

THE EFFECT OF AUDIT QUALITY ON THE MARKET VALUE OF LISTED FINANCIAL FIRMS IN NIGERIA

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Abstract

This research investigates the impact of audit quality on the market value of listed financial services firms in Nigeria, utilizing an ex-post facto research design. The study encompasses 35 firms consistently listed on the Nigerian Exchange Group between 2011 and 2021, employing purposive sampling to ensure comprehensive and accurate data. Secondary data sourced from the Nigerian Stock Exchange Factbook and annual reports of the sampled companies were used for analysis. The independent variables considered were audit opinion, audit tenure, audit firm size, and audit fees, while the dependent variable was the firm's market value. A panel regression technique, specifically fixed and random effect models, was applied to evaluate the relationships. Descriptive statistics revealed varying degrees of associations among the variables, with the Shapiro-Wilk test indicating normal distribution for audit tenure and audit firm size. Correlation analysis showed significant positive associations between firm market value and audit fees, and a moderate positive association with audit firm size. The regression results indicated that audit fees positively and significantly impact market value, while audit firm size surprisingly showed a negative effect. Audit opinion and audit tenure, however, did not exhibit significant impacts. These findings contribute to the understanding of how different facets of audit quality influence the market value of financial services firms in Nigeria, with implications for regulatory policies and audit practices.

Keywords: audit quality, market value, financial services firms

Introduction

The turbulent impacts of the global financial crisis have underscored the crucial significance of credible, high-quality financial reporting. The attainment of such quality hinges upon the role played by external audits in buttressing the financial reporting quality of publicly traded companies (Musa & Shehu, 2014). A financial statement audit stands as a pivotal instrument in mitigating information asymmetries and upholding an efficient market milieu (Chinwe & Chinwuba, 2012). Nonetheless, for the audit process to enhance business performance, there must exist credibility

and reliability concerning audited financial data. Given the asymmetry of information and the consequential influence of financial data on investment decisions, the importance of the audit profession has surged. Audit quality emerges as a paramount concern in contemporary audit practices. Various stakeholders, both internal and external, hold a vested interest in the quality of audited financial data (International Accounting and Auditing Standards Board, 2011; Heil, 2012). The audit of financial statements acts as a regulatory mechanism for reducing information disparities and safeguarding the interests of diverse stakeholders by ensuring the accuracy of audited financial statements (Macharia & Gatuhi, 2013). Consequently, the auditing process serves as an indispensable instrument in augmenting the quality of financial report auditing.

According to Kronenbergr and Pietzsch (2017), auditors are professionals who operate on the principles of independence, professionalism, and trust. Effective functioning of capital markets necessitates thorough verification of financial statements to enhance business decision-making processes. Previous studies investigating audit quality, such as Molly and Teri (2016), explore its association with financial statement quality, earnings quality (Reza, 2015), corporate performance (Elewa & El-Hadad, 2019), auditor reputation (Skinner and Srinivasan, 2012), and earnings management (Inaam, Hlioui & Zehri, 2012; Chi, Ling and Mikhali, 2011). Wang and Huang (2014) elaborate that audit quality significantly influences market value. Skinner and Srinivasan (2012) assert that audit quality is a fundamental aspect of efficient capital market operations. The assurance provided by audit quality ensures the reliability of the information presented in financial statements. Information contained in financial statements forms the basis for stakeholders to accurately assess and assign values to the company.

Taking into consideration the points mentioned above, a robust and impartial audit holds significant importance in upholding an efficient market atmosphere, fostering trust in the reliability

and accuracy of financial statements crucial for the smooth operation of markets. Investors and other stakeholders prioritize the security of their investments. Shareholders entrust managers with authority to act in the best interest of the principal. This separation of ownership and control signifies a loss of direct control by shareholders and taxpayers over managerial decisions, leading to concerns regarding the safety of their investments (Amahalu & Ezechukwu, 2017). Hence, it is imperative to adopt high-quality audit practices and transparent policies to fulfill organizational objectives of safeguarding shareholders' assets and maximizing wealth.

