

IMPACT OF AUDIT QUALITY ON FINANCIAL PERFORMANCE OF BANKING INDUSTRIES IN NIGERIA

Obafemi Tunde Olutokunbo¹, Oyerinde, Simeon Gbadegesin², Kabiru Sani Muhammed³

¹Ph.D, Faculty of Management Science, Department of Accounting and Finance, Ajayi Crowther University, Oyo, Oyo State.

²Ph.D student, Faculty of Management Science, Department of Accounting and Finance, Ajayi Crowther University, Oyo, Oyo State.

³Department of Banking and Finance, Federal Polytechnic Offa, Kwara State

Email - obafemitunde01@gmail.com, simeongbadegesinoyerinde@gmail.com, muhammedkabir211@gmail.com

ABSTRACT

Internal audits help ensure accountability, transparency, and public property preservation. This research focused on impact of audit quality on financial performance of banking industries in Nigeria. The 2004-2019 study used secondary data from sampling banks' annual financial statements. Ex-post facto study design and descriptive statistics and OLS multiple regression estimation were used. Audit Company Size (AFS) and Audit Fee (AF) boost firm performance, whereas Audit Report Lag (ARL) hurts Nigerian banks' performance. Only Audit Fee (AF) was statistically insignificant ($p > 0.05$); Audit Firm Size (AFS) and Audit Report Lag (ARL) were significant ($p < 0.05$). Without enough effort to monitor the financial performance of banking businesses in Nigeria, they will continue to stray from reporting correct profits figures by providing earnings data that appear lovely but are not genuine, deceiving investors and other stakeholders. A long association between the Auditor and his client may threaten independence and audit quality due to personal ties and familiarity. This will reduce the Auditor's vigilance and favoritism toward the company's senior managers. The audit engagement may become commonplace, leading in less effort to discover internal control flaws and risk sources.

Keywords: Financial statements, Transparency, Accountability, Audit, Financial performance

1. INTRODUCTION

Financial statements help shareholders and others make economic and commercial decisions (Saddam, Mosab, Saleh, Jinyu and Ahmed, 2020). The data is used to evaluate financial situations, associated companies, and management. The quality of financial reporting of companies listed on the Nigerian Stock Exchange depends on the work of external auditors (Flayyih, Ali and Mohammed, 2018). A financial statement audit reduces information asymmetry and protects shareholder interests by ensuring that management has not materially misstated financial information. Most organizations and their management lack the accounting skills and materials to compile a public financial statement, according to Inayah and Prasetyo (2021).

Before making accounting choices, these organizations rely heavily on auditor guidance. This suggests auditors modify financial statements before auditing. When corporations make an accounting judgment or financial statement, they rely heavily on auditors. High reliance on the auditor means the auditor affects the financial accounts (Baatwah, Salleh, and Ahmad, 2018). According to Adenle, Anyanwu, Okafor, and Oyaleke (2022) the goal of an audit is to acquire adequate audit evidence to support the auditor's findings. The auditing process is completed with the auditor's conclusion in a signed audit report. In this report, auditors summarize audit findings and provide their opinion on the company's declared financial accounts.

Investors' importance of these reports and their substance is unclear and needs further scrutiny. Demand for audit services is caused by various causes, including the remoteness gap between financial statement users and preparers, user conflict of interest, complexity of economic activities, and expected effect of financial statements on decision making. Many factors affect banks' financial performance, including audits and management.

The poor financial performance of Nigerian corporations, especially banking industries, has been linked to audit quality. Nigerian banks audit quality should positively affect financial performance. Banking industries that use a credible audit firm are expected to have efficient financial performance. It was against this background that the researcher investigate the impact of audit quality on financial performance of banking industries in Nigeria.

2. STATEMENT OF THE PROBLEM

Shareholders and other users of accounting information use financial statements to make economic and business decisions (Saddam, Mosab, Saleh, Jinyu and Ahmed, 2020). Information is used to evaluate financial conditions, related company performance, and management performance. In general, external auditors support the quality of financial reporting of companies listed on the Nigerian Stock Exchange (Flayyih, Ali and Mohammed, 2018).

Companies rely on the auditor's advice before making accounting decisions. This suggests auditors affect financial statements before they audit. Companies rely heavily on auditors when making accounting decisions or financial statements. A high level of reliance on the auditor means the auditor affects the financial statements (Baatwah, Salleh, and Ahmad, 2018).

Adenle, Anyanwu, Okafor, and Oyaleke (2022) say the goal of an audit is to obtain sufficient audit evidence to support the auditor's opinion. This means the auditing process ends with the auditor's signed audit report containing his or her opinion. In this report, auditors describe audit findings and give their opinion on the company's published financial statements. The importance investors place on these reports and their contents is questionable and needs more study. The demand for audit services is triggered by many factors, including the remoteness gap between financial statement users and preparers, user conflict of interest, complexity of economic transactions, and expected effect of financial statements on decision making. Also, financial performance in banks is affected by auditing and management factors.

