownership and CEO duality on audit quality with attention on Malaysian listed companies. Logic regression analysis was used to evaluate the correlation between independent and dependent variables. Audit firm size was used as proxy for audit quality. They concluded that independence of the board and ownership of non-financial institutional has significant relationship with the size of audit firm. They further espoused that independence of board and ownership concentrations are essential ingredients for effective performance of the listed firms at Bursa Malaysia. Though, effect of engaging one of Big-4 audit firms as a proxy for audit quality was not considered as it could have significant influence on the outcomes of the research.

Azrul et al., (2015) investigated connections between corporate governance proxies such as audit committee composition & operation, block shareholders, ownership dominance and CEO duality on auditor quality selection in Malaysia. Their findings indicate that ownership concentration, political tie, and family control have significant link with quality of audit outputs. The Regression model and correlation analysis were used for data analysis. More variables such as board independence and diligence are not considered in the study to further support the research outcomes.

Mohammed and Ibrahim (2018) assessed the effect of audit fee on audit quality of listed conglomerates in Nigeria. Data for the study were collected from the annual reports and accounts of the listed firms. A panel data was adopted using OLS and Random Effects regression. Audit fee and audit firm size were used as a measured of independent variables with their impact on audit quality. However, this current study will consider usage of Logistic Regression analysis as a tool of data analysis.

Okaro and Okafor (2014b) studied the relationship between effectiveness of corporate board and its effect on external audit quality. Board meeting, size, diligence and proportion of non-executive directors on the board to ownership concentrations were used as proxies for determining board effectiveness. Descriptive and inferential statistics were adopted for data analysis. The study concluded that frequency of board meetings (i.e. Board diligence) is the most essential board attributes for an effective board and Audit Quality. This is in line with SEC code of 2018 directive which call for at least 4 board meetings annually. Nevertheless, the literature did not consider what would have been the research outcomes comparatively when two distinctive business environments are tested with the same variables.

Ilaboya and Ohiokha (2014) investigated the relationship between audit firms' uniqueness and audit quality. The multivariate regression technique with emphasis on Logit and Probit methods was applied for data analysis. This method was adopted as a result of the dichotomous nature of dependent variable and the fact that data used is both time series and cross-sectional. The study discovered a positive correlation amongst size of firm, independence of board and audit quality. However, further findings showed a negative correlation between auditor's independence, audit firm size, tenure of audit and audit quality. Board diligence and size were not used as part of independent variables.

### **Theoretical Underpinning**

Established facts amongst the CG scholars revealed neither single generally usual theoretical base nor commonly acknowledged representation that could be distinctively used to discuss corporate governance (Fooladi & Farhadi, 2011; Okaro & Okafor, 2014b; Ejeagbasi et al., 2015). Corporate governance has

become the most important tool of managing complexities in organizational structures. Some of the corporate governance supporting theories with relevant scholars is explained in subsequent paragraphs. Theoretical frameworks such as Agency and Resource Dependency theory shed more light into corporate governance and further buttressed its indispensable roles in providing the structure through which the objectives of the company are set, achieved and performance appraised.

### **Agency theory**

It was proposed by Economist “Alchian and Demsetz”, where principal entrust work to agent, who performs firm operations (Alchian and Demsetz, 1972; Eisenhardt, 1989) as cited in Abid et al. 2014). The apparent set back of the framework is that agent may consider their interest to be more paramount than that of the principal and the theory predominantly focused on improvement of shareholders’ wealth (Fooladi & Farhadi, 2011). But this is not the case when family owns and manages business, the interest of owners and management are aligned and the associated problems of principal-agency relationship will be diminished. The assertion is that CG characteristics need to be explained to the top-level managers so that their interests will be better addressed (Abid et al., 2014). The attention of this theory is on the relationship between the independence of board or leadership configurations and company’s efficiency.

