THE EFFECT OF BOARD COMPOSITION ON AUDITOR'S RISK ASSESSMENT IN NIGERIA

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ABSTRACT

This study examines the link between outside directors and audit fees. The study used data from 94 non-financial-listed companies on the Nigerian Stock Exchange from 2008 to 2013. The study used cross-sectional time-series feasible generalized least squares (FGLS) regression, which explains heteroscedasticity and autocorrelation in testing the effect of non-independent non-executive directors and independent non-executive directors on auditor pricing decisions in Nigeria. Our result indicates that the proportion of non-independent non-executive directors on boards has a negative relationship with audit fees, whereas the proportion of independent non-executive directors has a positive relationship with audit fees. Further analysis reveals that block shareholding moderates the effect between outside directors and audit fees. These findings have both policy and practical implications on corporate governance. For instance, future regulatory reforms can consider collaborative board models instead of the insistence on more independent director presence in the boardroom.

Keywords: grey director, independent director, audit fees, corporate governance, Nigeria

INTRODUCTION

Considering the Enron debacle along with other examples of corporate malfeasance, concern about the effectiveness of the board of directors' oversight function is increasing. Several corporate governance codes were

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globally revised, most of which focused on board composition and structure. These revised corporate codes emphasized boardroom independence with the inclusion of independent non-executive directors in the boardroom. New inclusions in the code not only improve board oversight, but also have implications on the quality of service rendered by external auditors. Non-executive independent directors emphasize the absence of social connection between the company and this class of director (Hoitash, 2011). From the theoretical lens of audit supply, the code of auditor engagement requires an auditor in assessing client-related risk (i.e., risk of reporting and governance failures) and in designing an appropriate audit response strategy (Carcello, Hermanson, Neal & Real, 2002; Zaman, Hudaib & Haniffa, 2011). Therefore, auditors view sound corporate governance monitoring mechanisms as a sign of internal control strength; such a board can also demand for a rigorous audit (Hines, Masli, Mauldin & Peters, 2015).

This study investigates the pricing behavior of Nigerian auditors considering the proportion of independent directors and grey directors in the boardroom. Theoretical arguments conflict on the ties between these classes of director and board monitoring (Hsu & Wu, 2014). Many multidisciplinary studies have addressed the issues on the monitoring effectiveness of board and auditor pricing decisions with respect to auditor risk assessment and the desire of the director for more audits (Vafeas & Waegelein 2007; Abdul Wahab, Mat Zain & James, 2011; Boo & Sharma 2008; Collier & Gregory 1996). Findings from most of these studies are inconclusive (Hay, Knechel & Wong, 2006). The inconclusiveness is attributable to the conflicting theoretical lens (demand versus supply perspective) by which the relationship is established. Therefore, treating the effect of the differing isolation perspective becomes difficult (Hines, Masli, Mauldin & Peters, 2015). The present study examines audit pricing in Nigeria from the theoretical lens of audit supply that is consistent with the important audit fees model by Simunic (1980). The model indicates that audit fees are a function of client size, client risk, and client complexity. This definition indicates that these client characteristics determine the influence of audit pricing from the purview of audit supply.

At present, countervailing arguments related to monitoring prowess of independent directors exist. Notably, Fogel and Geier (2007) assert that, “there is no predicate either in logic or in experience to suggest that a

majority of independent director will guarantee good corporate governance or better financial return of shareholders." For example, Hsu and Wu (2014) report a positive finding between firm failure and the proportion of independent directors in the boardroom, thereby presenting a case for a collaborative board model. Therefore, in contrast to the view that non-executive directors' close ties with management impede board-monitoring effectiveness, the collaborative board model suggests that such a connection can lead to favorable organizational outcomes (Hsu & Wu, 2013). According to corroborative board theorists (Westphal, 1999), these social ties can facilitate a corroborative working relationship between board members and management. The proponent argument of corroborative board theory suggests that grey directors enhance board advisory roles and may not be good monitors because of conflict of interest (Hsu & Wu, 2014; Westphal, 1999). Thus, we develop and interpret the study hypotheses from the audit supply perspective. We consider the influence of the presence of grey directors in the boardroom for auditor risk assessment and determine whether auditors adjust perceived audit risk assessment based on board composition.

