

**AUDIT COMMITTEE AND FINANCIAL PERFORMANCE OF LISTED REAL ESTATE  
COMPANIES IN NIGERIAN**

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**ABSTRACT**

*This study examined the relationship between audit committee and financial performance of listed construction and real estate companies in Nigeria. The ex post facto research design was adopted for the study with a population of six (6) listed construction and real estate companies in Nigeria as listed by the Nigerian Exchange Group in 2022. Data were retrieved from the annual reports of the selected construction and real estate companies for the period 2017 to 2021. Multiple regression analysis was used to analyzed the data gathered with the aid of Stata12 statistical software. The study revealed a negative and insignificant relationship between audit committee and net profit margin.. The study concluded that corporate governance has no significant relationship with financial performance of listed construction and real estate companies in Nigeria. The study recommended that audit committees of listed construction and real estate companies should be proactive in ensuring full compliance to corporate governance code 2018 for enhance financial performance. More financially literate board should be advocated for than the size of the board as this study revealed that board size has a positive but insignificant effect on financial performance. Finally, the independent directors should not only be increase but be made of directors that can provide necessary information to outsiders such as key stakeholders. As such, reducing the information asymmetry gap among insider and outsider.*

***Keywords: Audit Committee, Financial Performance, Real Estate***

**INTRODUCTION**

Corporate governance has become a burning issue all over the world. Our awareness of major corporate governance issues in Nigeria started with the discovery of overstatements in Cadbury Nigeria Plc accounts in 2007. Since then, many more have followed. The construction and real estate industry in Nigeria have witnessed some setbacks. With the continuous collapse of buildings in Nigeria, architects want authorities to strengthen the corporate governance in the construction and real estate industry. There are many challenges to the effectiveness of corporate governance in Nigeria. they range from corrupt practices, ownership structure, slow and inefficient judicial process to lack of enforcement mechanisms by regulatory bodies.

Good corporate governance requires the strengthening of regulatory of regulatory agencies as well as boosting the capacity of corporation to appoint competent board of directors. A situation where the regulatory agency is weakened by political consideration and saddled with too many functions does not augur well for regulation. The board of directors as the center of corporate ethic, in most cases involved in unethical practices. Certain boards of directors and audit committees failed to constrain "creative" accounting so as to keep up their earnings numbers to favour the shareholders and executives. This act has contributed immensely to the collapse of most corporate organizations. Also, low compliance to regulatory and environmental laws has resulted in the incessant reports of collapsed buildings and other ecological problems. Some staff of regulatory bodies prefer to take bribe rather than ensure that developers obtain the requisite permits and conform to statutory construction standards. These problems if properly addressed will enhance

financial performance of the construction and real estate industry. Previous studies show that poorly governed firms have lower operating performance while good governed firms demonstrate higher financial performance and market valuation (Ayodeji & Okunade, 2019; Bebchuk et al., 2004; Islami et al., 2020; Joshua et al., 2019; Kiptoo et al., 2021; Musah & Adutwumwaa, 2021; Okoye et al., 2020; Shleifer & Vishny, 1997).

A study by Kiptoo et al. (2021) on corporate governance and financial performance of insurance firms in Kenya used data collected from 51 for 2013-2018. The study concluded that corporate governance significantly affects the financial performance of insurance firms. Also, Musah and Adutwumwaa (2021) examined the effect of corporate governance on financial performance of rural banks in Ghana. The study further revealed a positive association between board size and ROA and ROE even though that of ROA was statistically insignificant. Also, board independence was found to be a significant determinant of rural bank financial performance. In Nigeria, Okoye et al. (2020) examined the effect of corporate governance on the financial performance of commercial banks in Nigeria. The ex-post facto design was adopted for the study. The Generalized Method of Moments (GMM) analytical technique based on STATA 13 statistical procedure was used to analyze the data. The study revealed that board size, directors' equity, and firm size substantially affect Nigerian banks' financial performance. Therefore, the study asserts that governance in business entities strongly affects their financial performance. Also, Ayodeji and Okunade (2019) examined the relationship between board independence and financial performance of deposit money banks in Nigeria and Canada. The panel data methodology was used with a blend of time-series and cross-sectional features for a period of 2008 and 2017. The study revealed that audit committee independence promoted financial performance of the deposit money banks in Nigeria while in Canada it was positive and insignificant.