The widely recognized failure of the audit process to detect financial inaccuracies has sparked a noticeable surge of interest and concern in overall financial reporting. Investors and other stakeholders have felt helpless and incapable of making informed financial decisions affecting entities in general due to the perceived inadequacy of audits in fully disclosing misrepresentations. This concern arises because the reliability of reported earnings and the ability of audits to effectively detect management's manipulation of earnings have come under significant scrutiny. Consequently, there is apprehension regarding the accuracy of reported income and its correlation with the audit process, especially in light of instances of corporate failures. Discrepancies in the quality of the audit process and auditor's reports lead to disparities in the credibility of auditors and the dependability of companies' earnings reports. The recent instances of corporate financial collapses present a significant challenge to the authenticity, integrity, efficiency, and relevance of the audit function. Badawi (2008) provides a compilation of companies involved in accounting scandals linked to poor audit quality and earnings manipulation over the past decade. In Nigeria, the necessity for high-quality audits and prompt financial information has become essential due to the escalating integration of Nigerian business entities into international capital markets and the adoption of International Financial Reporting Standards (IFRS) (Eriabie and Dabor, 2017).

Notable corporate scandals in Nigeria include instances involving Cadbury Nigeria Plc and African Petroleum (AP) (Okolie & Agboma 2008); Savannah Bank and African International Bank (Odia, 2007); Wema Bank, Nampak, Finbank, and Spring Bank (Adeyemi & Fagbemi, 2010); as well as Intercontinental Bank Plc., Bank PHB, Oceanic Bank Plc., and AfriBank Plc. The aim of this study is to analyze the effect of audit quality on the market value of listed financial services firms in Nigeria.

Literature Review

Egbunike and Abiahu, (2017) investigate audit firm report and market value of money deposit banks in Nigeria. The study adopted the ex post facto and correlational research design, with a study population that comprises all money deposit banks in existence as at 2015 financial year end covering a period of 5 years from 2010-2014. The study finds that audit quality has a significant effect on return on assets of Nigerian banks; Audit report and audit fee had no significant effect on return on assets, earnings per share and net profit margin of Nigerian banks. This study is also timely but if it had used a combination of both market and financial measures of performance, its result would have either been different or better and more reliable.

Also, Reza and Quraishi (2015) assess the impact of auditor ethics and auditor independence on share price in Bangladesh. The audited financial statements of thirty listed banks and their share prices have been considered in the study while audit report, loan outstanding and loan provision data were used to measure audit quality. Results from findings show that auditors of three banks compromise their independence and ethics by reporting that those banks' financial statements present true and fair view of their financial position rather than reporting the violation, and this violation lowers investors' confidence resulting to low share price. Even though conclusions were made from the findings, the researchers did not identify any specific model used to measure the

relationship between dependent and independent variables without stating whether it is a review. This might have affected their conclusion because the researchers made conclusions based on the inferences. Rudkhani and Jabbari (2013) carried out a study on the effect of financial ratios on auditor opinion for companies listed on the Terhan Stock Exchange (TSE) between 2005 and 2010. The study used a discriminant analytical technique to analyze data of 184 listed companies on the TSE and found out that there is a significant relationship between audit opinion and various financial ratio of which market value ratio was one.

Additionally, Rahimi, and Amini (2015) examine the relationship between audit quality and profitability in the companies on Tehran's Exchange Market. Auditor size and the auditor's tenure were used to measure audit quality. The study surveyed a total number of 52 companies accepted in Tehran's securities exchange market. Using correlation analysis, findings show that there is a positive and significant relationship between auditor's tenure and profitability. Also, there is a positive but non-significant relationship between profitability and auditor size. The findings here is consistent with that of Okolie and Izedonmi (2014) who investigate the impact of audit quality on the share prices of quoted companies in Nigeria using audit tenure as one of the proxies for audit quality and price per share as the dependent variable. They also used multiple regression method to analyze the data extracted from annual reports of 57 companies quoted on the Nigerian Stock Exchange for a period of six (6) years. The findings show that audit quality exerts significant influence on the market price per share of quoted companies in Nigeria. Similarly, Udeh, Chinedu and Okwo (2020) researched on the effect of Audit quality on firm performance using listed manufacturing companies in Nigeria for ten (10) year's period using OLS regression and found out that Audit tenure has a positive and significant relationship with firm performance. The outcome as also similar to the findings of Soyemi, Tihamiyu and Omale (2021) who investigated

audit quality attributes and firms performance for 40 non quoted financial services firms in Nigeria for 10 years period.