This study uses cross-sectional time-series FGLS regression to control for heteroscedasticity and autocorrelation using 426 observations of publicly listed Nigerian companies. The findings indicate that firms with an increased proportion of grey directors in the boardroom reduce the amount paid as audit fees, and an increased proportion of independent directors increases the amount paid as audit fees. Further analysis that involves the interaction of block shareholders with the proportion of independent non-executive directors suggest that block shareholders result in board monitoring and is therefore considered less risky. Overall, the result is consistent with the view of collaborative board theorists (Hsu & Wu, 2014; Westphal, 1999) and supports that the presence of independent director in the boardroom does not necessarily promote good corporate governance. These findings have several contributions to the literature. First, our finding suggests that auditor assessment of board composition risk affects audit pricing and that the proportion of independent directors tends to increase audit fees. Our findings and argument contradict the findings of Carcello, Hermanson, Neal and Real (2002) that argue from the audit demand perspective and documented that the increased audit fees are due to their high demand. Although independent directors supposedly enhance board monitoring, critics recently argue that their presence do not necessarily enhance board

independence because they may not be truly independent. According to the findings of Adegbite (2015), the traditional role and the overbearing influence of family owners in Nigeria may limit the oversight function and independence of the board. Consistent with this postulation, our findings suggest that the presence of independent directors may not be the solution for weak governance.

Second, our study contributes to the literature related to the role of grey director in the boardroom. To the best of our knowledge, prior studies focus on independent non-executive director and audit fees (agency theory). Cohen, Krishnamoorthy and Wright (2008) assert that the one-dimensional view of board role is dominant in literature and recommend that studies should consider other board responsibility in relation to auditing. Therefore, this study examined the relationship between grey director and audit fees from the theoretical lens of board collaborative theory as an area that has received less attention in literature. The nature of the study findings suggests that grey directors, such as those in Nigeria, can act similarly to an independent director because they are mostly likely to have the interests of shareholders at heart. Therefore, grey director affects auditor risk assessment. By investigating the relationship between grey directors and audit fees, this study extends the findings of prior studies (Carcello, Hermanson, Neal & Real, 2002) that have predominantly focused on the monitoring prowess of independent directors. Third, to the best of our knowledge, this study is the first to examine the corporate governance mechanisms as determinant of audit fees in Nigeria. Although studies have been carried out in this area from some emerging economies, the corporate governance landscape in some countries continues to vary, thereby limiting the generalizability of the frequently researched Anglo-American system in the Nigeria setting.[1]

Therefore, the distinctiveness of Nigerian corporate governance from the corporate governance environment from previous study provides an additional opportunity to extend the literature. The indigenization policy embarked upon by the Nigerian government at some point in time leads to the majority share ownership held mostly by founding families who have significant influence within the board and on management (Adegbite,

1 Nigerian corporate ownership, which determines the nature of the corporate problem, is characterized by individual blockholder control by founding owners and institutional investors (Adegbite, 2015).

2015). Therefore, the assumptions of market efficiency, competitive market, and market mechanisms, which are presupposed by agency theory, are not accurately applicable in Nigeria where ownership is concentrated (Adegbite, 2015). Moreover, corporate governance, with the revised 2011 code of corporate governance, only recently codified the requirement for the inclusion of non-executive independent directors; certain companies are yet to comply with this requirement. Although the compliance rate is poor, the independence of the purported independent director is susceptible to impairment because of the retained control of the founding family. The remainder of the study is as follows: Section 2 outlines prior literature and hypotheses development. Section 3 presents the sample selection procedure and research design. Section 4 contains the presentation of results. The final section concludes the study.

LITERATURE REVIEW

Shareholders rely on different mechanisms to align the interests of management with those of the shareholders because of the separation of ownership from management and the resulting consequences to which shareholders are exposed (Desender, Aguilera, Crespi, & GarcÍa-cestona, 2013). Boards of directors and external auditors are two important mechanisms that are instituted by management (Watt & Zimmerman, 1990). Although the significant role-play by sound governance mechanisms in resolving agency problem is widely pronounced, the empirical literature that examines the effect of corporate governance mechanisms on audit pricing is inconclusive (Hay, Knechel & Wong, 2006). Hay, Knechel, and Wong (2006) attribute the inconsistent findings to conflicting theoretical argument, endogeneity, and omitted variables; they recommend further studies.

