International Journal of Social Sciences and Management Research E-ISSN 2545-5303 P-ISSN 2695-2203
Vol 10. No. 5 2024 www.iiardjournals.org Online Version

Effect of Audit Quality on Financial Performance of Deposit Money Banks in Nigeria

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DOI: 10.56201/ijssmr.v10.no5.2024.pg107.117

Abstract
This study examined the effect of audit quality on the financial performance of deposit money banks in Nigeria. The need for high quality audit has become a global concern following corporate scandals involving Enron; World Com; Global Crossing, and Cendant. Again, Nigeria has experienced some cases of failed banks such as: Savanna Bank, All states Trust Bank, Assurance Banks of Nigeria and City Express Bank. Following the use of secondary sources of data collection, the study adopted ex-post facto research design. The population of the study comprised all the listed deposit money banks on the Nigerian stock exchange while the sample size consisted of thirteen (13) deposit money banks based on judgmental selection method. The data for the study were sourced from the annual reports and consolidated financial statements of the selected deposit money banks. The order of integration found during unit root test justified the use of ordinary least squares (OLS) regression method for hypotheses testing using the statistical Package for social sciences (SPSS 20). The study revealed that audit fee has a positive and statistically insignificant effect on the net income of deposit money banks in Nigeria. Further findings reveal that audit fee has a statistically significant effect on both earnings per share and liquidity of deposit money banks in Nigeria. The study recommends that the banks should go beyond their external audit to strengthen the internal audit of the banks. This is imperative because reliance on external audit alone has not proven to influence the net income of the banks despite the fee paid get quality audit services; again, the banks should take note paying the right audit fee entrenching quality audit service. This is because the benefit of quality services results reflects in the confidence of investors and customers which spurs the liquidity base of the banks and as a result increases the net income and earnings on shares invested.

Keywords: *Audit Fee, Net Income, Earnings Per share, Liquidity, Deposit money banks, Financial performance.*

Introduction

Audit quality is the basis of an efficient and effective financial reporting system. An external audit provides investors with confidence in the quality of financial statements and increases confidence in corporate reporting. The objective of an external audit is to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether due to fraud or error, and to enable the auditors to express an opinion on whether the financial statements have been prepared, in all material respects, in accordance with applicable framework of financial reporting, reports and communicates the auditor's findings in accordance with generally accepted accounting practice and standards. Kiabel (2016) emphasized that an independent auditor has a duty to report to shareholders and other users of financial statements that the accounts they have audited are true and fair or not. Okoli (2014) stated that investors and other stakeholders or users rely on audited financial statements to determine the firm value and financial performance of banks. External or independent auditors are expected to follow the relevant and procedures in auditing the financial statements of banks. The recent increase in corporate failures has necessitated an emphasis on audit quality. Audit quality increases investor confidence in audited reports and leads to improved firm value.

Skinner and Snnivasan (2012) noted that audit quality is a central component that improves market value. The quality of the audit provides a guarantee of the trustworthiness of the information presented in the financial statements. Ajekwe and Ibiamke (2017) argue that audit quality is critical for banks to achieve efficient and effective resource management as it can lead to rapid improvement in firm value. The function of external audit is reflected in the quality of the financial report or information that banks maintain to create trust among stakeholders and reflect the effectiveness and credibility of audit firms (Kwabena, 2017). Financial statement users and investors need reliable financial information for investment decision purposes. When an investor has confidence and trust in the audited financial statements of banks, it encourages investors to invest more in banks and believe that their investment is safe and secure, which in turn leads to an increase in the market value of banks. Miettinen (2011) stated that audit quality is of interest to users of internal financial reports, such as management, shareholders, audit committees and boards of directors, because they believe it helps reduce the cost of capital and leads to improved market value of banks. Audit services have been essential to the quality of financial reporting and firm value since the Industrial Revolution (Hassan & Farouk, 2014).

Banks and other financial intermediaries are at the center of recent global financial crises. The decline in the value of their asset portfolio, along with the fraudulent submission of fictitious financial statements and non-compliance with corporate governance principles, particularly as a result of distorted credit management, were some of the main structural sources of the crisis (Sanusi, 2010). The contested role of auditors in enhancing the quality, reliability and credibility of financial performance and financial performance has been controversial. This is because the auditor's independence from their clients can be impaired by, among other things, poor regulation and oversight of the auditing practice, the provision of non-audit services to the client, the auditor's personal interest in the client's business. Basically, the quality of reported earnings and the ability of audit quality to effectively limit earnings distortion and financial statement manipulation of the financial performance of firms worldwide and particularly in Nigeria have become highly controversial due to recent corporate accounting scandals (Badawi, 2008; Enofe, 2010).