The audit report is the medium of communication between the auditor and audit users, so it must be understandable, objective, and accepted as a relevant source of information. The quality and credibility of financial statements depend on audits (Siregar and Nuryanah, 2019). The audit quality of Nigerian banks should improve their financial performance. This is because banking industries that use a credible audit firm are expected to have reasonable financial efficiency. In light of this, this study examined the impact of audit quality on financial performance of banking industries in Nigeria.

3. RESEARCH QUESTIONS

The study was guided by the following research questions:

1. To what extent does audit firm size affect the financial performance of banking industries in Nigeria?
2. What is the effect of audit fees on the financial performance of banking industries in Nigeria?
3. What is the effect of audit report lag on the financial performance of banking industries in Nigeria?

4. RESEARCH HYPOTHESES

The following null hypotheses have been developed with the aim of achieving the research objectives:

- Ho1: Audit firm size does not have a significant impact on the financial performance of banking industries in Nigeria.
- Ho2: Audit fee does not have a significant impact on the financial performance of banking industries in Nigeria.
- Ho3: Audit report lag does not have a significant impact on the financial performance of banking industries in Nigeria.

5. CONCEPTUAL REVIEW

Audit Quality

Audit quality means recognizing misstatements and inaccuracies in financial statements (Alwardat, 2019). Audits verify that financial statements are honest and fair in all material respects. It followed GAAP. Quality is the obligation to make sound judgement. It implies ensuring the audit is conducted correctly. Audit quality relates to how auditors' independence, honesty, and objectivity affect financial statement quality (Baah and Fogarty, 2018). From the firm's standpoint, auditing is a continuous process that identifies issues affecting audit performance, analyzes conditions, formulates remedies, and monitors and improves performance.

Audit Firm Size

Audit firm size is operationally defined as a sampling bank's ability to hire any of Nigeria's Big 4 audit firms. KPMG, Ernst & Young, PWC, Akintola Williams, and Deloitte are Nigeria's Big 4 audit firms (Egbunike and Abiahu, 2017; Ismairat, Yusoff, Ali and Ghazalat, 2019). Some analysts feel the big four (KPMG, Ernst & Young, PWC, Akintola Williams, and Deloitte) have better access to advanced technologies and specialised employees than other firms. Larger firms do better audits, according to Oluyinka, Adeleke, and Deborah (2021). Larger organizations with more resources can recruit more skilled workers.

Audit firm size

Audit fees are agency fees for auditors who do audits. The audit price covers audit services, risk compensation, and profit demand. The audit fee effects audit quality, accounting firm growth, and the audit sector (Saddam, Mosab, Saleh, Jinyu and Ahmed, 2020). The amount of audit fees a customer pays its audit firm should reflect the degree of audit work performed. This level of work reflects the auditor's estimate of process complexity and risk. According to Adenle, Anyanwu, Okafor, and Oyaleke (2022), if an auditor wishes to decrease the risk of issuing a clean opinion when there are materially relevant distortions in the client's financial statements, he generally acts as the nature, extent, and timing of audit procedures, which influence the final amount of required fees.

Audit Report Lag

Audit report lag is the amount of days between a company's year-end and audit report date. An audit report is always a focus for audit firms, companies, regulators, and investors. Ibrahim, Mansor, and Ahmad (2020) say an annual report is a vehicle for discharging accountability and that audit delays increase with audit effort, decrease with incentives to give a timely report, and increase with a structured audit strategy. Alzoubi (2019) revealed that audit latency decreases financial reporting quality by not delivering timely information to investors.

Return On Assets (ROA)

ROA measures a company's profitability compared to its total assets. ROA shows how efficiently a company uses its assets to create earnings (Robin, Salim and Bloch, 2018). ROA shows investment earnings (assets). Public firms' ROA varies greatly by industry. When comparing ROA, it's ideal to use a company's past figures or a similar company's. ROA shows investors how well a company converts investments into net income. Higher ROA means the company earns more on less investment.

6. THEORETICAL FRAMEWORK

Agency Theory

Agency theory can be traced to Jensen and Meckling in 1976. Risk-sharing among individuals or groups was explored by Jensen and Meckling and it was discovered that risk-sharing problems usually arise as a result of the differential attitude of co-operating parties towards risk. The risk-sharing literature encompasses the agency problem that results when co-operating parties (individuals and or groups) have different objectives and attitudes to the division of labor (Jensen and Meckling, 1976). Eisenhardt (1989) further opined that agency theory was extended to the areas of management to determine how the objectives of individuals in an organization could be harmonized and used to achieve the corporate goals of the organization. Agency theory, therefore, involves the relationship or the interaction between the principal and the agent. The agency theory assumes that the principal and the agent are motivated by self-interest. Oluyinka, Adeleke and Deborah (2021) argue that agency theory also assumes that if the principal and the agents are mainly concerned about maximizing their wealth, agents are likely going to act their self-interest rather than the interest of the principal. In relation to the study, the agency theory is considered useful in explaining the effectiveness of corporate owners' strategy of using auditing as a means of reducing managerial excesses and waste of organizational resources.

