

AUDIT QUALITY VARIABLES AND EARNINGS RESPONSE COEFFICIENTS OF DEPOSIT MONEY BANKS IN NIGERIA.

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Oladejo, Morufu. O¹ Yinus S.O² Bello Wasiru³ & Tajudeen Sanni⁴

^{*1,2,3} Department of Management and Accounting, Faculty of Management Sciences Ladoké Akintola University of Technology, Ogbomoso, Oyo State, Nigeria

^{*2, 4} Kampala International University, Kampala, Uganda.

**E-mail of Correspondence Author: Mooladejo@lautech.edu.ng*

Abstract

A quality audit serves as a means to uncover errors, spurious, and manipulations, a signal of the credibility of corporate financial statements. Reports of systemic failure and conflicting findings by scholars on the financial health of Nigerian Deposit Money Banks (DMB) raised some queries on its audit report. This study examined the effects of Audit Quality Variables (AQV) on Earning Response coefficient (ERC) of Quoted Deposit Money Banks in Nigeria. Secondary data were used as obtained from the financial report of selected banks purposively. Representative variables employed for Audit Quality in the study are Audit Firm Size (AUDS), Auditors Independence (AUDIN), and Non-Audit Services (NAS) with ERC measure using Unexpected Earnings (UE). Mean Ranking Analysis was used to evaluate determinants of Audit Quality of DMB and Ordinary Least Square Regression was used to evaluate the influence of Audit Quality on Earnings Response Coefficient of DMBs in Nigeria at 0.05 level of significance. Findings revealed that AUDS (0.667), AUDN (10.2), and NAS (2.5) constitute the major determinants of audit quality variables of DMB. Result of analysis ($t = 1.30, p = 0.003$; $t = 1.21, p = 0.004$; and $t = 1.95, p = 0.001$) further showed that all identified audit quality variables such as AUDS, AUDIN, and NAS had a positive significant influence on ERC. The study, therefore, recommended that DMBs in Nigeria should employ the services of big audit firms whose policy considers audit quality variables to improve audit quality practice that will pave way for greater earnings quality and lower earnings management.

Keywords: Audit Quality, Audit Quality Variables, Earning Response Coefficient, Quoted Deposit Money Bank, Nigeria.

1.1 INTRODUCTION

There is an evidence of works on audit quality attributes mostly in the developed world but very few exist in developing economy especially on audit quality relationship with earnings response coefficient (ERC). For instance Francis, (2004) is of the belief that higher audit quality can be easier achieved by the larger audit firm. This is corroborated by Ilaboya, James and Friday (2014) that found audit firm size of impact on audit quality, Differences in audit quality as submitted by Okolie, (2014) result in disparity in the credibility of auditors and the reliability of earnings reports of firms. Thus, the recent corporate financial scandals pose a great challenge to the veracity, credibility, utility or value relevance of the audit function. According to Hussein and Hanefah, (2013) the existence of the auditor-related specifications such as professional competence, technical ability, auditor's liability as well as auditor independence will bring higher audit quality in large audit firms. The purpose of an audit activity needs sufficient competent evidences so that it can run successfully (Eko, 2012). However the recent corporate scandals have put in doubt the quality of reported earnings and the ability of audit quality (AQ) to successfully constrain earnings misstatements by companies across the world and Nigeria in particular as observed by Okolie, (2014).

According to Olabisi, Agbatogun and Akinrinlola (2017), the incessant failure of Nigerian deposit money banks has raised queries on audit quality in the Nigerian banking sector. In addition, Aliyu, Musa and Zachariah (2015), observed that high quality audit is the one that is capable of uncovering material errors and misstatements in the financial statement and that consistent defaults and failures and unwanted mergers and takeovers in the Nigerian banking sector recently questioned the quality of audit in the banking sector. Okolie, and Agboma (2008) observed that corporate scandals include the cases of Cadbury Nigeria Plc and African Petroleum (AP) and more recently Intercontinental Bank Plc., Bank PHB; Oceanic Bank Plc. and AfriBank Plc. These according to Okolie (2014) are known publicly reported cases that resulted in misleading financial reports. Studies of Abdelfatah (2015) and Aliyu et al (2015) showed that one of the major mechanisms put in place for control and assurances that the public funds are safe is financial statements audit.