All these studies carried out, to the best of my knowledge, none has significantly ascertained the relationship between corporate governance and financial performance of listed real estate companies especially in Nigeria in line with the new code of corporate governance code 2018. The Nigerian Code of Corporate Governance 2018 seeks to institutionalize corporate governance best practices in Nigerian companies. Now it is possible to study whether good corporate governance measures as stipulated by this new code have any influence on financial performance of listed real estate companies in Nigeria. Therefore, to bridge the gap in the existing body of literature, this present study empirically examines the relationship between corporate governance and financial performance of listed real estate companies on the Nigerian Exchange Group.

### **Purpose of the Study**

1. Determine the relationship between audit committee and return on asset of listed real estate companies on the Nigerian Exchange Group.
2. Determine the relationship between audit committee and net profit margin of listed real estate companies on the Nigerian Exchange Group.

### **Research Questions**

The following research questions were raised:

1. What is the relationship between audit committee and return on asset of listed real estate companies on the Nigerian Exchange Group?
2. What is the relationship between audit committee and net profit margin of listed real estate companies on the Nigerian Exchange Group?

### **Research Hypotheses**

The following research hypotheses were formulated and tested in this study.

**Ho<sub>1</sub>:** There is no significant relationship between audit committee and return on asset of listed real estate companies on the Nigerian Exchange Group.

**Ho<sub>2</sub>:** There is no significant relationship between audit committee and net profit margin of listed real estate companies on the Nigerian Exchange Group.

### **Agency Theory**

The proponents of this theory are Jensen and Meckling in 1976. This theory opened the important research area concerning the separation of ownership and control in the modern corporation and it defines the agency relationship as a contract in which one or more persons usually known as the 'principal' engages another person known as the agent to perform some service on their behalf, which involves delegating some decision-making authority to the agent. It is called the agency theory because it involves the principal (shareholder) and the agent (management).

As opined by Jensen and Meckling (1976), and Fama and Jensen (1983), an agency relationship occurs when the principal delivers decision-making authority to an agent to perform some service on the behalf of the principal. Shareholders (and debt holders) act as principals in seeking to obtain maximum utility from the actions of management (who serve as the agents). However, both parties in the relationship are utility maximizers and it is reasonable to believe that the managers will not always act in the best interests of the shareholders but will pursue self-interest creating the agency problem. As a result of having conflicting aspirations, both shareholders and managers incur monitoring and bonding costs respectively, known as agency costs. To increase firm value, one must therefore reduce agency costs. This is one way to view the linkage between corporate governance and corporate performance. Burton (2000) asserts that agency costs are best controlled by limiting management discretion through the establishment of structures to monitor and control management behaviour. Such structures include audit independence, board size, code of ethics, an independent chairperson and independent board sub-committee such as the audit committee. Such structures would serve to moderate management's self-serving behavior and improve the quality of information generated by management including financial and nonfinancial disclosures. Strong corporate governance mechanisms often align the interests of owners and managers. If the interest of the owners and managers have been aligned, the agency problem will not result to poor corporate governance. This theory was corroborated by various researchers (Darussamin et al., 2018, Abata & Migiro 2016; Alotaibi, 2014, Walid & Ameer, 2013).

This theory is relevant to this study because it highlighted the issue of agency cost and strategies on how to address it like the establishment of structures to monitor and control management behaviour. Such structures include audit independence, board size, and code of ethics.

### **Audit Committee**

An audit committee is an important corporate governance mechanism in firms which protect the interests of shareholders and oversee financial reporting (Mallin, 2006). It is a key monitoring mechanism, both in respect of shareholders and for other stakeholders' interests. The composition of audit committee is referred to as the number of directors appointed to be members of the audit committee, in this regard there could be small, medium and large audit committee (Boshnak, 2021).

Shareholders' interests are protected through the activities of audit committee because management may not always act in the interest of corporation's owners. Studies in favour of larger audit committee posited that when more people are involved in checking the activities of managers, wrongdoings will be reduced and performance will be enhanced. A number of studies which revealed positive relationship between audit committee size and firm performance include (Blaou et al., 2003; Kyereboah, 2007). However, other researchers like (Kajola, 2008; Hardwick et

al., 2003) reported that there is no positive relationship between audit committee size and the performance of firms.

The audit committee is seen as an effective subcommittee of a board of directors, which is important in good corporate governance (Abbott et al., 2004; Jensen & Meckling, 1976). Garcia-Meca and SanchezBallesta (2009) argues that an independent audit committee could enhance the quality and credibility of financial reporting. Cohen and Hanno (2000) emphasize the significance of audit committee independence to appraise management actions regarding risk assessment.

