

Effect of Audit Firm Characteristics on Audit Quality of Quoted Deposit Money Banks in Nigeria

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Abstract

This study investigates how the characteristics of audit firms are associated with audit quality in deposit money banks situated in Nigeria. The core explanatory variables employed or adopted were audit fees, audit tenure and audit rotation on audit quality. The study adopted ex-post factor research design. The population of the study consist of twelve (12) quoted deposit money banks on the Nigerian Exchange Group (NGX) as at 31st December, 2022 and twelve (12) banks were taken as the sample size using census sampling technique. The study period is from 2013 -2022. The data were collected from the annual reports and accounts of the selected banks. Data collected were analyzed using descriptive and inferential statistics and the hypothesis were tested using feasible generalized least square regression analysis. The empirical findings revealed that audit fees and audit rotation have positive and significant effect on audit quality while audit tenure has a negative and significant effect on audit quality. On the bases of the findings, the study concludes that audit fees and audit rotation are important ingredients in achieving good audit quality. Establishing rotation programmes with auditing should be implemented by all organizations seeking better planned undertakings of tasks regarding finance. The study recommended that banks should make use of standard audit firms like the big 4 so as to get better audit quality and there should be good policy for audit rotation for the banks in order to achieve better audit quality.

Keywords: Audit Fees, Audit Quality, Audit Rotation, Audit Tenure, Nigerian Exchange Group (NGX).

1.0 Introduction

Audits add legitimacy to the financial reportage procedure by ensuring that financial reports are fairly presented and comply with the relevant financial context. According to Akhalumeh et al. (2017), the main goal of an audit is to ensure the precision of these financial reports, with the absence of material errors being a key measure of audit quality. The auditor acts as an intermediary between management and shareholders, providing reports that accurately represent the true state of the audited entity. The ongoing debate over audit quality is largely motivated by global financial reporting scandals, which have frequently influenced users' perceptions and reception of accounting information, particularly the services provided by accountants and auditors (Mgbame et al., 2012). In recent times, the world has seen the demise of prominent corporations, which are frequently attributed to extensive fraud committed by directors in collusion with auditors. There are many well-known instances of corporate scandal, such as those involving WorldCom in the year 2002, Enron (an American energy behemoth) in the year 2001, Parmalat in the year 2003 and Polly Peck in the year 1991. These cases represent just a few among numerous others that have garnered public attention. Consequently, the significance of effective Corporate Governance is being increasingly emphasized to ensure proper management by directors appointed by shareholders. Corporate governance characteristics have the capacity to effectively enhance the sustainability reporting of firms (Razaq et al., 2023). Similarly, Korolo (2023) asserts that financial performance is significantly derived from good corporate governance. Bhasin (2010) observes

that recurring scandals resulting in media criticism has led to the development of various global governance norms and codes aimed at establishing best practices for businesses across all sectors.

Concerns about audit fees have arisen in the auditing industry. The audit firm determines these costs, which represent the total cost of the audit team's billing, and the client ultimately pays for the audit services. The money that the management of the company spends on an audit engagement is known as audit fees. The audit fees, agreed upon by both the company's management and auditors who were appointed by the Board of Directors, are paid in full on completing the engagement. The fees charged for the audit tasks is typically tied to the reputation of the audit firms, auditing services provided and the audit quality of their services (Jusoh et al., 2013).

The probability of an auditor identifying and disclosing significant errors, misrepresentations or omissions in a client's accounting system is used to evaluate the quality of audits (De Angelo, 1981). The independence and expertise exhibited by auditors play a critical role as they determine their capability to detect accounting violations effectively. Akhalumeh et al., (2017), stated that audit effectiveness in detecting fraud and major mistakes leading to observable discrepancies within financial statements was identified as one key indicator that suggests high-quality audits remain paramount for auditors.

The literature presents inconsistent findings regarding the impact of audit firm characteristics on audit quality. Some studies (Onaolapo et al., 2017; Kalanjati et al., 2019; Abdul-Rahman et al., 2017; Babatolu et al., 2016; Okolie, 2014; Anderson and Verm 2012) have found positive and significant relationship, which contradict others research that has been conducted by (Turel et al., 2017; Oladipupo and Monye-Emina, 2016; Aliu et al., 2018; Mali and Lim, 2018). To address this knowledge gap, the study focuses on examining how specific traits of auditing firms affect Nigerian quoted deposit money banks' audit quality. The pertinent research questions for this study are: what is the relationship between audit firm characteristics proxies of interest and audit quality of listed deposit money banks in Nigeria?