Furthermore, Emmanuel and Emem (2020) used a sample of twenty-two (22) listed manufacturing firms in Nigeria to examine the impact of audit firm attributes on the financial reporting quality. The study made use of ex-post facto research design and secondary data collected for the period of 2011 to 2015 from the audited annual reports and accounts and multiple regression to test the stated hypotheses. The empirical evidence revealed that auditor fees exert a significant impact on the financial reporting quality while audit firm size and audit delay exert insignificant impact on the financial reporting quality. The study recommended that management of manufacturing firms should ensure timely release of financial statement to users of accounting information thereby enhancing quality of decision making.

Also, Ugwunta, Ugwuanyi and Ngwa (2018) assess the effect of audit quality on share prices in Nigerian oil and gas sector using regression and covariance analyses. Findings show that audit committee composition and auditor type have significant effect on Market value of quoted firms. The covariance analysis suggests that while auditor type, auditor independence, and composition of the audit committee have significant relationship with Market value of shares, auditor's tenure has a negative relationship with the Market value per shares. This study is timely, but it focused only on aspect of performance hence the need for a study that will study the effect of audit quality on performance generally. Similarly, Aledwan, Yaseen, and Alkubisi (2015) examine the impact of audit quality on market value of quoted firms in Jordan. The study was descriptive in nature and the correlational and ex-post facto designs were adopted in carrying out the research. Multiple regression analysis using the SPSS (Version 15.0) was employed in analyzing the data and testing the stated hypotheses. The results of their findings show that auditor size and auditor independence

have significant impacts on the market value of quoted cement firms in Jordan. Hua, Hla, and Isa (2016) examine the impact of audit quality and financial reporting standard practices of firms on their financial success in Malaysia using audit firm size as proxy for audit quality and return on asset and return on equity as proxies for market value. The study Sampled firms listed on Malaysian stock market from the construction sector for the period of 2010 to 2013.

METHODOLOGY

The purpose of this section is to outline the methodology employed in conducting this research. This section is structured into various components including research design, study population, sample size and sampling method, data sources, model specification, data collection approach, analysis method, and variable measurement.

Research Design

The study adopted an ex-post facto research design due to the data collected pertaining to past events. Additionally, this design is appropriate when the researcher lacks control over the independent variables as the circumstances prompting the study have already transpired. This design is considered most suitable given that the study utilizes pre-existing audited financial statements from listed financial services companies in Nigeria.

Population of the Study

The study's population encompasses all the financial services firms listed in Nigeria. As of December 2021, there were 49 such firms listed on the Nigerian Exchange Group Market.

Sample and Sampling Technique

The sampling technique utilized is purposive, as firms were selected based on specific criteria. These criteria included firms being listed on the Nigerian exchange between 2011 and 2021, the availability of their annual financial reports during this period, and exclusion of newly listed or delisted firms from the study. Consequently, only financial services firms with consistent listing

and complete data were included in the final sample. The sample comprises 35 financial services firms listed on the Nigerian Exchange Group.

Instrument of Data Collection

The data utilized in this study primarily consists of secondary data, aligning with Salkind's (2010) approach. Data for the chosen publicly traded financial companies is sourced from the Nigerian Stock Exchange Factbook and the annual reports and accounts of the sampled companies.

Variable Identification and Measurement

This study identifies audit opinion, audit tenure, audit firm size, and audit fees as the independent variables, with the market value of the sampled firms serving as the dependent variable.

Model Specification

Drawing from theoretical literature and prior empirical research on the impact of audit quality on market value, we construct our model to encompass the factors influencing audit quality. In essence, the econometric form of our model is articulated as:

$$Desp_{it} = \beta_0 + \beta_1 Audo_{it} + \beta_2 Audt_{it} + \beta_3 Big4_{it} + \beta_4 Audf_{it} + \mu_{it}$$

Where:

Desp is share Price as at year end (Proxy for Firm market value), Audo is Audit Opinion, Audt is Audit Tenure, Big4 is Audit Firm Size, Audf is Audit Fees, β_0 is Constant, β_1 - β_6 is Slope Coefficient, μ is the Stochastic disturbance, i is i^{th} firm and t is time period

Panel Regression Technique

Panel data analysis, which represents a combination of regression, and time-series analysis is an analysis of data sets composed of a cross section of many subjects observed over time. Observing a broad cross section of subjects over time allows the researcher to study dynamic, as well as cross-sectional aspects of a problem (Frees 2004). The cross-sectional dimension and time-series

dimension, which form the two dimensions of panel data, enabled the researcher to construct complex models and conduct efficient statistical inferences, which may not be possible using pure cross-section data or time-series data (Hu et al. 2014).

