Effect of Audit Quality on Performance of Deposit Money Banks (DMBs) In Nigeria

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Abstract

We examined the effect of audit quality, represented by audit firm size, auditor tenure, client importance and auditor specialization on the performance, represented by Tobins Q, of listed Deposit Money Banks (DMBs) in Nigeria. Secondary data extracted from annual report and accounts of of 8 DMBs was analyzed using panel multiple regression technique. Result of Hausman specification test suggests that the Ordinary Least Square (OLS) regression result was most appropriate for the dataset. The regression result indicates that auditor tenure has significant positive effect on Tobins Q of DMBs in Nigeria. In contrast, client importance has a significant negative relationship with Tobins Q while audit firm size and auditor specialization respectively have insignificant positive and negative effect on Tobins Q of DMBs in Nigeria. Based on the result, the study recommends among others auditor tenure of three years and above for Nigerian companies as it is capable of enhancing the performance of Deposit Money Banks in Nigeria.

Key words: Audit Quality, Deposit Money Banks, Auditor Tenure,

1.0 Introduction

Increase in business complexity has necessitated separation of management from ownership. This divorce of management from ownership in modern corporations has made stewardship accounting inevitable. Managers, under the agency arrangement, are responsible for running the affairs of the company on behalf of the owners. However, due to ostensible information asymmetry and conflict of interest, owners require mechanisms that compel managers to safeguard the interests of diverse stakeholders (Farouk & Hassan, 2014) in the firm. External audit is one of the measures that are believed to check these managerial excesses.

Audit of financial statements reduces information asymmetry in a firm and protects the interests of stakeholders through provision of assurance on the correctness, truthfulness and fairness of the financial statements prepared by management. This is in view of the fact that high quality audit is expected to detect material misstatements, errors, and losses which results from managerial opportunism in the quest to increase their economic largesse at the expense of other stakeholders of the firm (**Alaswad & Stanišić, 2016; Tyokoso, Sabari, Dogarawa & Hassan, 2017**).

Audit of financial statements is therefore an important part of the regulatory and supervisory framework which is of significant public interest. The extent to which audit lends credence to the reliability of financial statements in turn depends on the quality of audit services rendered (Smii, 2016). Audit quality is the joint probability that the auditor detects and reports questionable accounting practices of the firm (Tyokoso & Tsegba, 2016). Audit quality is therefore capable of influencing corporate performance, through mitigation of risks and significant misstatements. The lower risk of misstatements consequently, increases the confidence of capital market investors in financial reports which also lowers the cost of capital and increases the market valuation of the firm (Heil, 2012). Users of audited financial statements therefore believe that the information it contains are completely free from material bias and so depend on it to allocate scarce economic resources with expectations of commensurate returns. Investor confidence is therefore associated with the level of truthful and fair presentation of financial statements which in turn is a product of audit quality (Okolie & Izedonmi ,2014) Consequently, audit quality and its association with performance of firms is a major concern of researchers in accounting literature. The importance of a study of the relationship between audit quality and the performance of listed firms in Nigeria cannot be over emphasized in view of the fact that many Nigerian firms are struggling to regain credibility amidst national and international investors (Farouk & Hassan, 2014). This need has sparked academic debate on the relationship between audit quality and performance of firms in Nigeria recently. Though the literature is awash with many studies, most of them from both Nigeria and foreign literature documented mixed and inconsistent evidence between audit quality and firm performance (Farouk & Hassan, 2014; Ching, Teh, San & Hoe, 2016; Smii, 2016).

In addition, there are relatively few studies in Nigeria that examine the relationship between audit quality and performance of listed firms even though some companies in Nigeria such as DMBs have been accused of inflating performance amidst clean audit reports from highly reputable audit firms in Nigeria. This calls to question the quality of audit services and reported performance of listed Nigerian companies. More so, some of the recent studies in Nigeria which investigates the relationship between audit quality and performance of firms such as Farouk and Hassan (2014) proxied firm performance by accounting measures such as ROA. However, the use of accounting- based measures of firm performance in previous studies on audit quality and firm performance is erroneous and so renders the results of such studies doubtful. This is because audit quality has no direct effect on the accounting based performance of listed firms but capital market- based performance according to the signaling theory of audit.