The boardroom comprises different individuals that have the common goal of steering the company direction. Prior literature defined the major role of the board of directors to involve the provision of advice and to execute an oversight function (Pfeffer & Salancik, 1978). The board of directors is an internal control mechanism (Walsh & Seward, 1990) and its effectiveness depends on its composition. Consistent with this notion, the agency theory emphasizes board independence by the inclusion of additional outside directors in the boardroom. The term outside director

refers to the directors that do not participate in the daily operation of the business. This class of director comprises independent directors that have no affiliation with the management or shareholders, and others who have such an affiliation, otherwise known as grey directors (Hsu & Wu, 2014).

Meanwhile, external auditors consider boards of directors clients who appoint and determine the scope of an audit (Desender, Aguilera, Crespi, & GarcÍa-cestona, 2013). Therefore, the effectiveness or otherwise of corporate governance mechanism have implications for audit fees (Zaman, Hudaib, & Haniffa, 2011). Several studies indicate that internal control mechanisms of the firm have significant influence on the control-risk assessment of the auditor and on the scope of audit (Tsui, Jaggi, & Gul, 2001). Conflicting arguments suggest that corporate governance mechanism can either lead to more audit fees or reduced audit fees. For instance, given that sound corporate governance will lead to an effective internal control, auditors can rely on the internal control of the client to reduce the extent of substantive and compliance tests, thereby resulting in audit fees and vice versa. By contrast, an effective board control mechanism can demand for quality audit, thereby increasing audit fees. Tsui, Jaggi and Gul (2001) examine the relationship between internal monitoring mechanism of the firm and its effect on audit fees and find a negative relationship that suggests that effective internal monitoring mechanisms are associated with lower control risk, thereby resulting in lower audit effort and audit fees. Carcello, Hermanson, Neal and Real (2002) use the audit fees of 1,000 sampled fortune companies in the US and report a positive relationship, thereby indicating that effective board monitoring mechanisms leads to demand for more audit quality. Hence, audit fees are increased.

The focus of this study is different from previous studies that focus on audit pricing. Recent events in the corporate world have elicited more attention on boardroom composition. As an alternative to the initial focus on independent non-executive director dominated boards, literature and codes of corporate governance now advocate for a balanced mixture of independent and grey directors to enhance board efficiency, consistent with the collaborative board model. Given the paucity of empirical study on corroborative board theory, our research makes an important contribution. In this paper, we specifically examine the influence of the presence of grey and independent directors in the boardroom on audit fees while controlling other client related factors.

Association between Independent Non-Executive Director and Audit Fees

The influence of independent corporate board regarding the presence of independent non-executive director on the corporate board of the internal control of the firm and the board oversight function has buoyed in corporate governance literature. Codes of corporate governance indicate the extent to which boards of directors can provide effective monitoring to the proportion of independent directors in the boardroom. Independent directors enhance the ability of the board to perform oversight (Jensen & Meckling, 1976). This is possible because they are free from any contractual relationship that can impair their independent judgement. Reputational capital and the need to maintain some level of professionalism (Fama & Jensen, 1983) also incentivize independent non-executive directors to protect the shareholder interests. Therefore, the board of directors will objectively evaluate the management and penalize erring members of the management team without fear of favor (Williams, Bingham & Shimeld, 2013).

Many empirical findings provide a positive linkage between board independence and board effectiveness. For example, Beasley (1996), Chahine and Filatotchou (2011), Setia-Atmaja, and Haman and Tanewski (2011) report that independent directors improve the quality of corporate reporting. In addition, Finkelstein and D'Aveni (1994) support that independent directors discipline poorly performing CEOs, whereas Byrd and Hickman (1992) suggest that independent directors protect shareholder wealth. Tsui, Jaggi, and Gul (2001) note that the presence of independent directors in the boardroom enhances the reliance of auditors on client accounting systems, thereby reducing the amount paid as audit fees. Although arguments generally support the monitoring prowess of independent non-executive directors, countervailing arguments exist, thereby suggesting that certain factors can limit the effectiveness of independent non-executive directors in the boardroom. Hu and Wu (2014) find a positive relationship between corporate failure propensity and the proportion of independent non-executive director on corporate board. Given that empirical findings regarding the effectiveness of independent non-executive director are inconsistent, the present study posits that:

H_1: A relationship occurs between the proportion of independent non-executive director in boardroom and audit fees.