In this study, the descriptor panel data came from a sample of firms and in this context, a “panel” represented firm year observations. Panel data set can also be balanced and unbalanced. In a balanced data set, all elements are observed in all time frames whereas in an unbalanced data set certain data category is not observed. The data for this current study is balanced and the Stata statistical software could handle the balanced data. Panel data offers some benefits, and this includes the fact that it has many large data sets with increased variability and less collinearity among the variables that leads to many reliable estimates (Baltagi 1995). Panel data sets are also able to control for observable and unobservable individual heterogeneity by tracking subjects over time to model subjects’ behavior. Moreover, panel data analysis accounts for relationships among a limited number of different subjects (Frees 2004). Therefore, it offers the advantage of studying complex issues of dynamic behavior.

Specifically, the econometric techniques adopted in this study are the panel fixed and random effect regression techniques. The rationale for its usage is based on the following justifications: the data that was collected may have time and cross-sectional attributes as well as across the sampled firms (cross-section); panel data regression provides better results since it uses large observation and reduces the problem of degree of freedom (Muhammad, 2012); it avoids the problem of multicollinearity and help to capture the individual cross-sectional (or firm-specific) effects that the various pools may exhibit with respect to the dependent variable in the model. Hausman and Taylor (1981) also recommended panel data estimation method because it enables a cross-sectional time series analysis which usually makes provision for a broader set of data points,

but also because of its ability to control heterogeneity and endogeneity issues. Hence panel data estimation allows for the control of individual-specific effects usually unobservable which may be correlated with other explanatory variables included in the specification of the relationship between dependent and explanatory variables.

Descriptive Analysis

The study conducts a descriptive statistic for both the explanatory and dependent variables of interest. Each variable is examined based on the mean, standard deviation, maximum and minimum.

Table 1

Descriptive Statistics

VARIABLES	MEAN	SD	MIN	MAX	NO OBS
DESP	3.76	7.81	0.12	47.95	385
AUDO	0.05	0.07	0	1	385
AUDT	0.66	0.47	0	1	385
BIG4	0.64	0.48	0	1	385
AUDF	4.62	0.67	3.32	6.25	385

Source: Author (2024)

The average market value, represented by DESP, stood at 3.76 with a standard deviation of 7.81. Share prices ranged from a minimum of 0.12 to a maximum of 47.95. These findings suggest that, on average, the share price of financial services firms in Nigeria during the study period was 3.76. Regarding the independent variable of audit opinion (AUDO), the data indicates a mean of 0.05 and a standard deviation of 0.07. Audit opinions ranged from a minimum of 0 to a maximum of 1. This indicates that, on average, approximately 5% of the firms examined received a qualified audit opinion, while the remaining 95% received an unqualified audit opinion from their external auditor. We observed that the average audit tenure (AUDT) was 0.66 with a standard deviation of 0.47. Audit tenures ranged from a minimum of 0 to a maximum of 1. Our findings indicate that approximately 66% of the firms included in our study have engaged an external auditor for more

than 3 years. As for audit firm size (BIG4), it had an average of 0.64 with a standard deviation of 0.48. The range for audit firm size was from 0 to 1. This suggests that, on average, around 64% of the firms in our sample employed the services of big4 auditors, while the remaining 36% opted for non-big4 auditors. Additionally, we found that audit fees had an average of 4.62 with a standard deviation of 0.67. Audit fees varied from a minimum of 3.32 to a maximum of 6.25.

Normality Test

The study utilizes the Shapiro-Wilk test of normality test. Therefore, we conducted a residual normality test, as shown in the table 2.

Table 2

Normality Test

VARIABLES	NO OBS	W	V	Z	PROB<Z
DESP	385	0.51	129.26	11.55	0.00000
AUDO	385	0.50	131.70	11.59	0.00000
AUDT	385	0.99	0.64	-1.06	0.85615
BIG4	385	0.99	0.44	-1.95	0.97466
AUDF	385	0.93	19.54	7.06	0.00000

Source: Author (2024)

According to the findings in Table 2, it appears that the dependent variable, share price, as well as the independent variables, audit opinion and audit fees, do not exhibit a normal distribution. This conclusion is drawn from the Shapiro-Wilk test, which reveals significant probabilities of the z-statistics at a 1% significance level. However, it is noteworthy that both the independent variables of audit tenure and audit firm size display a normal distribution, as indicated by the insignificant probabilities of the z-statistics at either the 1% or 5% significance level.