The objective of this investigation is to assess the effect that audit firm characteristics have on the level of auditing excellence within Nigerian deposit money banks listed in the Nigerian exchange group. Specifically, to ascertain the extent to which audit fees, tenure and rotation affect the quality of audit of listed deposit money banks in Nigeria.

2.0 Literature Review and Hypotheses Development

Concept of Audit Quality

Watts and Zimmerman (1978) state that the quality of an audit is based on how thoroughly and logically an auditor examines a company's financial data to ensure its accuracy. A major indication of high-quality auditing is providing unqualified opinions without wavering in response to suspected fraudulent statements, as per De Angelo (1981). Akhalumeh et al. (2017) assert that audits aim primarily to guarantee freedom from any significant misstatements in financial reports, serving as measures for analysis concerning their extent checked by auditors' abilities and incentives for detecting accounting errors - another crucial factor indicating audit quality.

Nyaboke and Omwenga (2016) note that audit quality encompasses two key dimensions; the first is detecting errors in financial statements, while the second involves ensuring they are reported properly. In terms of defining audit quality, Palmrose (1988) couches it as an assurance level i.e., how likely it is for financial statements to be free from significant misstatements consistent with their objective of attaining accuracy through auditing. A vital component of overall audit competence highlighted by

Davidson and Neu (1993) review on this topic relates to a given auditor's capability to identify material obfuscations or distortions which could influence net income calculations so that corrective action can ultimately follow suit.

Concept of Audit Fees

Audit fees are the amount of money that a company's management pays for audit services, which is determined by mutual agreement between the auditors chosen and approved by the board of directors. The payment covers all costs incurred throughout the course of an audit to ensure its quality (Kross, 1984). However, Kross cautioned against potential conflicts arising from auditor payments undermining financial statement value due to compromised independence. Yassin and Nelson (2012) suggested that higher fees correspond with better auditing efficiency compared to lower-paying firms but Aliu et al., 2018 study on Nigerian petroleum companies found little correlation between audit quality and fee changes - in fact it was negatively impacted.

Concept of Audit Tenure

Audit tenure denotes the duration of association between an auditor and a client as characterized by Hartadi (2009). Significantly, long-standing auditor-client relationships tend to diminish audit quality according to Carey and Simnett's finding in 2006; longer tenures could have adverse effects on audit quality, specifically within areas that follow less stringent accounting regulations depicted by Rickett et al., in 2016. Conversely, several studies suggest potential benefits from prolonged cooperation with the same audit firm. According to Myers et al.'s argumentation in 2003, extended periods of engagement enable greater cognition about clients' operations and environment leading towards more effective audits. Additionally highlighted is Monroe and Hossain's optimistic correlation observed whereby higher levels of auditing proficiency were linked inversely with shorter involvement timeframes further adding support for favorable implications resulting from elongated collaborations emphasizing practical solutions reflected through informed findings that contribute positively toward enhanced performance standards suggested via aforementioned research conclusions delineating motivating factors validating lengthier associations concerning auditors conducting subsequent evaluations underscoring continued relevance propelling cognizance forging progressive methodologies forming positive entente amidst involved entities enabling optimal results overall.

Concept of Audit Rotation

The legal requirement of mandatory audit firm rotation dictates the maximum duration a specific firm can work with a client before being replaced. This rule, as noted by Onwuchukwa et al., (2012), entails that regardless of effectiveness, independence, or relationship with the client be terminated after several years and another appointed in their stead. The practice helps to reduce potential conflicts between parties involved- including clients and auditors -as observed by Kalanjati et al., (2019). Nonetheless, Mali & Lim (2018) found out that enforced rotation could affect quality control while switching up partners may improve it slightly according to observations made by Kalanjati et al., (2019).