The need for high-quality external auditing has become a global concern following the corporate scandals involving Enron; World Com; Global Crossing and Cendant. There are some cases of failed banks in Nigeria such as: Savanna Bank, All States Trust Bank, Assurance Banks of Nigeria and City Express Bank. The ongoing failures of banks and firms around the world have raised some fundamental questions about audit quality, the independence of external auditors and more. Bad audit reports from banks and companies have made attracting quality and sustainable foreign investment in Nigeria elusive. Studies have shown that the confidence of users of financial statements is increasingly eroded by the poor quality of audit reports presented in financial statements issued in Nigeria (Enekwe, Onyekwelu, Nwoha, & Okwo 2016). Following the deficiencies identified, this study was conducted to investigate the effect of audit quality on the financial performance of depository money banks in Nigeria.

Literature Review

The concept of audit and audit quality has generated different opinions among researchers and academics over the years. However, DeAngelo (1981) defined audit quality as the market's collective assessment of the likelihood that a given auditor would detect a breach in the clients' accounting system and report the breach. This definition includes two aspects of audit quality, auditors' ability to detect misstatements and independence in reporting such misstatements. The quality of a firm's audit ultimately depends on the integrity, objectivity, intelligence, competence, experience and motivation of the personnel who perform, supervise and review the work. DeAngelo's definition of audit quality links audit quality one-to-one with financial reporting quality. Financial reports where all accounting violations have been detected and reported by the auditor represent high quality. The degree of assurance that no material error will go undetected and unreported is a measure of audit quality.

Audit quality can be viewed as the likelihood that auditors will detect and report misstatements in the company's financial statements, audit quality can be viewed as the accuracy of information provided by auditors to investors and the ability to judge, freedom of judgment, the correct development of judgment of competence and independence of auditors at the level of assurance achieved . Fasua and Osifo (2020) stated that a high quality audit is conducted in accordance with generally accepted auditing standard to provide reasonable assurance that the audited financial statements and related information are presented in accordance with generally accepted accounting principles and are not materially misstated, whether due to errors or fraud.

Aliyu, Musa and Zachariah (2016) stated that external audit is a corporate governance mechanism that reduces information mismatch and protects the interests of investors, users and stakeholders. A high quality audit report means a lower risk of impropriety, thereby increasing confidence in the capital market, which in turn leads to lower costs of capital and improved financial performance. Audit quality encourages banks to maintain and adopt high quality accounting standards to ensure that their financial reports are credible and reliable. Barzegarnezhad (2017). stated that audit quality promotes sound corporate governance, sound accounting practices, effective financial management and reduces debt service interest, leading to improved market value of banks.

Okolie and Izedonmi (2014) suggested that high audit quality of audited reports is considered essential to the functioning of banks because continuous opinion on bank financial statements increases the value of banks. Olabisi, Agbatogun and Akinriola (2007) stated that high trust, confidence and credibility through quality audit in the business environment of banks solves the problem of information asymmetry between management and users of financial reports. It turns out that the price of a bank's market share represents the value of its future earnings. This is why bank investors show a high interest in reported bank earnings. Healy and Wahleh (1999) reported that bank management adopts various earnings management strategies to deliberately manipulate banks' target earnings to achieve a high stock price or value. Earnings management can weaken the credibility of financial reporting. Adeyemi and Fagbemi (2010) argued that the essential function of an external auditor is to lend credibility to financial reports and reduce the information risk that financial reports are biased, misleading, macerating, incomplete and some material misstatements that have not been prevented from being discovered.

Kilgore, Radich, and Horrison (2011) reported that according to agency theory, audit fees are an agency cost for principals. The essence of the agency theory is that the principal, shareholders employ the auditor as an executive for an annual fee to protect his interest. These core interests drive the demand for audit services, which explains the demand for audit services and the pricing of audit fees. Sumunic (1980) argued that audit fees are determined based on the cost structure, the amount of resources used by the auditor in performing the audit, and the external audit unit cost to the auditor and all opportunity costs. The audit fee is considered a key factor in the independence and quality of the audit.

Audit fees can be defined as the amount charged to the client for the performance of specific services by the accountant. Fees may vary by size or by type of service provided, but researchers have often questioned whether this affects audit quality. The amount of the audit fee may vary depending on the risk of the engagement, the complexity of the service, the level of expertise required, the cost structure of the public accounting firm, and other professional considerations (Rahmina & Agoes, 2014). Audit fees can be explained as the amount charged by the auditor for the audit performed. This means the amount charged by the auditor for any work done to form an opinion on the true and fair state of affairs or position of the client's business. Suharli and Nurlaelah (2008) described an audit fee as a fee charged to a public accounting client for financial audit services. Yuniarti (2011) that the audit fee is the fee paid for the annual audits and revisions of the financial statements for the last fiscal year. The amount of the audit fee may vary depending on the complexity of the services, the risk of the assignment; the cost structure of the Public Accountants Firm, the level of expertise required and other professional considerations.

