



## The Influence of Politically Connected Directors on Audit Quality of Quoted Firms in Nigeria

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**Abstract:** This study examined the influence of politically connected directors on audit quality of quoted firms in Nigeria. The variable of politically connected directors (POCD) was analysed to determine the nexus with audit quality (AUDQ). For the objective of the study to be achieved, a total of twenty two (22) non-financial firms quoted on the Nigerian Exchange Group (NXG) as at 2020 were selected carefully and analysed for a period (2015-2020). The panel regression was used with the help of Eview 9.0 econometric packages for data analysis. The result revealed that the independent variable of politically connected directors (POCD) had a positive and significant influence on audit quality (AUDQ) of non-financial quoted firms in Nigeria at the level of 5%. The study therefore recommends that politically connected directors should be encouraged because it enhances audit quality of non-financial quoted companies. The study suggested that future studies should also work on other corporate governance variables to investigate the influence on audit quality.

**Keywords:** Audit quality; Chief executive officers; Political connected directors; Nigeria

**JEL Classification:** M4; G34; M42; G30

### 1. Introduction

The political connection of Chief Executive Officers (CEOs) is likely going to improve the worth of the firm in respect of the managerial abilities of the firm. Firm that has politically connected directors can benefit from easier access to finances, lower rate of tax and stronger market power in terms of competition. Usually, such benefits are higher when the company operates in countries where corruption is high among the officials of executive, low protection of properties rights, non-democratic government or highly interventionist government (Ang, Ding & Thong, 2013). Politically connected directors may be appointed for their experience and knowledge with government procedures, their insights into the actions of government, their ability to enlist the government for the interest of the company at the expense of competitors or to forestall government action into the management of the company (Faccio, 2006). In the same vein, politically connected directors can lead to value reduction of the firm when political appointees of lower quality are directors that run the firm as political bureaucracy (Rui & Ganna, 2021). Similarly, these set of directors do not abide to corporate governance code of the Financial Reporting Council of Nigeria, 2018. As a result, corporate failure may be the earned results. Although, governments are more likely to bail out companies facing financial difficulties if they have political connected directors (Faccio, 2006).

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Ang, Ding and Thong (2011), defined a firm to be politically connected when one member on its board of directors is at least a former cabinet minister of the government or ex-member or a current of former senior civil servant or a serving of parliament of the Nigerian government. Little value is added to firm in countries where political corruption is quite low. CEOs that are well connected to politicians by way of professional, academic and family ties tends to adopt riskier strategic choice like tax avoidance (Kim & Lee, 2021). CEOs that are connected politically are less expected to be fired and the forced turnover sensitivity to the performance of companies is weaker for CEOs that are connected than their peers that are non-connected. This indicates that CEOs have the tendency to use their political resources for their betterment in a transition economy. Costs may be outweighed by political connections benefits when companies do not meet the target of their profitability (Jiaxing, 2021). Industries that are subjected to the regulations of more stringent government such as building industry, food processing industry etc, that are politically connected directors may possibly have an impact that is significant to the value of the company. Political connection can be a double-edged sword that can jeopardize or enhance the value of the company (Hyejeong, Shin & Ji-Young, 2021). Political connected directors have positive impact on both the CEO pay and firm performance, and that this impact is stronger in countries that are less developed (Huiying, 2018). CEO political connection positively affects corporate success (Weichao, 2021). The existence of politically connected director's is what upturn and override the discretion of the CEO to dwell into the manipulations of real earnings. More politically connected director's presence may be given the power to overrule the decision of the CEOs (Armayau, Rohaiola & Redhwan, 2020). CEOs that are politically connected have smaller equity holding than the ones without political background. Political connection significantly lowers the CEO turnover performance sensitivity and turnover probability. The performance of firms improves after political connected CEOs are replaced, particularly if replaced by new ones that are not connected politically (Jerry, Xiaofei, Meijun & Garry, 2011). However, CEO political connections play the role of determining executive compensation (Wu, Li & Ying, 2018).

Firm efficiency can be improved by politically connected CEOs when the firms are depending on the government financially and are under its stringent monitoring by the government (Hyejeong & Ji-Young, 2021). However, these politically connected directors' attitude of management may affect the quality of audit in their respective firms. Based on this, the study will investigate the influence of politically connected directors on the quality of audit of quoted firms in Nigeria. Audit quality is all about the ability of an auditor to identify a breach in the financial statement of an organization and report that breach in his audit report to the client.