Chen et al. (2008) found a significant positive relationship between Tobin's Q and audit committee independence. Hamdan et al. (2013) examined the relationship between audit committee independence and firm performance of 106 financial firms listed on the Amman Stock Exchange Market from 2008 to 2009, the study revealed that audit committee independence has a significant influence on firm performance. Triki and Bouaziz (2012) investigated the effect of the audit committee's characteristics on financial performance, measured by ROA and ROE, of a sample of 26 Tunisian firms listed on the Tunis Stock Exchange from 2007 to 2010. The results showed the essential role of the audit committee in protecting the interests of shareholders, as well as the effect of the audit committee's characteristics on the financial performance of Tunisian companies.

### **Return on Asset**

The concept return on asset (ROA) is one financial ratio used in financial statement analysis. It is an indicator of how profitable a company is relative to its total assets. ROA gives a manager, investor, or analyst an idea as to how efficient a company's management is at using its assets to generate earnings (Hargrave, 2021). Return on Assets (ROA) as defined by Golin (2001) cited in Ameer and Mhiri (2013) is the ratio of net profit to total assets and it measures the managerial ability of firms' management to generate income by utilizing company assets at their disposal. It shows how efficiently the resources of the company are used to generate income. It reflects how efficient the management of a company is in generating net income from all the resources of the institutions (Khravish, 2011).

According to Sugiono and Untung (2016), return on assets (ROA) measures the rate of return from business on all existing assets. This ratio describes the efficiency of the funds used in the company. Murhadi (2015) opined that return on assets reflects how much return is generated on every money invested in assets. Wen (2010) stated that a higher ROA shows that the company is more efficient in using its resources. However, many factors influence ROA such as firm's degree of capitalization. ROA favours highly capitalized institutions because it treats equity capital as free funds-there is no cost associated with them. Return on asset is calculated mathematically as;

$$\text{Return on Assets} = \frac{\text{Profit Before Tax}}{\text{Total Assets}} * 100$$

### **Net Profit Margin (NPM)**

Net Profit Margin also known as operating profit margin is a financial ratio used to calculate the percentage of profit a company made from its total revenue. Operating profit margin is greatly influenced by the cost of goods sold. If the cost of goods sold increases, the operating profit margin will decrease, and vice versa (Yoshua, 2012). It is also seen as the percentage of revenue left after all expenses have been deducted from sales. The measurement reveals the amount of profit that a business can extract from its total sales. Net profit margin measures the amount of net profit a company obtains per naira of revenue gained. Net profit margin help investors assess if a company's management is generating enough profit from its sales and whether operating costs and overhead costs are being contained. It is a key indicator of the financial health of an organization (Murphy, 2021).

It is calculated mathematically as;

$$\text{Net Profit margin} = \frac{\text{Profit After Tax}}{\text{Total Revenue}} * 100$$

When a company's net margin exceeds the average for its industry, it is said to have a competitive advantage, meaning it is more successful than other companies that have similar operations. While the average net margin for different industries varies widely, businesses can gain a competitive advantage in general by increasing sales or reducing expenses or both (Murphy, 2021).

## METHODOLOGY

The research design adopted for this study was the ex post facto res The population of this study comprised of six (6) listed real estate companies on the Nigeria Exchange Group in 2022. The instrument for data collection for this study was the financial report of selected listed real estate companies as obtained from the Nigerian Exchange Group for the period of 2017- 2021. The data for the study was analyzed using the descriptive and inferential statistics.

(I) The descriptive statistics assumed a univariate analysis which was used to show the distribution of the variables of study. The descriptive statistics used were the mean score, frequency distribution and standard deviation while

(II) The inferential statistic used was Pearson correlation coefficient and multiple regression. The multiple regression was used to test the postulated null hypotheses on the relationship between human resource cost and financial performance at 0.05 level of significance computed with the aid of Stata12 software.

## Results

### Test of Hypothesis 1

**Ho<sub>1</sub>:** There is no significant relationship between audit committee and return on asset of listed real estate companies on the Nigerian Exchange Group.

**Table 1:** Regression on the relationship between audit committee and return on asset

Linear regression	Number of obs = 50
	F( 4, 45) = 1.57
	Prob > F = 0.1995
	R-squared = 0.1940
	Root MSE = 8.6039

roa	Robust		t	P> t	[95% Conf. Interval]	
Coef.	Std. Err.					
acom	-6.027827	2.948528	-2.04	0.047	-11.96647	-.0891877
bosz	2.033136	1.262023	1.61	0.114	-.5087085	4.574981
boid	-3.791156	2.299496	-1.65	0.106	-8.422578	.8402663
fsz	1.306463	1.111547	1.18	0.246	-.9323086	3.545234
_cons	10.21271	9.921832	1.03	0.309	-9.770889	30.1963

Source: output from STATA version 12.