Auditors Theory of Inspired Confidence

The auditors' theory of inspired confidence as developed by the Limperg Institute in the Netherlands in 1985 offers a linkage between the users' requirement for credible and reliable financial reports and the capacity of the audit processes to meet those needs. It sees through the development of these needs of the public (stakeholders) and the audit processes over time. The theory of inspired confidence states that the auditor, as a confidential agent, derives his broad function in society from the need for expert and independent examination as well as the need for an expert and independent judgment supported by the examinations. Thus, accountants and auditors are expected to know and realize that the public continues to expect a low rate of audit failures. This requires that the auditors must plan and perform their audit in a manner that will minimize the risk of undetected material misstatements. The accountant is under a duty to conduct his work in a manner that does not betray the confidence that he commands.

The basic assumption of the theory of inspired confidence is that the duties and responsibilities of the auditors are a derivation from the confidence that is bestowed by the public on the success of the audit process and the assurance that the opinion of the accountant conveys (Boskou, Kirkos and Spathis, 2019). Therefore, auditors are expected to maintain reasonable quality assurance especially given that an audit failure is effectively a career-ending event.

Empirical Review

Some scholars have investigated Nigeria's audit quality and financial performance with contradictory methods and findings. Hind, Dua, and Essia (2021) studied the effect of audit fees on audit quality in Nigeria using a sample of NSE listed cement businesses. The study compares audit fee, tenure, client size, leverage ratio, and audit quality. Analyzing the link between explanatory variables and the dependent variable used the Ordinary Least Squares Model. The study analyzed secondary data from 2010-2015 annual reports of chosen companies. Audit fee, audit tenure, client size, and leverage ratio demonstrate a shared significant connection with audit quality. Audit fee has a favorable impact on audit quality with at and p-values of (4.04 and 0.001) and a positive correlation coefficient of 0.7513. The study proposes that the government adopt comprehensive policies to improve Nigeria's audit quality.

Alam, Ramachandran, and Nahomy (2020) studied the impact of Board features, CEO authority, and legal supervising on EM in conventional and Islamic banks. Study results are important in deciding that 'Islamic' shouldn't be utilized for business. Promoting a value-based business can guarantee reliability and property. Ogbodo and Akabuogu (2018) studied the impact of audit quality on Nigerian banks' financial performance. The study studied the effect of audit firm size on Nigerian banks' return on assets, audit committee independence on return on equity, and audit committee effect on profit margin. This study had three research topics and hypotheses. The survey includes 16 Nigerian Deposit Money Banks. The study used data from 2008 to 2017 bank financial statements and a regression tool in SPSS Version 20. The study concluded that business size affects listed Nigerian banks' return on assets and audit committee independence affects return on equity. The study recommended that organizations select audit firms with undeniable audit quality and reputation; however, the argument on audit quality is not decided.

Ibrahim, Mansor, and Ahmad (2020) examined the link between company audited accounts and actual financial gain management of Nigerian listed non-financial firms. The survey shows that internal audit mediates between audited accounts and revenue management. The analysis showed audit fees and complete auditors improve financial gain, while a shorter audit tenure prevents profit manipulation. The survey results also showed that non-financial firms listed in Africa that are small and have low financial gain must place a lot of emphasis on the independence of their audit committee. Flayyih, Ali, and Mohammed (2018) studied the effects of the board of directors, audit committee, and concentration on company results. They also analyzed the importance of audit quality in bank governance and revenue management in the Iraqi securities market. The audit affects five aspects under firm governance in earnings management, according to the conclusions.

Gap in knowledge

Over time, it was ascertained that this research on impact of audit quality on financial performance of banking industries in Nigeria has only been done by a few authors who focused on manufacturing firms, other writers focused on insurance companies. This study will bridge the gap and also extend the time frame to a current year in a bid to unfold the contradicting findings that existed over time.

7. METHODOLOGY

Research Design

The study's research design is ex-post facto. The researcher chose this design because she does not want to modify or control the variables. Secondary data were used. The statistics were gathered from the individual consolidated annual reports of ten (10) selected Nigerian banks: Unity Bank, Zenith Bank, Fidelity Bank, FCMB, Sterling Bank, Eco Bank, Wema Bank First Bank, Guaranty Trust Bank and United Bank of Africa. These banking industries were chosen based on their financial performance and the availability of financial statements.