Several factors have been considered as corporate governance variables that can influence audit quality of quoted firms such as board size, board independent, board gender diversity, audit committee composition amongst others. However, very few studies have examined political connection of directors as the variable of corporate governance that can influence audit quality of quoted firms in Nigeria. As such, this study is motivated to explore the influence of politically connected directors on audit quality of quoted firms in Nigeria.

Corporate governance simply refers to how corporate entities are controlled and directed with the aid of the board of the firm to bear ultimate responsibility for the firm performance (Gacar, 2016). Most literature on corporate governance do not see political connection as corporate governance variable because of inability to measure its existence in corporate firms. However, it is a factor to be recognized in corporate governance literature. The influence of politically connected directors cannot

be undermined as it has impact on audit quality of an organization. As such, it should be investigated in corporate governance research.

Therefore, does politically connected directors influence audit quality of quoted firms in Nigeria? The broad objective of the study is to investigate the influence of politically connected directors on audit quality of quoted firms in Nigeria. While the specific objective is to determine the influence of politically connected directors on audit quality of quoted firms in Nigeria.

The hypothesis is formulated and stated in a null form.

**H<sub>0</sub>:** Politically connected directors have no significant influence on audit quality of quoted firms in Nigeria

The scope of the study focusses on the influence of politically connected directors on audit quality of quoted firms in Nigeria for the period (2015-2020).

## 2. Methodology

The study adopted the panel survey data from the non-financial sector of the economy. The company's panel data survey covers the period of six years (2015-2020). The population of the study entails the entire non-financial sectors quoted on the Nigerian Exchange Group (NXG) as at 2020. These companies are those categorized as consumer goods, industrial goods, healthcare, construction/real estate, agriculture and ICT. Sample size of twenty two (22) non-financial companies was carefully used in the study. In order to ascertain the influence of politically connected directors on audit quality of non-financial quoted firms in Nigeria, the study model specification is stated in the form of econometric as stated below:

$$\text{AUDQ} = \beta_0 + \beta_1\text{POCD} + e.$$

The relationship a-priori expectation is that  $\beta_1 < 0$ ; meaning, the study anticipates that the parameter ( $\beta$ ) of the independent variables POCD will have no significant influence on audit quality.

### Where:

AUDQ = Audit quality (dependent variable: measured by a dummy variable that takes the value of "1" if auditor is among the Big 4 and "0" otherwise (Isaboke & Naziri, 2018).

POCD = Politically connected directors (independent variable: measured by dummy variable that takes 1 as a value if a firm is politically connected and 0 otherwise) (Isaboke & Naziri, 2018).

e = Error terms

### 3. Results and Discussion

#### 3.1. Data Presentation and Result Analysis

**Table 1. Descriptive Statistics**

	AUDQ	POCD
Mean	0.645669	0.103520
Median	1.000000	0.000000
Maximum	1.000000	0.571000
Minimum	0.000000	0.000000
Std. Dev.	0.480204	0.137217
Skewness	-0.609100	1.076188
Kurtosis	1.371003	3.334647
Jarque-Bera	21.89503	25.10741
Probability	0.000018	0.000004
Sum	82.00000	13.14700
Sum Sq. Dev.	29.05512	2.372386
Observations	127	127

Source: Computation of the researchers (E-view 9.0).

Table 1 above reports the descriptive statistics of the examined variables with good emphasis on the mean, maximum, minimum, standard deviation as well as the results of Jarque-Bera test. The result revealed mean value of audit quality (AUDQ) to be 0.645669, while politically connected directors (POCD) indicated 0.103520. The normality test based on the result of the Jarque-Bera test however shows that variables employed are distributed normally (probability of the various variables (p-value)) are found to be less than 5% critical p-value.

**Table 2. Correlation Matrix**

	AUDQ	POCD
AUDQ	1.000000	
POCD	0.204686	1.000000

Source: Computation of the researchers (E-view 9.0).