In addition, given the fact that many reported cases of corporate scandals in Nigeria involve DMBs, the credibility of audited financial statements in the banking sector becomes doubtful. It is therefore imperative to examine the effect of audit quality on the performance (proxied by a market- based performance measure, Tobins Q) of banks in Nigeria to restore the lost public confidence in financial statements of listed companies which is capable of impacting negatively on the market performance of banks and Nigerian companies generally.

Despite these gaps, previous studies such as Farouk and Hassan (2014), Okolie and Izedonmi (2014), and Modum, Ugwoke and Onyeanu (2013) have not addressed the subject matter especially within the context of Deposit Money Banks (DMBs) in Nigeria. This study therefore examines the effect of audit quality on the performance of Deposit Money Banks in Nigeria to fill the gaps in the local literature. Consequently, the study hypothesized that audit quality proxied by audit tenure, client importance, auditor industry specialization and audit firm size have no significant effect on the performance (proxied by Tobins Q) of listed Deposit Money Banks in Nigeria. The rest of the paper is organized into literature review and theoretical framework in section 2, methodology in section 3, results and discussion in section 4, and conclusion and recommendations in section 5.

2.0 Literature Review and Theoretical Framework

Business performance is a term that is used synonymously with firm performance which is a subset of organizational effectiveness that covers both operational and financial outcomes. Although the conceptual proposal of Venkatraman and Ramanujan (1986) is widely referred to by strategic management scholars, measures of firm performance used in empirical studies show a wide variety of approaches. The most commonly used measures are growth, profitability, market value, customer satisfaction, employee satisfaction, social performance and environmental performance. In this study, market value (represented by Tobin's Q) is used as a performance measure. Audit quality according to DeAngelo (1981) is the market-assessed joint probability that a given auditor detects a breach in the client's accounting system and reports the breach to stakeholders. The European Supreme Audit Institution (EUROSAI) extends this definition to include the degree to which a set of inherent characteristics of an audit fulfills requirements such as legal and professional requirements. Traditionally, the audit process assesses the probability of material misstatements and reduces the possibility of undetected misstatements to an appropriate assurance level (Knechel, 2009). The proper execution of an audit assignment influences the integrity of financial reporting and investors' confidence in the financial reports of the firm (Levitt, 1998).

The definition of DeAngelo (1981) captures two key issues: the competence of the auditor which indicates the likelihood of detecting financial misstatements and the independence of the auditor which shows the ability to report detected financial misstatements to stakeholders. In his view, Khan (2006) itemized three fundamental perspectives from which audit quality may be perceived: input, output, and context factors. From the input perspective, audit quality is represented by the auditor's personal attributes such as skills and experience, ethical values and mindset, soundness of audit technology and the availability of adequate technical support geared toward supporting a high quality audit. From the output dimension, audit quality is attributed to important influences on audit which affect stakeholders assessments of audit quality such as auditor's report and auditor communications to those charged with governance of the firm. From the context perspective, audit quality is represented by factors that influence the auditors work such as sound corporate governance, law and regulation, and the quality of applicable financial reporting framework. Despite non- availability of a universally accepted definition of audit quality in the accounting literature, this study views audit quality as the probability that the auditor both detects and reports fraudulent accounting practices of the client.

Theoretically, extant literature documents many theories which explain the relationship between audit quality and firm performance. Prominent among these theories is the agency theory which revolves around information asymmetry between the principal (shareholders) and the agent (management) of the firm. Agency problems arise as a result of the separation of ownership from control in modern business organizations where the agent uses the economic resources entrusted to him at the detriment of the principal. To mitigate information asymmetry associated with agency relationship, shareholders engage the services of high quality external auditors to protect their interests. High quality audit is therefore capable of reducing the costs of misstatements in financial statements; restore confidence in a firm's financial reporting quality and increases market valuation of the firm.