### **The Resource Dependence Theory**

Resource dependence theory explained the relationship between board of director’s functions and outside business environments. The theory explains how firm external resources affect its processes and there was an assertion that organization survival and sustainability partly relied on how important resources from its external environment are fetched, sustained and utilized. Therefore, enlistment into the board of directors is primarily hinged on resources services (Ajayi, & Zahhirudin, 2016). Firms are relied on each other for exchange of resources and this formed the motive resources are the basis of power for firms as they are fundamentally valuables, expensive to replicate, uncommon and no replacement (Hitt et al., 2012). Both power and resources are directly related (Abid et al., 2014).

## **METHODOLOGY**

### **Sample Selection**

Secondary data were selected from the annual reports with a sample of 50 companies randomly picked from a population of 73 companies listed in the Nigerian Stock Exchange from two sectors. However, only 34 companies with sufficient data were used (i.e. 21 selected from financial services firms and 13 from consumer goods sector). Purposeful sampling technique was adopted and top active-traded listed companies were considered good representation of quoted companies in these two sectors. Annual and Board of Directors reports, covering period of 2015-2018 were employed to extract information on the variables needed to test each of the formulated hypotheses. The two business environments were considered suitable for the study because they are noticed to be guided by similar audit procedures and guidelines. As part of criteria considered for selecting the companies are that the company should have been listed on Stock Exchange before 2015 and its membership should have continued until 2018; and should not have closed down its trading more than 6 months to the research.

### **Definition of Variables**

The dependent variable is audit quality (AQ). The predictor variables were preferred based on the work of the previous scholar’s including Ejeagbasi et al., (2015) and Motavassel et al., (2013). The variables with their corresponding measurement details and scholars are shown in Table 1 below.

Table 1 Variables Measurement

S/N	Variables	Definition	Type	Determinants	Supporting Scholars
1	BI	Board Independence	Independent	Number of Non-Executive Directors divided by the numerical strength of the board members	Motavassel, Ansari, Golzar & Zarfsaz (2013); Aribaba & Ahmodu (2017), Ilaboya J., & Ohikkha I., (2014)
2	BD	Board Diligence	Independent	Determined by the frequency of Board meetings conducted annually	Aribaba & Ahmodu (2017)
3	AQ	Audit Quality	Dependent	One (1) – represents when firm is audited by one of big-4audit firms and Zero (0) when otherwise.	Mohamed & Mohamed (2012)

Source: Authors’ Compilation (2022)

### Model Specifications

Descriptive Statistics and logistic regression analysis were adopted in this study to test hypotheses formulated as well as evaluating the correlation between the independent and dependent variables. The logistic regression model is shown below:

$$AQ = \beta_0 + \beta_1BI + \beta_2BD + e$$

Where: **AQ**= Audit quality; **BI** = Board independence; **BD**= Board diligence

### DATA PRESENTATION & ANALYSIS

This section presents the data used for the study as well as the descriptive and inferential statistical analyses carried out on them.

Table 2: Descriptive Statistics

	Audit Quality		Board Diligence		Board Independence	
	Consumer Goods Sector	Financial Service Sector	Consumer Goods Sector	Financial Service Sector	Consumer Goods Sector	Financial Service Sector
<b>N</b>	13	21	13	21	13	21
<b>Min.</b>	0	0	3	4	0	0
<b>Max.</b>	1	1	7	8	1	1
<b>Mean</b>	0.85	0.86	4.85	5.05	0.62	0.95
<b>SD</b>	0.376	0.359	1.214	1.071	0.506	0.218

Source: Author’s Computation from SPSS 20.0 Output (2022)

Table 2 shows the minimum, maximum, mean and standard deviation of the variables in the study for both sectors. The result shows that on average, not less than 85% of the sampled firms are audited by Big-4 audit firms. The result further shows a minimum and maximum of 3 and 7 meetings respectively held by the

board for the years under reviewed. Board independence for both the consumer goods sector and the financial service sector has means of 62% and 95% respectively (revealing extremely high level of Board independence for the samples reviewed).