Table 1 above shows the regression result on audit committee and return on asset. The table revealed the existence of a negative but significant relationship between audit committee and return on asset of listed real estate companies on the Nigerian Exchange Group (p-value= 0.047).

It means that a 1% increase in audit committee will bring about a 6.03% decrease in return on asset all other variables held constant. Since the p-value of the independent variable is less than 0.05, we therefore reject the null hypothesis and conclude that "There is no significant relationship between audit committee and return on asset of listed real estate companies on the Nigerian Exchange Group."

### Test of Hypothesis 2

**Ho<sub>2</sub>:** There is no significant relationship between audit committee and net profit margin of listed real estate companies on the Nigerian Exchange Group.

**Table 2:** Regression on the relationship between audit committee and net profit margin.

Linear regression	Number of obs = 50
	F( 4, 45) = 3.03
	Prob > F = 0.0268
	R-squared = 0.1578
	Root MSE = 144.48

npm	Robust		t	P> t	[95% Conf. Interval]	
	Coef.	Std. Err.				
acom	-83.97373	47.30315	-1.78	0.083	-179.2472	11.29969
bosz	29.44346	25.44465	1.16	0.253	-21.80469	80.69161
boid	-51.44933	39.22565	-1.31	0.196	-130.4539	27.55519
fsz	9.353201	13.39295	0.70	0.489	-17.62158	36.32798
_cons	265.9751	165.1865	1.61	0.114	-66.72758	598.6778

Source: output from STATA version 12

Table 2 above shows the regression result on audit committee and net profit margin. The table revealed the existence of a negative and insignificant relationship between audit committee and net profit margin of listed real estate companies on the Nigerian Exchange Group (p-value= 0.083). It means that a 1% increase in audit committee will bring about 83.97% decrease in net profit margin all other variables held constant. Since the p-value of the independent variable is greater than 0.05, we therefore accept the null hypothesis that "There is no significant relationship between audit committee and net profit margin of listed real estate companies on the Nigerian Exchange Group."

### Discussion of Findings

#### **Audit committee and return on assets of listed real estate companies on the Nigerian Exchange Group.**

The study revealed the existence of a negative but significant relationship between audit committee and return on asset of listed real estate companies on the Nigerian Exchange Group (p-value= 0.047). This finding is in line with the finding of Joshua et al. (2019) that concluded that audit committee, board composition and bank size all had positive and significant relationships with return on asset. This finding is further corroborated by the finding of Esther and Henry (2018) that concluded that audit committee qualification, audit committee meeting had a significant positive relationship with accounting information disclosure.

This finding is in contrast with the finding of Al-Homaidi et al. (2019) that concluded that audit committee composition has an insignificant effect on return on assets.

### **Audit committee and net profit margin of listed real estate companies on the Nigerian Exchange Group.**

The study revealed the existence of a negative and insignificant relationship between audit committee and net profit margin of listed real estate companies on the Nigerian Exchange Group (p-value= 0.083). This finding is in line with the finding of Abata and Migro (2016) that revealed that that corporate governance variables like board independence, audit committee independence and audit committee size are insignificantly correlated with earnings management.

This finding is in disagreement with the finding of Rafique et al. (2015) that revealed a positive significant relationship between ROE and PM and three corporate governance mechanisms (board size, board composition and audit committee).

### **CONCLUSIONS**

From the literature reviewed and results of the analysis carried out, this study revealed that audit committee has a significant relationship with return on asset whereas it has an insignificant relationship with net profit margin. While board size and board independence have an insignificant relationship with financial performance (return on asset and net profit margin). Therefore, the study concluded that corporate governance has no significant relationship with financial performance of listed real estate companies in Nigeria.

### **RECOMMENDATIONS**

The following recommendations are made in respect to the findings of the study.

- i. The independence of audit committee should be improved on for better corporate governance for enhance financial performance.
- ii. Audit committees of listed real estate companies should be proactive in ensuring full compliance to corporate governance code 2018 for enhance financial performance.
- iii. More financially literate board should be advocated for than the size of the board as this study revealed that board size has a positive but insignificant effect on financial performance.
- iv. A mix of insiders and outsiders on the board and this should be on the basis of accessing the firm profile and roles of the expected directors before deciding on the issue of nonexecutive for enhance financial performance.

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