Methods of Data Analysis

The Ordinary Least Squares (OLS) multiple regression was employed to evaluate panel data since it is the Best Linear Unbiased Estimator (BLUE) for estimating this type of model.

Model Specification

The regression model is as specified by Frances Galton (1974) thus;

$$y = a + x + e \dots (1)$$

Therefore, rewriting the model in line with equation 1 above, the study has that:

$$ROA = f(AFS, AF, ARL) \dots (2)$$

Where; ROA = Return on Asset;

AFS = Audit Firm Size;

AF = Audit Fee;

ARL = Audit Report Lag

To empirically examine the impact of audit quality on financial performance, the study hypothesized that financial performance proxy as Return on Assets (ROA) depends behaviorally on the various audit quality constructs. Thus, such behavioural influence was given as;

$$ROAt = a + b1 AFS_t + b2 AF_t + b3 ARL_t + et \dots (3)$$

In a bid to control all the variable values in the equation (3), we rewrite equation (3) as; $ROAt = a + b1AFSt + b2AFt + b3ARLt + b4MIS_t + et \dots (4)$

Where; a = Constant parameter; b1 to b4 = parameters to be estimated; t = periods 2004 - through 2019; et = error term.

8. RESULTS AND INTERPRETATIONS

Table 1: Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std. Deviation
ROA	-.4500	.0800	.012125	.0427128
AFS	.0000	1.0000	.930818	.2545658
AF	6.7767	8.7709	8.010446	.4362706
ARL	1.1139	2.7612	1.916505	.2649579

Source: Author's Computation, 2022

Table 1 illustrates the mean return on assets (ROA), audit firm size (AFS), audit fee (AF), and audit report lag (ARL) of banking industries in Nigeria. The table above illustrates the series' standard deviation. Return on assets (ROA), audit firm size (AFS), audit fee (AF), and audit report lag (ARL) for Nigerian banking industries are .0427128, .2545658, .4362706, and .2649579, respectively. The minimum return on asset (ROA), audit firm size (AFS), audit fee (AF), and audit report lag (ARL) of banking industries in Nigeria are -.4500, .0000, 6.7767, and 1.1139, while the maximum values are .0800, 1.0000, 8.7709, and 2.7612.

Table 2: Empirical Result of Ordinary Least Square Method

Variables	Coefficient	Std. Error	t-stat.	Sig. Value
(Constant)	-.004	.078	-.048	.962
AFS	.025	.013	1.982	.049
AF	.012	.009	1.304	.194
ARL	-.056	.012	-4.574	.000

Source: SPSS version 24.0

Table 2 displays independent variable OLSR coefficients. The results showed that the p values of audit firm size and audit fee coefficients are statistically significant at a 5 percent level of significance, except for the auditor's fee, which is not. This means that a 1% increase in audit firm size and auditor's fee will boost return on asset (ROA) of banking industries in Nigeria by 2.5% and 1.2% correspondingly over time. Table 2 shows that the p values of audit report lag coefficients are negative and significant at the 5% level. This shows that a 1% increase in the number of days an audit firm takes to submit their audit report after the end of the accounting year will result in a 5.6% fall in return on asset (ROA) of banking industries in Nigeria over time.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.388a	.150	.128	.0400044	.150	6.805	4	154	.000

Table 3 shows that the adjusted coefficient of determination (R²) offers a better explanation of ROA variations. The value of 12.8% shows that the explanatory variables (AFS, AF, ARL, and TA) can jointly explain about 13% of the ROA variation, while other variables not captured in the model account for the rest. The F-statistics p-value 0.001 suggests the model is well-fitted, constructed, and integrated. OLS confirms this, as the likelihood value is 0.01 percent. The analysis contradicts the null hypothesis and concludes that audit firm quality influences Nigerian bank ROA.

9. CONCLUSION

This study aimed to prove the importance of audit firm quality as a predictor of bank ROA in Nigeria. This study tested hypotheses based on reviewed literature. Statistically, audit firm size and audit fee are positively related to Nigerian banking industries' return on assets. The statistics showed that audit report latency affects Nigerian banks' return on assets. This study gives empirical evidence for the literature-hypothesized link. The study concludes that audit firm quality affects bank ROA in Nigeria.

10. RECOMMENDATIONS

The study's findings suggest the following:

1. There is a need to continue to engage audit firms within the big 4 auditing firms in Nigeria to continue to influence the return on assets of banking Nigeria significantly and positively;
2. There is a need for banking Industries in Nigeria to improve the fees that accrue to auditors to continue the positive effect it has on their ROA;
3. There should be an effective and prompt submission of signed audited annual reports, i.e. there should not be more than 31 days delay in submitting audit report.

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