Correlation Analysis

We employed the Pearson correlation coefficient (correlation matrix) and the results are presented in the table below.

Table 3

Correlation analysis

VARIABLES	DESP	AUDO	AUDT	BIG4	AUDF
DESP	1.0000				
AUDO	-0.0468	1.0000			
AUDT	0.0722	0.0519	1.0000		
BIG4	0.4418	-0.0956	-0.0186	1.0000	
AUDF	0.7094	-0.0745	0.1139	0.5982	1.0000

Author's computation (2024)

Regarding the correlation between audit quality proxies and firm market value, the aforementioned findings reveal a weak negative association between firm market value and audit opinion (-0.0468). Conversely, there is a weak positive association between firm market value and audit tenure (0.0722), a moderate positive association between firm market value and audit firm size (0.4418), and a strong positive association between firm market value and audit fees (0.7094). Nevertheless, to examine our hypotheses thoroughly, regression analysis will be necessary as correlation tests cannot establish causality.

Estimation Results

To examine the cause-effect relationships between the dependent variables and independent variables as well as to test the formulated hypotheses, we used a panel regression analysis since the data had both time series (2011 to 2021) and cross-sectional properties (listed financial services firms).

Table 4

Random Effect Estimation

Variable	Coefficient		P-Value
AUDO	-0.104		0.967
AUDT	0.192		0.602
BIG4	-1.864		0.005**
AUDF	5.936		0.000***
F-statistics/Wald Statistics	44.20		0.0000***
C	-22.614		0.000 ***
R- Squared	0.3750		
VIF Test	1.25		
Heteroscedasticity Test	344.22 (0.0000) ***		
Hausman Test		2.78 (0.5946)	

Note: **, ***, implies statistical significance at 5% and 1% levels respectively

Based on the Random Effect regression, we noted an R-squared value of 0.3750, indicating that approximately 38% of the systematic variations in firm market value, represented by share price, within the pooled financial services firms over the observed period, were collectively accounted for by the independent variables in the model. However, the portion of firm market value not accounted for can be attributed to the omission of additional independent variables that may influence firm market value but were not included in the model, thus captured within the error term. The findings indicate that while an increase in qualified audit opinions among financial services firms in Nigeria tends to decrease their firm market value, this negative impact lacks statistical significance. This outcome is consistent with the lending credibility theory, which suggests that independent auditors enhance the credibility of financial statements through their audit work and reports. Typically, unqualified opinions positively influence firms' market value. This result aligns with previous empirical studies indicating that audit opinions have an insignificantly negative effect on firm market value (Egbunike & Abiahu, 2017;).

The results reveal that the longer a specific external auditor remains engaged with a financial services firm, the greater the market value of such firms, although this positive impact lacks

statistical significance. It is commonly believed in practice that maintaining an auditor for an extended period, as permitted by law, enhances audit quality as the auditor becomes familiar with client-specific issues. Consequently, this familiarity positively influences market values. Consistent with prior empirical research, our findings suggest that audit tenure has an insignificantly positive effect on firm market value (May & Rasha, 2019). Our study uncovers a surprising trend: the market value of listed financial services firms in Nigeria tends to decrease when they enlist the services of Big 4 auditors. This finding aligns with Imhoff's (1988) assertion that certain large audit firms may possess perceived quality rather than actual audit quality, primarily due to their reputation. Typically, companies audited by the Big 4 attract stakeholder confidence due to the prestige associated with these firms, positively impacting their market value. However, our research findings diverge from this commonly held belief. Instead, our results are consistent with prior empirical evidence indicating that audit firm size negatively affects firm market value (Yoladinta and Cahyonowati, 2022).

Furthermore, evidence indicate that an increase in the audit fees charged by external auditors corresponds to a rise in the market value of listed financial services firms in Nigeria. Elevated audit fees suggest that proficient auditors charge fees commensurate with their costs to ensure integrity and avoid compromising audit quality, thereby producing a reliable audit report. Moreover, high audit fees signify a quality audit, signaling to the market the credibility of the financial statements and thus contributing to an increase in firm market value, in accordance with the lending credibility theory. This outcome is consistent with prior empirical studies demonstrating a significant positive effect of audit fees on firm market value.

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