Association between Grey Directors and Audit Fees

In addition to the monitoring role of the board of directors, the board also provides counseling and advisory service to the management. Recent studies acknowledge this multifaceted role and identify the weaknesses in the present board composition requirement,[2] thereby making a case for a collaborative board. Collaborative board theory advocates for a collaborative working relationship among board members with a duly composed boardroom (Hsu & Wu, 2014). Therefore, the theory supports the performance of grey directors. Raghunandan and Rama (2003) define grey directors as those directors who have social relationships with the firm. Hsu and Wsu (2014) affirmed that this class of director can be a former employee of the firm. Proponents (Westphal 1999; Adam & Ferreira 2007) of collaborative theory argue that economic ties of directors with the firm, as characterized in grey directorship, can also discharge their oversight function effectively and efficiently, such as the advisory role (Hoitash, 2011). Adam and Ferreira (2007), and Westphal (1999) reveal that director and management social ties can improve board collaboration, "mutual trust, and information flow." Westphal (1999) documents that personal ties improve board advisory roles and firm performance. Adam and Ferreira (2007) further support this view when they document that board and management social ties incentivize the board to provide quality advice, thereby producing good results. Consistent with the collaborative board theory, Hoitash (2011) also reports that social ties improve financial reporting quality in which companies are less likely to experience material weakness in their internal controls and financial restatements.

Although many studies suggest that board affiliation with management hinders board oversight function, the collaborative board theory suggests otherwise. Cohen, Krishnamoorthy and Wright (2007) assert that during the assessment of client control risk, auditors consider the overall function of the board as enshrined in the codes of corporate governance, and they perceive boards that have a working relationship with management as low risk. Considering that emerging evidence acknowledges the contributory role of grey directors in enhancing board performance, this study postulates that:

H_2: A relationship is found between the proportions of grey directors inside the boardroom and audit fees.

2 The presence of additional independent directors in the boardroom as suggested in agency theory.

RESEARCH DESIGN

Sample Selection and Data

This study aims to discuss the relationship between board structure and pricing decisions of auditors. The sample of Nigerian publicly listed companies with the exclusion of financial companies[3] is the basis of empirical analysis in this study. In addition to financial companies, this study also excludes companies with missing annual reports and missing information. Therefore, the final sample consists of 94 companies listed on the Nigerian Stock Exchange between 2008 and 2013. The sample procedure is shown in Table 1.

Table 1: Sample Selection

PANEL A	2008	2009	2010	2011	2012	2013	TOTAL
Total listed companies	213	214	215	196	192	190	1,220
Financial institutions	-65	-65	-65	-56	-56	-56	-363
No audit report date	-5	-2	0	-3	-2	-3	-15
Incomplete data	-15	-8	0	-5	-6	-10	-44
1Missing annual report	-68	-72	-76	-54	-51	-51	-372
TOTAL SELECTED COMPANIES	**60**	**67**	**74**	**78**	**77**	**70**	**426**
PANEL B	**Freq.**	**Percent**	**Cum.**				
Agriculture	20	4.69	4.69				
Conglomerate	45	10.56	15.25				
Consumer	93	21.83	37.08				
Industrial goods	65	15.26	52.34				
Natural resources	8	1.88	54.22				
Service	86	20.19	74.41				
Healthcare	33	7.75	82.15				

3 Financial companies were excluded because of the additional regulatory requirements that are faced by companies that operate in this sector. For instance, in addition to the revised code of corporate governance, companies in this sector comply with sector specific codes of corporate governance. Therefore, corporate governance structures of financial related companies are different from those of other sectors.