Review of Prior Empirical Studies

Ezeala and Nwachukwu (2023) Studied the effect of audit tenure on the financial reporting quality of listed non-financial firms in Nigeria. The study adopted Ex-post facto research design while the sample size is 23 listed non-financial firms. Data were collected from the annual reports of the purposive sample, over a ten-year period 2012-2021. Both descriptive and inferential analyses were carried out in the study. Ordinary least square were used to estimate in the regression coefficients with which the null hypothesis

was tested at 5% significance level. The findings revealed that audit tenure has positive but non-significant effect on quality of accruals of listed non-financial firms in Nigeria.

Oladejo (2022) examined the impact of audit tenure on the quality of financial reporting of deposit money banks in Nigeria. The study used secondary data. The study population included all the 20 listed deposit money banks in Nigeria. Using a purposive sampling method, 13 banks were selected. The collected data were analyzed using the Random Effect Method. The results showed that, audit tenure had a positive and significant relationship with financial reporting quality.

Lambe et al., (2021) studied the impact of audit engagement on audit quality of listed industrial manufacturing company, in Nigeria over a ten (10) year period from 2011-2020. The study adopted a retrospective research design and the study used secondary data. The panel regression analysis technique was used to analyze the research data. The result showed that the audit tenure has a positive and significant effect on audit quality.

Okoye et al., (2022) investigated the impact of auditors' rotation and ascertaining the non-audit services on audit quality of non-financial firms listed in Nigeria. The study used ex-post facto research design. The sample size is 67 listed non-financial firms in Nigeria using purposive sampling technique. The study revealed that auditors' rotation has a significant positive effect on audit quality while non-audit services has no significant positive effect on audit quality of non-financial firms listed on the Nigerian Exchange Group.

Imegi and Oladutire (2018) examined the relationship between mandatory auditor rotation and audit quality in Nigeria firms. Ordinary Least Square (OLS) econometric technique was use to analyze the impact of audit rotation on audit quality. Findings revealed that there is a significant relationship between mandatory auditor rotation and audit quality.

Omoye and Aronmwan (2013) conducted a study on audit rotation and audit quality in the Nigeria banking sector. The study revealed that the rotation of audit firm has a negative significant effect on audit quality. Investigation was also carried out by Kwon et al., (2010) using a unique database consisting of 12,463 firm-year observations in Korea between 2000 and 2007, examines the effect of mandatory audit firm rotation on audit hours, audit fees, and audit quality. The results found out that mandatory audit firm rotation increases the cost for audit firms and clients while having no discernable positive effect on audit quality.

In their study, Hussain et al., (2018) examined the effect of audit fees and audit quality of 88 listed companies in Nigeria from 2012 -2016. Multiple regression was used in the estimation model. The study shows that higher audit fees are associated with lower levels of discretionary charges and thus imply a better audit quality.

Heil, (2012) investigated the relationship between auditors' remuneration and discretionary accruals in Australia, revealing a complementary connection between financial reporting, value and auditors' remuneration. However, they disagreed with the notion that auditors' remuneration impairs auditors' objectivity. Francis (2024) evaluated the impact of audit committee and its attributes, as well as the application of internal audit on auditors' remuneration in Australian firms, findings showed that high auditors' remuneration correlated with good audit quality.

Yuniarti (2011) examined the link between factors that affect audit quality of 24 Bandung firms in 2009. He suggested that higher audit fees increase and improve audit quality due to auditors' efforts and accounting firms should enhance amount of audit fees that lead to higher audit quality. He also found out that audit fees significantly and positively affect audit quality.

Hoitash et al., (2007) examined the impact of audit fees and audit quality. Their study showed that fees paid to auditor can impact in way; large fees paid to auditor increases quality of audit. Higher audit fees are related to non-audit service makes auditors more dependent on their clients. In their study, they examined audit fees for period of 2000-2003 and found that there is a significant positive relationship between audit fees and audit quality.

In their 2017 study, Turel et al., examined the link between audit quality and audit firm tenure in Turkey over a seven-year period from 2009-2016. Two models were employed to gauge audit quality; specifically, modified reports generation propensity and discretionary accruals focus. The findings indicated that shorter tenures at auditing firms did not affect the overall standard of audits conducted.

The study conducted by Onaolapo et al., (2017) investigated the connection between audit expenses and audit excellence, utilizing a sample of cement enterprises registered with the Nigerian Stock Exchange. The research demonstrated that several factors such as client size, audit duration, expenditures for auditing services, as well as leverage ratio were significantly linked to excellent audits at large scale.