The relationship among the investigated variables is displayed in table 2 above. When audit quality (AUDQ) is at unit value of 1, politically connected directors (POCD = 0.204686) was noticed to be positively correlated at low values. Since it is observed that the value is not greater than 0.90 (90%), hence, it means an absence of multi-collinearity. The result of the variance inflation factor further revealed that the problem of multi-collinearity did not appear in the regression variables.

**Table 3: Variance Inflation Factors**

Variance Inflation Factors  
Date: 10/28/21 Time: 05:28  
Sample: 1 22  
Included observations: 22

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.012392	1.663249	NA
POCD	0.504666	1.663249	1.000000

Source: Computation of the researchers (E-view 9.0).

Variance inflation factors result is shown in table 3 above. Low centered (VIF) of 1.000000 is displayed in the result for politically connected directors (POCD). Effect of the result shows that multi-colinearity problem is found not to appear in regression variables. The result of the VIF likewise supported the result of correlation matrix that tells multicollinearity problem did not appear in variables of regression.

**Table 4. Panel Least Squares Regression Results**

Dependent Variable: AUDQ				
Method: Panel Least Squares				
Date: 10/28/21 Time: 05:07				
Sample: 2019 2020				
Periods included: 2				
Cross-sections included: 22				
Total panel (balanced) observations: 44				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.674795	0.072284	9.335374	0.0000
POCD	1.501753	0.467042	3.215455	0.0025
R-squared	0.197541	Mean dependent var		0.840909
Adjusted R-squared	0.178435	S.D. dependent var		0.369989
S.E. of regression	0.335359	Akaike info criterion		0.697160
Sum squared resid	4.723563	Schwarz criterion		0.778259
Log likelihood	-13.33752	Hannan-Quinn criter.		0.727236
F-statistic	10.33915	Durbin-Watson stat		1.029309
Prob(F-statistic)	0.002507			

Source: Computation of the researchers (E-view 9.0).

The result of the analysis of regression that is shown in table 4 above indicates the result of the panel least square (PLS) regression. From the table, it was ascertained that politically connected directors (POCD) could explain about 19% of total variation in audit quality (AUDQ) and the variable explained 17% of the systematic variation in audit quality (AUDQ) after adjustment, whereas the model did not explained about 83%. The implication is that the explanatory variable of politically connected directors (POCD) could account for a reasonable change in audit quality (AUDQ) in the sampled companies. The estimation shows that other variables are also there that can explain the behaviour of audit quality (AUDQ). The F-statistic (overall statistic) is noticed to be significant, because the calculated 10.3 (F-value) > critical F-value at 5% significance level. Meaning the model is statistically significant. The Durbin Watson statistic value that stood at 1.029309 indicates the present of autocorrelation. The outcome implied that politically connected directors (POCD) had positive and significant influence on audit quality (AUDQ) since the probability value of 0.0025 is found to be lesser than the critical t-value at absolute level of 5% significantly. The result also shows that a politically connected directors (POCD) is in line with our model a priori expectation.

### 3.2. Discussion of Findings

The explanatory variable of politically connected directors (POCD) was found to have significant influence on audit quality (AUDQ) of non-financial companies in Nigeria at the level the 5%. The result is in line with our a priori expectation. A t-value of 3.215455 was reported in the result with a significant probability (0.0025) value. The result further shows a relationship that is significant between politically connected directors (POCD) and audit quality (AUDQ) of non-financial firms in Nigeria.

### 4. Conclusion and Recommendations

The study examined the influence of politically connected directors on audit quality of quoted firms in Nigeria. The panel data that pertain to the quoted firms on the Nigerian Exchange Group (NXG) as at 2020 for the period (2015-2020) was used adequately. The study chooses Audit quality (AUDQ) to represent the dependent variable while politically connected directors (POCD) represented the independent variable. The findings of the study indicated that the independent variable of politically connected directors (POCD) was found to have significant influence on audit quality (AUDQ) of non-financial companies in Nigeria at the level the 5%. It is recommended by the study that politically connected directors should be encouraged because it enhances audit quality of non-financial companies. In terms of implication of the study, it increases the prevailing literature on the implications of politically connected directors on the quality of audit of Nigeria quoted non-financial companies. Though this study has contributed to knowledge in several ways, it has its own limitations, as only one explanatory variable of corporate governance (politically connected directors) was used. It is therefore suggested that future studies should also work on other corporate governance variables to investigate the influence on audit quality.

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