ICT	20	4.69	86.85				
Oil and Gas	36	8.45	95.30				
PANEL B	**Freq.**	**Percent**	**Cum.**				
Construction	20	4.69	100.00				
TOTAL	426	100					

Regression Model and Specification

This study uses panel estimation approach to examine the hypotheses on the relationship between corporate governance characteristic and audit fees. This approach is considerably more suitable for a group of firms listed on the Nigerian Stock Exchange because of the bias caused by unobserved heterogeneity. Given the presence of contemporaneous correlation[4] and heteroscedasticity[5] as characterized in panel data, this study uses feasible GLS (FGLS) to correct for this problem. However, the Breusch-Pagan Lagrange multiplier test rejects the null hypothesis of no effect in the cross sectional unit over the period because the P-value is 0.000, thereby suggesting that pool OLS is not appropriate. The Hausman test result shows that FE model is preferable to the random effect model. Therefore, the model of Simunic (1980) is developed as follows:

$$\begin{aligned} LOGAF_{it} = {} & \alpha_{it} + \beta_1 IND\_{it} + \beta_2 GREY\_{it} + \beta_3 IND\_EXE_{it} + \beta_4 GREY\_EXE\_ \\ & {}_{it} + \beta_5 LOGTA_{it} + \beta_6 BIG4_{it} + \beta_7 CA_{it} + \beta_8 QUICKRATIO_{it}\ \beta_8 \\ & + GEARING_{it} + \beta_9 BUSSEG_{it} + \beta_{10} INVT\_{it} + \beta_{11} ROA_{it} + \\ & \beta_{12} LOSS_{it} + \beta_{13} BUSY_{it} + \beta_{14} DELAY_{it} + \beta_{15} BLOCKSHR_{it} + \\ & \beta_1 INDUSTRY\ EFFECT_{it} + \beta_{16} YEAR\ EFFECT_{it} + \varepsilon_{it} + \mu_{it} \end{aligned}$$

where, log audit fees ($LOGAF_{it}$) refers to the amount paid by the client i as audit fees in year t; independent non-executive director (IND_{it}) refers to the percentage of independent directors in the boardroom; grey non-executive director ($GREY\_{it}$) refers to the percentage of grey directors in the boardroom; ratio of independent director to executive director (IND_EXE_{it}) refers to the number of independent directors scaled by the

4 Wooldridge test for autocorrelation in panel data fails to reject the hypothesis of no first-order autocorrelation because the P-value is 0.00525.

5 Likewise, the modified Wald test for groupwise heteroscedasticity in fixed effect regression model fails and is significant at 0.000 percent, thereby suggesting the presence of heteroscedasticity.

number of executive directors; and ratio of grey director to executive ($GREY\_EXE_{\_it}$) refers to the number of grey directors scaled by the number of executive directors. Consistent with earlier studies, we control for client size, complexity, risk, and auditor related attribute. Natural log of total assets in thousands ($LOGTA_{it}$) refers to the client size. Auditors related to attribute proxy by audit quality ($BIG4_{it}$) refers to the dummy variable that represents the big four audit firms, coded 1 when the firm is audited by one of the big firms or 0 otherwise; busy period ($BUSY_{it}$) refers to the dummy variable that represents a client that has March and December as their financial year-end, coded 1 when the client financial year-end falls in these month or 0 otherwise; audit lag ($DELAY_{it}$) refers to the number of days between financial year-end and the day the audit report was signed. Client risk is proxy by (CA_{it}) and refers from the current asset to current liability; quick ratio ($QUICKRATIO_{it}$) refers to the current asset minus the inventory scaled by current liability and loss (LOSSit), which refers to the dummy variable that represents clients who recoded negative earnings after interest and tax. Business segment proxy client complexity ($BUSEG_{it}$) refers to the number of client business segment; inventory ($INVT_{\_it}$) = balance sheet value of closing inventory scaled by total asset. Measure of client performance (ROA_{it}) refers to the net income divided by total asset. Form of ownership ($BLOCKSHR_{it}$) refers to the outstanding share of the company with more than 5% held by individual block shareholders. Finally, we control for variation between year and industry.