In a study conducted by Oladipupo and Monye-Emina (2016) in Nigeria, the impact of non-standard audit fees on audit quality was examined. The results indicated that audit fees have no significant impact on audit quality in Nigerian quoted companies. Kalanjati et al., (2019) research which showed that audit partners rotation enhanced levels of audit quality.

In a study conducted by Abdul-Rahman et al., (2017), secondary data from the annual reports of listed cement manufacturing companies in Nigeria spanning 2010-2015 were analyzed to investigate how audit fees influenced audit quality. The findings revealed that there was a significant link between various factors, such as the leverage ratio, client size, audit tenure, and auditors' charges with the overall quality of auditing services delivered.

A study by Aliu et al., (2018) analyzed the correlation between audit fees and audit quality in downstream petroleum firms located in Nigeria which resulted in identifying a feeble and unfavorable relationship among them. Mali and Lim (2018) observed that mandatory rotation of audit firm decreases the standard of audits.

Mohammed et al., (2018) analyzed nine downstream petroleum companies in Nigeria that were listed publicly. They discovered a significant inverse correlation between audit fees and the quality of audits conducted by them. Conversely, Okolie's findings from 2014 as well as Babatolu et al., results published in 2016 revealed a considerable positive link between auditor remuneration and audit quality.

Ilechukwu (2017) examined the impact of audit fees on audit quality in Nigeria's consumer goods sector between 2011-2016 using the pooled data OLS regression technique. Their findings revealed that audit fees and explanatory variables account for 38% of the audit quality of the selected firms. The study discovered that audit fees have a positive but insignificant effect on audit quality in the consumer products sector of Nigerian quoted companies.

Anderson and Verma (2012) investigated audit size, audit duration, and audit firm rotation using a probit model. Larger audit firms, according to their data which came from 2,148 listed Asian companies offer better audits because of their more conservatism than smaller companies. Furthermore, the study revealed that audit quality is much influenced by national-level elements. According to the study, whereas longer auditor tenure is linked with reduced audit quality, rotating audit firms can improve audit quality.

Based on the foregoing, the following null hypotheses have been developed in this study:

- H1: *Audit fees have no significant effect on audit quality of listed deposit money banks in Nigeria.*
- H2: *Audit tenure have no significant effect on audit quality of listed deposit money banks in Nigeria.*
- H3: *There is no significant relationship between audit rotation and audit quality in the Nigeria deposit money banks.*

Theoretical Review

In 1984, stakeholder theory was introduced by Edward Freeman who believed that a business should not only aim to benefit its owners but also all parties involved. This view highlights the importance of acknowledging other stakeholders such as employees, customers, suppliers and the wider community in addition to shareholders when considering a company's responsibilities. Stakeholder theory is an organizational management framework for addressing groups impacted by businesses including creditors and local communities while covering key values like social responsibility within market freedom underpinned with ethical principles defined through business practices -known as "social contract". Antonelli et al., (2016) further emphasized this perspective revealing how corporate decisions affect multiple stakeholders whose interests ought to be safeguarded beyond just focusing on shareholder wealth alone. With evidence emerging that some entities are being overlooked concerning accounting application using agency theory according Antonelli et al., (2016). The ongoing debate over audit quality is largely motivated by global financial reporting scandals. Hence, the need for corporate governance to be in place. Also, the necessity for accurate monitoring that has led to auditor for the role needed to give an examination of independent of company affairs in other to give a good expression of a perception of the financial statements of the corporation.

Furthermore, the stakeholder's theory emphasizes that an organization can only achieve effectiveness by satisfying the need of every stakeholder, that is both the agents and shareholders (Modugu et al., 2012). In this situation, the agents (managers) who are employed by the principals (shareholders) are expected to live to their expectations by harnessing the resources to maximize the wealth of the shareholders (Patton, 1990). The stakeholder's theory thus seeks to explain the hierarchy and affairs of an entity concerning producing financial data that would satisfy the curiosity of every shareholders and other stakeholders (Abdulrazaq, 2013). Stakeholder theory is relevant to this study because it recognizes the need of all stakeholders in the annual reports while prescribing audit quality.