Studies have shown that emerging markets seem to experience earnings fluctuations and market volatility and that there is a relative paucity of research on ERC determinants in emerging markets. Evidence from the available literature of accounting and value relevance suggest that the drivers of audit quality with influence on ERC are little known and the literature on the subject is not well developed. Existing literature shows that the size of audit fee is the most critical factor capable of eroding audit quality and auditor independence (Semiu and Johnson 2012). According to DeAngelo (1981) some of the attributes of audit that could affect the audit quality positively and increase the chances of discovering and reporting material intentional errors and misstatements in the financial statements include the size and experience of the auditor, auditor remuneration and

the joint audit services. It is further shown that in Nigeria researches on these factors in the banking sector are few thus making it imperative for the current study to provide empirical evidence on the effect of the determinant factors on audit quality of quoted Deposits Money Banks (DMBs) in Nigeria.

Studies on how audit quality influence earning management of (DMBs) in Nigeria cannot be adequate considering the sensitivity of the financial sub sector to the developing economy like Nigeria. The paper aims to evaluate the influence of Audit Quality Variables on Earnings Response Coefficient of Nigerian Deposits Money Banks (DMBs). The paper aims to examine the effects of Audit Quality Variables on Earnings Response Coefficient of Nigerian Deposits Money Banks (DMBs).

1.3 Research Hypotheses

H_0^1 : There are no significant differences in the effects of determinant factors on Audit Quality of DMBs

H_0^2 : Earning Response Coefficient is not significantly influenced by audit quality Variables.

2. Literature Review and Conceptual Explanation

2.1 Audit Quality (AQ)

Evidence from the literature traces the basic meaning of Audit Quality Variables (AQ) to the work of DeAngelo (1981). The import of DeAngelo (1981) definition is that AQ is a probability that an auditor will find and honestly report material mistakes, distortions, or exclusions in the customer's financial statements. Other researchers that have followed this attempt include Heras (2012) who portrayed audit quality as the probability of distinguishing audit disappointment, training auditors and boosting them to oblige administrative advantage, which is firmly identified with auditing benchmarks and Riley (2001) that viewed audit quality as multidimensional and characteristically imperceptible, and that there is no single auditor trademark that can be utilized as an intermediary for it. Without direct measures for quality, audit purchasers must survey the quality by utilizing surrogates, or the general notoriety of an auditor. As indicated by Stanley and Perelayefa, (2016), audit quality essentially underscores the degree to which the yield of the procedure serves the choice valuable capacity of the bookkeeping data framework

2.2 Determinants of Audit Quality

Several studies have been conducted on the drivers of audit quality both in the developed and developing world. This has become necessary and is expected to be continuous due to the sensitivity of audit requiring greater degree of ethical conduct and otherwise adequate regulatory attention. Studies like DeAngelo 1981; Dehkordi and Makarem 2011 found that audit firm size does not have significant influence on audit quality. For audit firm industry specialization and

audit quality linkage Balsam et.al 2003; and Krishna 2003; found significant positive relationship between audit quality and audit firm industry specialization. Knechel and Vanstraelen 2007; Hsieh 2011; Siregar, et.al 2012; found significant positive relationship between extended audit firm tenure whereas, Al-Thuneibat, et al. 2011; found significant negative relationship between extended audit tenure and audit quality. Moses, Ofurum and Egbe, (2016) found positive significant impact of audit committee characteristics on quality of financial reporting in listed Nigerian banks

Moreover like other developing economy, research conducted in Nigeria in the area of determinants of audit quality generally focused on the relationship between audit quality and audit firm-specific determinants. Even if client related factors specifically corporate governance attributes i.e. board leadership structure, and size of independent non-executive board members have significant effect on audit quality, it is less focused in Nigeria audit market as evidenced from the literature.