EMPIRICAL ANALYSIS

Spearman Correlation and Descriptive Statistic

Table 2 presents the Spearman correlation statistic. Multicollinearity constitutes a serious threat to regression analysis when it exists among variables. The correlations among the variables do not constitute a serious threat to our regression, because the correlation is less than the 70% of the threshold (Tabachnick & Fidell, 2007). The variance inflation factor (VIF) for all the variables is also less than the 10% of the threshold (Tabachnick & Fidell, 2007). These two measures indicate that multicollinearity is not a major problem in the regression analyses.

Table 2: Spearman Correlation between Variables

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1	AF	1.00																
2	IND_	0.11	1.00															
3	GREY_	-0.08	-0.59	1.00														
4	IND_EXC	0.07	0.89	-0.52	1.00													
5	GREY_EXC	-0.02	-0.22	0.75	-0.15	1.00												
6	TA	0.60	0.09	-0.05	0.06	0.02	1.00											
7	BIG4	0.29	0.05	-0.11	-0.01	-0.11	0.21	1.00										
8	BUSY	0.07	-0.27	0.28	-0.20	0.12	0.03	-0.05	1.00									
9	LOSS	-0.14	-0.10	0.13	-0.09	0.12	-0.15	-0.12	-0.09	1.00								
10	DELAY	-0.08	-0.14	0.09	-0.13	0.02	-0.13	0.06	-0.19	0.22	1.00							
11	BLOCKSHR	-0.17	-0.06	0.06	-0.04	0.00	-0.16	-0.20	-0.08	0.10	-0.07	1.00						
12	BUSSEG	0.28	0.01	0.00	0.02	0.01	0.09	0.05	0.13	-0.11	0.06	-0.05	1.00					
13	INVT_	0.55	0.17	-0.18	0.10	-0.08	0.67	0.28	-0.02	-0.20	-0.16	-0.22	0.14	1.00				
14	GEARING	-0.09	-0.05	0.07	-0.03	0.11	-0.05	-0.08	0.02	-0.14	-0.09	0.04	-0.03	-0.12	1.00			
15	CA	-0.07	-0.04	-0.01	-0.02	-0.02	-0.06	-0.04	0.01	-0.17	-0.08	0.02	-0.04	-0.09	0.54	1.00		
16	QUICKRATIO	-0.04	-0.06	0.00	-0.04	-0.04	-0.03	-0.01	0.02	-0.14	-0.06	0.02	-0.02	-0.12	0.51	0.95	1.00	
17	ROA	0.04	0.05	-0.03	0.05	-0.03	0.07	0.04	0.01	-0.38	-0.06	-0.09	-0.08	0.09	0.04	0.06	0.05	1.00

Table 3 presents the descriptive statistic for each variables. The mean percentage for audit fees is 17,410 Naira and ranges between 350, 000 Naira to 20,006,300 Naira. The average number of non-executive independent director to the total size of the board is 4%, with the range of 0 to 1.29%. The average number of grey directors to the total size of the board is 69%. Of the firms, 65% have their accounts audited by big four audit firms with 86% of the firms having March and December as their accounting year-end. The average size of the firms measured by total assets of firms is 26,700,000 Naira. In addition, 6.62% of the total shares are controlled by individual block shareholders, at as high as 70.80% of total company shares.

Table 3: Descriptive Statistics

VARIABLE	OBS	MEAN	STD. DEV.	MIN	MAX
AF	424	17410.	27895	350.00	200063.
IND_	426	0.04	0.13	0.00	0.29
GREY_	426	0.69	0.18	0.00	1.00
GREY_EXC	426	3.48	2.51	0.00	12.00
IND_EXC	426	0.19	0.72	0.00	7.00
TA	426	26700000	60800000	68953.00	843000000
BIG4	426	0.65	0.48	0.00	1.00
BUSY	426	0.86	0.35	0.00	1.00
LOSS	426	0.19	0.39	0.00	1.00
DELAY	426	119.81	58.72	36.00	358.00
BLOCKSHR	424	6.62	13.26	0.00	70.80
BUSSEG	426	3.81	1.70	1.00	8.0
INVT_	426	3841582	7018636	0.00	64400000
GEARING	426	1.14	1.38	-0.36	15.95
CA	426	1.60	1.50	0.00	17.27
QUICKRATIO	426	1.12	1.43	-2.00	17.12
ROA	426	0.06	0.28	-1.72	3.41