Another theory that relates audit quality to corporate performance is the signaling theory which sees audit as a mechanism that can mitigate information asymmetry among related parties. Signaling theory, according to Spence (1973), suggests that companies with good performance use financial information disclosure to send favourable signals to the market about their potentials. Companies with high quality auditors such as the big 4 auditors, send signals to the market that their financial statements are more credible than those audited by lower quality auditors.

The market therefore associates auditors such as big audit firms and specialist auditors with higher audit quality than other auditors and rewards companies audited by high quality auditors with larger improvements in share prices (Teoh & Wong, 1993; Krishnan & Yang, 1999). The positive signal of transparency and credibility which high audit quality sends to the market, provides assurance to the stakeholders about the quality of earnings disclosed in financial statements and suggests a positive association between market based performance and audit quality.

The theory of inspired confidence also explains the association between audit quality and market based performance of firms. This theory was developed by the Limperg Institute in Netherlands in 1985. The theory suggests that the auditor, as a confidential agent, derives his function in the society from the need for expert and independent examination, and professional judgment. In performing his duties, the auditor is expected to approach his work with due care and diligence, realizing that the public expect no audit failures. The auditor must therefore plan and perform his duties in a manner that minimizes the risk of undetected material misstatements in financial statements (Limperg Institute, 1985).

The auditors' theory of inspired confidence explains the users' requirement for credible and reliable financial reports and the capacity of the audit processes to meet those needs. The theory suggests that the duties and responsibilities of the auditor are derived from the confidence which the public places on the success of the audit process and the assurance which the audit opinion provides. Auditors are therefore expected to maintain reasonable quality assurance in view of the fact that audit failure is a career-ending event. Though several theories explain the association between audit quality and firm performance, this study is anchored on signaling theory in view of the fact that it best explains the context for audit and the relationship between audit quality and the market- based performance of listed Deposit Money Banks (DMBs) in Nigeria.

Following the theoretical link between audit quality and firm performance, empirical studies have also examined the effect of audit quality on firm performance in both Nigeria and foreign literature. For instance, Ching, Teh, San and Hoe (2015) investigated the relationship between audit quality and financial performance of listed companies in Malaysia. Fifteen companies from the industrial products and consumer products industry listed on the Main Board of Bursa, Malaysia were sampled from 2008 to 2013. The findings of the study indicate that audit quality have a significant positive effect on firm performance.

Similarly, Smii (2016) *examined the effect of audit quality on the performance of six (6) listed Tunisian firms from 2005 to 2009. The study found that size of the audit firm, auditor specialization, the co-commissioner and the size of the audit committee are positively associated with firm performance. Also,* Okolie and Izedonmi (2014) investigated the relationship between audit quality and market value per share of companies quoted on the Nigerian Stock Exchange. The study sampled 57 companies over the period of six years from 2006 to 2011. Audit quality was represented by audit firm size, audit fees, auditor tenure and audit client importance. The result of the study indicates that audit quality exerts significant influence on the market value per share of quoted companies in Nigeria.

In another study, Martinez and Moraes (2014) examined the association between Tobin's Q and audit fees of 12 Brazilian companies from 2009 to 2011. The results suggest a significant relationship between Tobin's Q, audit fees and non-audit fees of firms.

3.0 Methodology

Our study adopts correlational research design because this design enables us to test the relationship between audit quality and performance of Deposit Money Banks in Nigeria. The population of the study comprises all the fifteen (15) listed Deposit Money Banks (DMBs) in Nigeria as at 31st December, 2015. The sample is however, made up of eight (8) Deposit Money Banks selected based on data availability. The eight selected banks are those that disclose full information about their auditors such that the study variables can be measured. The sample represents 53% of the study population which is considered adequate in view of the large representation of the population which is the hallmark of sampling. Secondary data were extracted from the annual report and accounts of the sampled companies downloaded from the official websites of the banks from 2009 to 2015. The data collected for the study was later analyzed using panel multiple regression technique with the help of Stata version 11.