Table 3: Logistic Regression Results

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
Consumer Goods Sector	Constant	-.485	0.332		-1.459	0.179
	Board Independence	0.298	0.138	0.402	2.159	0.005
	Board Diligence	0.105	0.058	0.339	1.819	0.102
Financial Service Sector	Constant	0.915	0.877		1.043	0.312
	Board Independence	-169	0.480	-103	-353	0.729
	Board Diligence	-048	0.099	-145	0.489	0.631
	<b>R<sup>2</sup></b>	<b>Adj. R</b>	<b>F</b>	<b>Sig.</b>	<b>Nagelkerke R<sup>2</sup></b>	<b>Cox &amp; Snell R<sup>2</sup></b>
Consumer Goods Sector	0.717	0.623	7.614	0.008	1.000	0.576
Financial Service Sector	0.131	-0.22	0.856	0.483	0.889	0.498

Source: Author’s Computation from SPSS 20.0 Output (2022)

Table 3 reveals the results of the Logistic Regression for both the Consumer Goods and Financial Sectors of the economy. The results further show the explanatory power of the model as measured by the Nagelkerke R Square and adjusted R Square. According to Tabachnick and Fidell (1996), the adjusted R Square provides a better estimation of the true population value, especially with a small sample. For the Consumer Goods Sector, the adjusted R<sup>2</sup> shows a value of 62.3% indicating that the model really describes the data. The result shows that board independence has positive and significant relationship with audit quality owing to the fact that p-value (0.005) is less than 0.05 for the Consumer Goods Sector while this is not true for the Financial Sector as an insignificant relationship was found between the variables (Sig. fig. = 0.729). In view of this result, the Hypothesis 1 is rejected for the Consumer Goods Sector and accepted for the Financial Service Sector. More so, the logistic regression analysis as shown in Table 3 also reveals that board diligence has a positive but not significant relationship with audit quality for both sectors; hence, we accept hypothesis 2. Table 4 shows the summary of the results.

Table 4: Summary of Results

Sector	Hypothesis 1	Hypothesis 2
Consumer Goods Sector	Rejected	Accepted
Financial Service Sector	Accepted	Accepted

Source: Authors’ Compilation (2022)

## DISCUSSION OF FINDINGS

Findings from the study show that board independence has both positive and significant relationship with audit quality in consumer goods sector. This finding is consistent with Ejeagbasi et al., (2015) and Motavassel et al., (2013) who suggested that both variables have a positive impact on quality of the audit work with the claims that independent board of directors hired higher-quality audit services to safeguard shareholder's interests and protect board of director's reputations. However, the same predictor variables indicate positive but no significant relationship in financial services sector. This result, though, is consistent with the conclusions of Bakare (2019) and Okaro and Okafor (2014b) but in contrast with Adeyemi and Fagbemi (2010).

The research further confirmed that board diligence has positive and no significant relationship in consumer goods sector – a result which is in contrary to the findings of Ilaboya and Ohikkha (2014). Analysis of the financial service sector showed that board diligence has negative and no significant correlation with quality of audit outputs. This finding is in tandem with the study of Adeyemi and Fagbemi (2010).

## CONCLUSION AND RECOMMENDATIONS

### Conclusions

The study examined the effect of CG characteristics on the quality of audit of both consumer goods and financial services sectors from a comparative perspective. The findings will be used to improve upon variables that can enhance audit quality more in each sector. The results from consumer goods sector indicate that size of board and independence of board have positive and significant correlation with audit quality while board diligence has a positive but no significant relationship with Audit quality.

But in financial sector services, board size has positive but no significant relationship with audit quality while both board diligence and independence have negative and no significant relationship with audit quality. The conclusion is that even when the same variables are used in different business environments the outcomes will not be the same.

### Recommendations

Following the conclusions from the study, the following recommendations are made:

1. Consumer goods sector Board of directors should improve on frequency of meetings conducted to meet up with SEC code of 2018 directive which calls for at least 4 board meetings annually.
2. Independence of Board of directors should be further enhanced by increasing the numbers of non-executive director's representations. This is to safeguards the minority interests and for the reliability of financial disclosures to be assured.

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