3.0 Methodology

The research adopts an ex-post facto design and concentrates on twelve deposit money banks that are enlisted in the Nigerian Exchange Group (NGX) by 31 December 2022. All of these banks were included using a census sampling technique. The study encompasses the timeframe from 2013 to 2022, with data obtained from both bank accounts and annual reports. Analysis was performed utilizing descriptive as

well as inferential statistical methods, wherein hypotheses were tested via feasible generalized least squares regression analysis.

Model Specification

The model is stated as follows:

$$AQ = \beta_0 + \beta_1 AF + \beta_2 AT + \beta_3 AR + \mu \quad (1)$$

Where:

AQ = Audit Quality

AF = Audit Fee

AT = Audit Tenure

AR = Audit Rotation

μ = Error (Stochastic term)

Operationalization of Study Variables

The dependent and explanatory variables are the two sets of variables used in this study, as shown in Table 1 below:

Table 1: Variable Definition and Measurement

Variables	Symbol	Measurement
Dependent:		
Audit quality	AQ	Expressed as the probability that a company uses one of the big 4s.
Independent:		
Audit Fee	AF	Measured as the total amount of audit fees paid for the engagement of the audit.
Audit Tenure	AT	Dichotomous variable: 1 if the auditor from year t-1 is the same as the auditor from year t; otherwise, zero.
Audit Rotation	AR	Determined by how frequently a firm's auditors change. Place 1 if one of the Big Four stays with the company for more than three years; otherwise, place 0.

Source: Authors' Computation, 2024.

4.0 Results and Discussion

Descriptive Statistics Analysis

Table 2: Descriptive Statistics Results

Variables	Mean	Std. Dev	Minimum	Maximum	Obs. No
AQ	0.88	0.32	0.00	1.00	120
AF	482362.3	1079179	65000	1700000	120
AT	0.725	0.44	0.00	1.00	120
AR	0.76	0.42	0.00	1.00	120

Source: Authors' Computation, 2024 (STATA Output).

In Table 2, the variables are accompanied by their relevant descriptive statistics. The average audit quality is recorded as 0.88 with a standard deviation of 0.32, while the audit fee varies from N65,000 to N1.7 million and has an average value of N482,362 along with a standard deviation of N107,917. The mean for audit tenure stands at 0.725 alongside a standard deviation score which amounts to 0.44. Lastly, the Audit Rotation values range from zero all the way up until one; these scores have been found to have an overall mean value equaling to a total number (or result) of 0.76.

Data Normality Test

Table 3: Normality Test (Shapiro-Wilk)

Variables	W	V	Z	Prob.
AQ	0.898	9.720	5.095	0.00
AF	0.243	72.803	9.606	0.00
AT	0.818	1.757	1.262	0.103
AR	0.971	2.775	2.287	0.011

Source: Authors' Computation, 2024 (STATA Output).

The results of the Shapiro-Wilk normality test were displayed in Table 3 above. The results indicated that the audit tenure has a p-value of 0.103, indicating that it is normally distributed, while the audit quality, audit fees, and audit rotation had p-values of 0.00, indicating that they are not normally distributed. As a result, the correlation matrix will use Pearson correlation.

Table 4: Correlation Matrix (Spearman Correlation)

Variables	AQ	AF	AT	AR
AQ	1.00			
AF	0.112	1.00		
AT	-0.049	-0.114	1.00	
AR	-0.016	-0.153	0.233	1.00

Source: Authors' Computation, 2024 (STATA Output).

The Spearman correlation results are presented in Table 4, revealing a positive correlation between Audit Quality and Audit Fees. In contrast, there is a negative correlation of -0.049 observed between Audit Tenure and Audit Quality as well as a negative correlation of -0.016 noted for the association between Audit Rotation and Audit Quality. Moreover, none of the variables display correlations that surpass 0.9 suggesting that multicollinearity should not be an issue among these factors.

Regression Analysis

Table 5: Regression Analysis: Feasible Generalized Least Square Regression

Variables	Coefficient	z-value	p-value
con.	0.599	6.24	0.00
LAF	0.062	3.82	0.00
AT	-0.023	-6.17	0.00
AR	0.014	4.85	0.00
Wald Test: chi2			46.45
Prob.			0.000
Multicollinearity Test: vif			1.05
Random Effect Test: Breusch and Pagan Lagrangian Multiplier Test			
Chi2			0.00
Prob.			1.00
Heteroskedasticity Test: Breusch-Pagan/ Cook-Weisberg Test			
Chi2			25.36
Prob.			0.00
Cruss Sectional Dependence Test: Pesaran Test			
F stat.			6.88
Prob.			0.00
Autocorrelation Test: Wooldridge Test			
F stat.			5.38
Prob.			0.04

Source: Authors' Computation, 2024 (STATA Output).