2.1.4 Earnings Response Coefficients (ERC) and its Measurements

The earnings response coefficient (ERC) has been described to be estimate of the change in a company's stock price due to the information provided in a company's earnings announcement. ERC is the effect of a dollar of unexpected earnings on stock returns and, in principle, can be measured as the slope coefficient in the regression of abnormal stock returns on unexpected earnings (e.g. Cho and Jung,1991). The ERC is therefore the estimated relationship between equity returns and the unexpected portion of a firm's earnings. Shangguan (2007) defines ERC as the measure of the extent to which stock prices react to earnings surprises. Therefore, the audit of a company's accounts according to Okolie (2014) signals the beginning of a process for earnings announcement. Collins and Kothari,(1989) described ERC as an estimate of the change in a company's stock price due to the information provided in a company's earnings announcement. Zakaria, (2012) observed that cross sectional variation in ERC has been the subject of extensive and rigorous research at least in developed economies. ERC is the impact of a dollar of surprising earnings on stock returns and, on a fundamental level, can be estimated as the incline coefficient in the regression of unusual stock returns on startling earnings (Okolie,, 2014;Pimentel, 2009; Chambers, Freeman and Koch 2005). The ERC is the assessed connection between equity returns and the startling bit of a company's earnings (Zakaria, 2012). Further, Shangguan (2007) characterizes ERC as the proportion of the degree to which stock prices respond to earnings shocks. Prior studies indicate that price is the appropriate scaling factor from the theoretical derivation of the ERC based on the dividend and earnings capitalization formulae as submitted by Okolie, 2014.

This study will anchor on agency and organisation theory because audit fills a crucial need in advancing certainty and strengthening trust in financial information and agency theory is based on the arrangement that specialists have more information than principals and that this information asymmetry unfavorably influences the principals' capacity to screen whether their interests are in effect appropriately served by the operators (Gerrit and Mohammad, 2007). Organization theory depends on this connection between speculators (principals) and managers (Agents). An organization is seen as a trap of agreements. A few gatherings (providers, bankers, clients, workers

and so forth.) make some sort of commitment to the organization at a given cost. The undertaking of the administration is to arrange these gatherings and contracts and attempt to upgrade them: low cost for obtained supplies, high cost for sold products, low financing costs for credits, high offer costs and low wages for representatives. In these connections, the executives is the specialist, which attempts to pick up commitments from principals who are bankers, investors, representatives.

3.0 Methodology

The study area covers all existing Quoted Deposit Money banks in Nigeria. This study focused on the identified Quoted banks through the floor of the Nigeria Stock Exchange. Fifteen (15) Deposit Money banks in Nigeria as of 2019 were quoted on the Nigeria stock exchange, out of which six (6) were purposively selected for the study for a period of 8 years from 2010-2017. These 6 banks are Access, Diamond, Fidelity, FBN, Eco bank, and Zenith bank. Lagos state was chosen based on the fact that all the banks established their head office in Lagos and the city is known to be at the forefront of economic and commercial activities. Data were extracted from annual reports and accounts of the selected banks. The secondary data may be referred to as any data obtained through documented information from journals, articles, or other forms of publications. The importance of the secondary data shows ways to find information for research but also aids in explaining and understanding the research problem (Ghauri and Grønhaug 2010). Data collected were analyzed using descriptive statistics like tables while the formulated hypotheses were tested through the use of Regression Analysis at 95% confidence level.

3.1 Model for the extent of influence of Audit Quality Variables (AQV) and ERC

This study adapts and modifies the model used by Teoh and Wong, (1993) used in Okolie, (2014) to measure influence of AQV on ERC. Linear regression analyses were used to test the relationship between the dependent variable (ERC) and the identified independent AQ measurement variables.

$$Y = \beta_0 + \beta_{x_1} + \beta_{x_2} + \beta_{x_3} + \beta_{x_4} + \varepsilon \dots\dots\dots$$

Where: ERC =Earning Response Coefficient, ERC = UE (Unexpected Earnings) = (EPS_{it} – EPS_{it,t-1}) x100MPS_{it}. EPS = Earnings per share and MPS = Market price of share.

AQV: Auds_{Si} Auditor Firm Size, Audini = Auditor independence, NAS_i = Non Audit Services,

4.0 RESULTS AND DISCUSSION

4.1 Data Presentation

As stated earlier, data for the study were gathered through the use of secondary. The research hypotheses for the study were tested at 95% confidence level (0.05). The results on objectives of the study were presented in table 4.1 to 4. 4.

4.2 Descriptive Statistics of Determinant Variables of Audit Quality used for the study

Table 4.1 shows that the mean value of Audit Size (Audsiz), Audit Independence (Audin), and Non Audit Services (NAS); 0.67, 10.26 and 2.5, respectively. A comparison of the mean of the variables with the maximum values for each of the variables indicated that all occur as a determinant factor of audit quality. Furthermore, the low value standard error (.47, 4.21 and 1.1) of all the identified variables also buttress that all the variables incorporated into the model form an attribute to audit quality.