Results of Regression Analysis

Table 4 presents the result of the cross-sectional time-series FGLS used to examine the relationship between corporate governance mechanisms and auditor pricing decision. Model 1 examines the effect of independent director on the audit fees payment and demonstrates that audit fees are positively related to the proportion of independent director (IND_) on the board ($P<0.01$), which is consistent with hypothesis 1. Model 2 examines the auditor's assessment of grey directors and reveals a negative association between the proportion of grey directors (GREY_) in the board ($P<0.01$) and audit fees charges, which is consistent with the collaborative board model suggested by Westphal and hypothesis two. Models 3 and 4 in Table 4 further examine whether the weight of independent and grey directors relative to executive director on the board is associated with audit fees. A positive and significant relationship exists between audit fees and the weight of independent directors relative to executive directors (IND_EXC) on the board, whereas the ratio of grey directors to executive directors (GREY_EXC) is negatively associated with audit fees. This result indicates that an increased number of independent directors relative to executive directors will not improve the perceived auditor assessment of client. However, an increased number of grey directors relative to executive directors will reduce the perceived audit risk associated with client audit.

In controlling variables, variables with the exception of few variables are consistent with theory (Hay, Knechel & Wong, 2006). Client size measured by log total asset (LOGTA) has a positive relationship with audit fees. Client complexity measured by the number of business segments (BUSSEG) and inventory (INVT_) also has a positive relationship with audit fees, thereby suggesting that complex clients pay more, which is consistent with agency theory. Client risk proxy with current asset ratio (CA) and GEARING reveals a negative coefficient, and quick ratio (QUICKRATIO) exhibits a positive relationship with audit fees. Profitability measured by LOSS has a positive relationship with audit fees. BLOCKSHR exhibits a negative relationship with audit. Auditor-related attributes, BIG4 and BUSY, have a positive relationship with audit fees, as expected.

Table 4: Regression Results for Audit Fees

VARIABLE	MODEL 1	MODEL 2	MODEL 3	MODEL 4
CON	1.16	1.28	1.18	1.28
	(13.20 ***)	(14.31***)	(13.53***)	(14.31***)
IND_	0.20			
	(5.12***)			
GREY_		-0.01		
		(-4.86***)		
IND_EXC			0.03	
			(4.27***)	
GREY_EXC				-0.01
				(-4.86***)
LOGTA	0.37	0.36	0.37	0.36
	(33.37***)	(31.88***)	(33.59***)	(31.88***)
BIG4	0.32	0.33	0.33	0.33
	(18.29***)	(17.72***)	(17.83***)	(17.72***)
CA	-0.06	-0.06	-0.08	-0.06
	(-2.66***)	(-2.67***)	(-3.64***)	(-2.67***)
QUICKRATIO	0.06	0.05	0.08	0.05
	(2.41***)	(2.21***)	(3.43***)	(2.21***)
BUSSEG	0.02	0.02	0.02	0.02
	(3.63***)	(3.62***)	(3.55***)	-3.62
INVT_	0.05	0.03	0.12	0.03
	-0.86	-0.50	(1.77**)	-0.50
ROA	0.00	0.02	0.01	0.02
	-0.16	-0.64	-0.50	-0.64
LOSS	0.06	0.06	0.05	0.06
	(3.12***)	(3.10***)	(2.67***)	(3.10***)
GEARING	-0.01	-0.01	-0.01	-0.01
	(-2.04***)	(-1.17)	(-2.12***)	(-1.17)
BUSY	0.06	0.07	0.05	0.07
	(3.94***)	(4.28***)	(3.42***)	(4.28***)

VARIABLE	MODEL 1	MODEL 2	MODEL 3	MODEL 4
DELAY	0.00	0.00	0.00	0.00
	(-1.77**)	(-2.15***)	(-1.74**)	(-2.15***)
BLOCKSHR	-0.01	-0.0065	-0.01	-0.01
	(-12.69***)	(-12.80***)	(-12.79***)	(-12.80***)
YEAR EFFECT	YES	YES	YES	YES
INDUSTRY EFFECT	YES	YES	YES	YES
Obs	426.00	426.00	426.00	426.00
ADJUSTED R-SQUARE	0.89	0.89	0.88	0.89
F-STATISTIC	0.00	0.00	0.00	0.00

Notes: *** Significant at 1 percent level; **, significant at 5 percent level; *, significant at 10 percent (two-tailed). The dependent variable is log of audit fees (LOGAF). A continuous variable that represents the amount collected as remuneration of the auditor in Naira.