The study variables and their measurement are presented in table 1 below:

Table 1: Variables and their Measurement

Variable	Symbol	Measurement
Tobin's Q	TQ	Total market value of the firm/total assets value of the firm
Audit firm size	FS	A dummy variable 1, if the firm is audited by a Big 4 auditor, 0 otherwise
Audit firm tenure	AT	Number of consecutive years the client has retained a particular audit firm. Dummy variable 1 for 3 years^{+}, 0 otherwise
Client Importance	CI	Ratio of client's sales to the sum of all clients' sales audited by an auditor within the sample size
Auditor specialization	AS	A dummy variable 1 if market size (MS) of the auditor =20 percent and 0 otherwise.

The linear relationship between the dependent and independent variables is represented in the panel multiple regression model below:

$TQ_{it}= \beta_o+\beta_1AT_{it}+\beta_2CI_{it}+\beta_3FS_{it}+\beta_4AS_{it}+ e_{it}$

Where:

TQ_{it}= Tobin's Q for firm i in time t.

AT_{it} = Audit firm tenure for firm i in time t.

CI_{it}= Client Importance for firm i in time t.

FS_{it}= Audit firm size for firm i in time t.

AS_{it}= Auditor specialization for firm i in time t.

$\beta_o, \beta_1, \beta_2, \beta_3$ and β_4= Model coefficients.

e_{it}=Error term.

4.0 Results and Discussion

The descriptive statistics of the study variables are presented in table 2 below:

Table 2: Descriptive statistics

Variable	Mean	Std dev	Min	Max	Obs
TQ	0.58125	0.51825	0.05	0.98	56
AT	0.60714	0.49280	0	1	56
CI	0.54190	0.34051	0.02804	1	56
FS	0.76785	0.42602	0	1	56
AS	0.61818	0.49031	0	1	56

Source: Output from Stata

Table 2 shows that the mean value of TQ is 0.58125, while the minimum and maximum values are 0.05 and 0.98 respectively. The standard deviation of TQ is 0.51825, which suggests low variability of performance among the sampled firms. The table also indicates that AT has a mean value of 0.60714, minimum and maximum values of 0 and 1 respectively, with a standard deviation of 0.49280 which is below the mean, suggesting low variability of auditor tenure among the sampled firms. Also, the mean value of CI from table 2 above is 0.54190 with minimum and maximum values of 0.02804 and 1 respectively. The standard deviation of CI which is 0.34051 shows low level of variability of client importance among the sampled firms. Similarly, the mean value of FS is 0.76785, minimum value is 9 and maximum value of 1. The standard deviation of FS is 0.42602 which explains low level of variability in the FS of the firms under study. Finally, FS has mean value of 0.61818, minimum value of 0 and maximum value of 1, with standard deviation of 0.49031 which indicates low level of variability in the FS of the firms under study. Furthermore, the association between and among the variables of the study was determined using Pearson Correlation analysis. The result of correlation matrix is presented in table 3 below:
The result of correlation analysis as presented in table 3 shows that AT and AS are positively correlated with TQ while CI and FS are negatively correlated with TQ. The table also reveals that CI and AT, FS and CI, AS and CI are negatively correlated while FS and AT, AS and AT, AS and FS are positively correlated.