Table: 4.1. Descriptive statistics of Determinant Variables of Audit Quality used for the study

Variables	N	Minimum	Maximum	Mean	Std.Deviation
AUDS	48	0	1	.6666667	.4763931
AUDIN	48	.17	23.5	10.25875	4.208508
NAS	48	1	4	2.5	1.129865

Source: Author's Computation (2020)

4.3 Assessment of relationship between Audit Quality Variables (AQV) and Earning Response Coefficient (ERC)

With a view to ascertain relationship between variables employed in the study, the study conducted correlation analysis. Pearson correlation was used to examine if there was any correlation or degree of association between Audit Quality Variables and Earning Response Coefficient (ERC). From the result presented in table 4.2 on assessment whether there is significant relationship between AQV and ERC was presented.

More so, the correlation coefficient between Earning Response Coefficient (ERC) and audit size is found to be positive (0.0611), implying direct relationship between the variables. ERC and audit independent is positive as expected (0.0230), implying that increase in audit independence will improved the audit quality in a firm. Furthermore, (ERC) and Non Audit Service are found to be positively correlated (0.1404), implying that there is degree of association between ERC and Non Audit services. Collectively the results ($r = 0.0611; 0.0230; 0.1404, P < 0.05$) revealed that there is degree of association between Audit Quality Variables and Earning Response Coefficient (ERC). Due to this results the null hypothesis earlier stated that there is no significant relationship between audit quality variables and earning response coefficient of DMBs is rejected while the alternative hypothesis is endorsed.

Table 4.2: Pearson Correlation Matrix

	ERC	AUDSIZ	AUDIN	NAS
ERC	1.0000			
AUDSIZ	0.0611	1.0000		
AUDIN	0.0230	0.0929	1.0000	
NAS	0.1404	0.0000	0.0774	1.0000

Source: Author's Computation (2020)

4.4 Effect of Audit Quality on Earning Response Coefficient (ERC)

To establish the extent of effect of audit quality on earning response coefficient, this study conducted regression analysis. Ordinary least square regression was used to examine the extent to which Audit Quality Variables influence Earning Response Coefficient (ERC). The analyses of result presented in table 4.3 indicated that audit quality is positively and significantly related to earning response coefficients at 0.003, 0.004 and 0.001 percent respectively.

The result indicates that Independent variables incorporated into this model have been able to revealed that Audit quality positively influence Earning Response Coefficient (ERC) with coefficient of determination (R^2) of 0.6600 (approximately 66%) and also supported by high value of Adjusted (R^2) significant at 0.6470 (approximately 65%). The F-Value (1.27) and P-Value (0.0004) also confirmed the significance of the model. Due to this result the null hypothesis earlier stated that Earning Response Coefficient is not significantly influenced by audit quality variables is rejected while the alternative hypothesis is endorsed.

Table 4.3: Influence of Audit Quality Variables on Earning Response Coefficient (ERC)
Variables: ERC, AUDSIZ, AUDIN, NAS

Variable	Coefficient	Standard Error	T-Test Values	Probability
C	41.94477	21.20071	1.53	0.002
AUDSIZ	7.281347	4.434892	1.30	0.003
AUDIN	.0611032	.626846	1.21	0.004
NAS	9.334131	9.203782	1.95	0.001

R-square= 0.6600, Adjusted R-square=0.6470, F-statistics=1.27, Prob(F-stat)=0.0004

Source: Author's Computation (2020)

5.0 Conclusion and Recommendation

The research generated important results showing the major determinant factor of audit quality like AUDSIZ, AUDIN and NAS. Furthermore, results from analysis showed that there is a significant relationship between Audit Quality Variables and Earning Response Coefficient (ERC) and that all the identified audit quality variables such as Audit size (AUDSIZ) Audit Independence (AUDIN) and Non audit services (NAS) are significant to audit quality and cause the quality of sampled banks to increase in the sampled periods and that Audit quality variables positively influence earning response coefficient of the sampled deposit money banks in Nigeria.

It therefore recommended that Deposit Money Banks in Nigeria should endeavor to employ the services of one of the big audit firms in order to improve audit quality, allows for greater earnings quality and lower earnings management.

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