Table 5 presents the results of the Feasible Generalized Least Squares Regression, which were used for hypothesis testing and additional post-estimation analysis. The Variance Inflation Factor (VIF) is 1.05, well below the threshold of 10, indicating no multicollinearity among the variables. Furthermore, the Breusch and Pagan Lagrangian Multiplier test for random effects produces a p-value of 1.00 and a chi-squared value of 0.000. Since the p-value exceeds the 5% significance level, the estimation using pooled ordinary least squares regression is deemed appropriate for the data analysis.

After conducting a pooled ordinary least squares regression analysis, the model was further validated through additional post-estimation tests. The Breusch and Pagan Lagrangian Multiplier test revealed that there were remaining heteroscedasticity issues with a p-value of 0.00, while the Pesaran test for cross-sectional dependence identified residual dependency problems also with a p-value of 0.00. However, based on the Wooldridge Test for panel autocorrelation results which indicated only mild significance at an alpha level of 0.05 regarding residuals' potential auto-correlational concerns. These errors were addressed by adopting feasible generalized least squares regression methods instead; aiming towards better improving our overall accuracy in predictions and formulaic enactments.

According to the results of Feasible Generalized Least Squares Regression, Nigerian deposit money banks demonstrate a notable enhancement in audit quality with an elevation in audit fees. This statement is substantiated by a coefficient value of 0.062 with the corresponding p-value of 0.00, this implies that a

naira increase in audit fee will increase audit quality. This is in line with findings of Onalapo et al., (2017), Babatolu et al., (2016) and Okoli (2014). Audit tenure has negative and significant effect on audit quality of deposit money banks in Nigeria with co-efficient of 0.023 with the corresponding p-value of 0.00, which was in support with the findings of Turel et al., (2017) who reported a weak relationship between audit tenure and quality, the study shows that longer audit periods have a significantly negative effect on quality. On the other hand, Abdul-Rahman et al., (2017) discovered that prolonged auditing durations positively impact quality levels. Finally, audit rotation has positive and significant effect on audit quality of deposit money banks in Nigeria, it means that if there is proper audit rotation has prescribed by the professional bodies, the better the audit quality of deposit money banks. This result aligns with Kalanjati et al., (2019) findings, which highlight the substantial benefits associated with audit rotation for improving audit quality. However, Mali and Lim's (2018) study report adverse effects of rotating auditors on maintaining satisfactory levels of auditing standards.

5.0 Conclusion and Recommendations

This study has examined the effect of audit firm characteristics on audit quality of listed deposit money banks in Nigeria and data has been sourced for, using secondary data and from the discussion of finding, the study reach conclusion that audit fees and rotation has a positive and significant impact on audit quality of listed Deposit Money Banks in Nigeria. However, it was also noted that prolonged audit tenure negatively influenced the effectiveness of audits quality of listed Deposit Money Banks in Nigeria. This implies that audit fees and audit rotation is one of the important factors to be considered in achieving good audit quality because higher-priced auditing services were deemed more effective than lower-cost alternatives due to increased expertise utilization. The importance placed upon appropriate management practices such as coordinated fee structures and professional guidance regarding rotations emphasizes their role in guaranteeing optimal results during future bank assessments for secure banking transactions by loyal customers who depend financially through intermediation via deposits leading institutional stability beneficial towards economic growth driven nation-state objectives can be achieved successfully over time with satisfactory outcomes sustained overtime adhered universally throughout industry standards without exceptions made or compromises met ensuring success while avoiding danger posed from risky conduct subverting best interests held at stakeholders investments sake.

In view of the findings, the research recommends that Management of DMBs should employ the services of reputable audit firms like the BIG 4 to enhance their auditing quality. Additionally, the management of DMBs in Nigeria should implement a robust rotation scheme for audits to further elevate its audit quality standards in banking institutions.

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