Table 3: Correlation Matrix of the study variables

Variable	TQ	AT	CI	FS	AS
TQ	1.0000				
AT	0.2404	1.0000			
CI	-0.4484	-0.0176	1.0000		
FS	-0.0505	0.1639	-0.2325	1.0000	
AS	0.1099	0.2750	-0.3953	0.2675	1.0000

Source: Output from Stata, 2017

To enhance the robustness of regression results normality, heteroskedasticity, multicollinearity and Hausman specification tests were performed. Result of Shapiro-Wilk normality test shows that data for all the variables except PRO and FS were normally distributed and insignificant at 5%. Result of Breusch-Pagan/Cook-Weisberg test for heteroscedasticity shows a chi-square of 1.93 which is not significant at 5%. This means that variation in the error term across the variables is homoscedastic. Multicollineaarity test was carried out using Variance Inflation Factor (VIF) and tolerance values. VIF values were consistently below the maximum threshold of 10 (rule of thumb) confirming that there is no multicollinearity problem in the data used.

Hausman specification test was carried out to enable us select between the fixed effect and random effect regression results considering the panel attribute of the dataset. The result of Hausman test shows a chi-square of 5.82 which is not significant at 5%, and indicates that random effect regression result should be selected. In addition, Breusch and Pagan Lagrangian multiplier test for random effect was carried out to enable us select between OLS and random effect regression results. The result suggests that OLS regression result is most appropriate for the dataset. On the basis of the above tests, the OLS regression result is presented in table 4 and analyzed below:

Table 4: Regression Results

Variable	Coefficient	T-value	Sig
AT	0.3056071	2.35	0.023
CI	-0.8194342	-4.15	0.000
FS	-0.2358222	-1.57	0.124
AS	-0.1399534	-0.97	0.336
Cons	1.102226	5.35	0.000
R-squared			0.3069
Adj			0.2515
F-statistics			5.54
Probability			0.0009

Source: Output from Stata, 2017

The regression result presented in table 4 shows that the coefficient of AT is 0.3056071 which implies that AT has a significant positive relationship with TQ of listed Deposit Money Banks in Nigeria. This is an indication that one percent increase in AT leads to a corresponding 0.3056071 increase in TQ of listed DMBs in Nigeria. Based on this evidence, the study rejects the first hypothesis which states that there is no significant relationship between auditor tenure (AT) and firm performance (represented by Tobins Q) of DMBs in Nigeria. This finding is consistent with the finding of Okolie and Izedonmi (2014) which documented a significant association between AT and firm performance.

The result presented in table 4 also indicates that CI has coefficient of -0.8194342 which suggests negative relationship between CI and TQ of the firms under study. This means that a one point increase in CI leads to 0.8194342 point increase in TQ of the firms under study. The t-value of CI is -4.5 which is significant at 1%. Based on this result, the null hypothesis of no significant relationship between CI and TQ is rejected.

The table also shows a coefficient of -0.2358222 for FS which indicates that a one point increase in FS leads to 0.2358222 point decrease in TQ of the firms under study. The relationship between FS and PRO is not significant as FS has a t-value of -1.57 which is not significant at 5%. On the basis of this outcome, the null hypothesis of no significant relationship between FS and TQ is not rejected.

Similarly, the table shows a coefficient of -0.1399534 for AS which means that AS has a negative relationship with TQ of the firms under study. The result indicates that a one point increase in AS is accompanied by 0.1399534 point increase in TQ of the sampled firms. The t-value of -0.97 for AS is not significant at 5%. Hence, the null hypothesis which states that there is no significant relationship between AS and TQ is not rejected. This finding is contrary to the finding of Okolie and Izedonmi (2014).

5.0 Conclusion/Recommendations

The study examined the effect of audit quality on financial performance of listed Deposit money Banks in Nigeria. The result of regression analysis shows that AT and CI have significant effect on TQ of listed Deposit Money Banks in Nigeria while FS and AS were found to have no significant effect on TQ of the firms under study. The study therefore concludes that audit tenure and client importance play a prominent role in the determination of TQ of Nigerian firms.

Based on the findings of the study, the following recommendations were made:

i. The study recommends auditor tenure of three years and above for Nigerian companies as it is capable of enhancing the performance of Deposit Money Banks in Nigeria.

ii. Public companies in Nigeria should disclose all payments made to the external auditor since client importance has a significant influence on the performance of Deposit Money Banks in Nigeria.

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