ADDITIONAL ANALYSIS

Corporate governance mechanisms in certain cases serve as substitutes for one another. For instance, such mechanisms can also serve as an effective control for agency problem because of the significance interest of external blockholders (Eng & Mak, 2003). Therefore, we predict that such blockholders can mitigate the risk profile of independent director. We then investigate the relationship among audit fees and the interaction between the proportion of independent director and external block shareholding, and among audit fees and the interaction between the proportions of grey directors. Our results show that the interactive effect between the proportion of independent directors and external block shareholding has a negative relationship with audit fees, thereby suggesting that external block shareholding substitutes enhance the performance of independent directors and reduce audit fees. The result for interactive effect between the proportion of grey directors and external block shareholding also has a negative relationship with audit fees.

Table 5: Regression Results on Interacting Effect of Block Shareholding

	MODEL 1		MODEL 2	
	COEF.	**Z**	**COEF.**	**Z**
IND_	0.48	2.40***		
IND_BLCKSHR	-0.02	-1.66*		
GREY_			-0.01	-9.45***
GREY_BLCKSHR			-0.15	-4.13***
LOGTA	0.37	27.76***	0.35	27.61***
BIG4	0.34	16.76***	0.34	17.47***
LAG	0.00	-1.56***	0.00	-1.78***
LOSS	0.07	3.19***	0.07	3.34***
BUSY	0.05	2.69***	0.08	3.76***
BLOCKSHR	0.00	-0.37	(omitted)	
BUSSEG	0.02	3.87***	0.02	6.75***
INVT_	0.10	1.46	0.07	0.99
GEARING	-0.01	-1.62**	-0.01	-1.84**
CRATIO	-0.07	-2.84***	-0.07	-2.86***
QUICK	0.08	2.86***	0.07	2.77**
ROA	0.03	0.86	0.03	0.97
_cons	1.13	11.16***	1.32	12.61***
YEAR EFFECT	YES			YES
INDUSTRY EFFECT	YES			YES

Notes: *** Significant at 1 percent level; **, significant at 5 percent level; *, significant at 10 percent (two-tailed). The dependent variable is log of audit fees (LOGAF). A continuous variable that represents the amount collected as remuneration of auditors in Naira.

DISCUSSION OF FINDINGS AND CONCLUSION

In this study, we investigated the relationship between firm's board composition and audit fees in Nigeria. The study specifically examines the effectiveness of independent and grey directors. Towards the set objectives, we use cross-sectional time-series FGLS regression use in controlling for heteroscedasticity and autocorrelation by using a sample of 94 publicly listed Nigerian companies. The findings indicate that the proportion of grey directors in the boardroom reduces the amount paid as audit fees, whereas an increase in the proportion of independent directors increases

the amount paid as audit fees. Given the interaction of block shareholders and the proportion of independent non-executive directors, further analysis suggests that block shareholders enhance independent non-executive board monitoring; block shareholders are thus considered less risky and cause a reduction in audit fees. The findings of this study have considerable implications for audit fees literature. Consistent with collaborative board theory (Adams & Ferreira, 2007; Westphal 1999), this study reveals that auditors will respond favorably by reducing audit fees when the proportion of grey directors to board size and executive directors is high because of the low risk profile of grey directors. A possible reason is that grey directors are in the best position to obtain vital information necessary for the delivery of board functions because of their social ties with the management.

Second, grey directors are known to contribute with their experience during board deliberation. Generally, the result reveals board performance of its advisory and monitoring roles has consequences for auditor risk assessment, thereby resulting in audit fees. However, consistent with the assertion of Fogel and Geier (2007), the presence of non-executive independent directors does not guarantee good corporate governance. Therefore, future regulatory reforms can consider collaborative board models instead of the insistence on more independent director presence in the boardroom.

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