Financial performance

According to traditional valuation theory based on economic theory, the value of earnings per share is equal to the present value of future net dividends, which is a measure of how well a firm has performed financially. The trade-off between the principles of relevance and reliability is also likely to affect the financial performance of accounting information. For example, the historical cost basis of accounting is fairly reliable, but historical costs may not be relevant (Tambun, Manurung & Murwaningsari 2018). Abandoning the principle of revenue accounting could increase the relevance of accounting information, but would certainly lead to a decrease in reliability. Similarly, measuring returns based on fair values of assets may increase the relevance of accounting information, but may lead to reduced reliability. The reliability principle is one of the main reasons why financial statements lack forward-looking information that affects market values (Sharma, 2011). This is why authors such as Chinedu and Chidoziem (2017) relied on net income as a measure of firm financial performance to obtain information about firm performance without forecast bias.

But Ugwunta and Ugwuany (2018) argued that financial performance and quality of accounting information is determined by how well it meets the needs of users and that the study of financial performance is an assessment of the relationship between accounting information and capital market values. The financial performance of accounting information is related to when accounting information can correctly predict changes in liquidity, stock prices and their returns, i.e. value-relevant information allows investors to make informed decisions. The degree of financial performance is a function of the development of accounting regulation, control mechanisms, the business cycle, internationalization and economic development, and the structure of the industry, which displays accounting data about the market and information that helps investors make reliable investment decisions.

This study was based on the agency theory presented by Jensen and Meckling in 1976. The theory stated that there is a relationship between a principal and an agent (eg an owner) employs another person as an agent (or steward) to perform a service on their behalf. . The performance of this service has the effect of delegating certain decision-making authority to the agent. This delegation of responsibility by the director and the resulting division of labor are useful in promoting an efficient and productive economy. However, such delegation also means that the principal must trust the agent to act in the best interests of the principal.

Estitemi and Omwenga (2016) stated that since principals do not have access to all available information at the time the agent makes a decision, principals are unable to determine whether the decision made by the agent is favorable or unfavorable to the interest. companies. To avoid moral hazard, the principals decide to implement a monitoring process such as an audit to control the agent's actions in making some decisions for the firm. They describe an audit as the cost of a bond paid by an agent to a third party to satisfy the principals' demand for accountability. All other costs incurred in running the business are borne by the principals to protect their economic interests.

Eneisik and Akani (2021) investigated the relationship between audit quality and market value of listed banks in Nigeria. They compared audit quality with audit fees, audit duration and audit firm size. Their study hypotheses were tested using panel least squares regression through pooled effect, fixed effect and random effect determined by Hausman test, fixed effect was accepted. The findings show that audit fees have a negative and insignificant impact on the market price per share. Empirical evidence suggests that audit duration had a negative and significant impact on the market price per share. Empirical evidence suggests that audit firm size had a negative and insignificant effect on the market price per share.

Other empirical studies linking audit quality and audited financial performance have mixed conclusions. For example; Chinedu and Chidozie (2017); Motoke and Omwenga (2016); Ogbodo (2017) reported a positive relationship between audit quality and financial performance of manufacturing firms. However, a study by Chikwemma and Nwadialora (2019); Isah and

Muhammed (2019) on audit quality and financial performance of manufacturing firms reported a mixed result of significant and no significant relationship between audit quality and financial performance of manufacturing firms. Empirical evidence suggests that much of the studies on audit quality and financial performance and audit quality and firm value are conducted in developed countries such as Monametsi and Agasha (2020); Wijaya (2019); Ani and Mohammed (2015). Empirical evidence suggests that few studies have been conducted on audit quality and financial performance of depository banks in Nigeria. The present study is focused on deposit money banks in Nigeria.

Methodology

The study adopts *ex-post facto* design because secondary sources of data were explored. While all the deposit money banks listed on Nigeria stock exchange as at January, 2022 were used as the population of the study, judgmental non-probability method of sample size determination was used. In view of this, thirteen (13) deposit money banks listed on the floor of Nigeria Stock Exchange were selected. The 13 listed deposit money banks represented the sample size for this study, for a five (5) years period spanning from 2016-2020. Amongst the listed banks, only Jaiz bank is not included because the bank has no up to date data on the required variables due to its listing year on the Nigerian Exchange group.

Model Specification

Using simple regression analysis, the model is specified as follows

NI = ∫ (AF)…….. Model 1

EP = ∫ (AF)…….. Model 2

LQ = ∫ (AF)…….. Model 3

Then the econometric function of the above

$NI = \beta_0 + \beta_1 AF_{it} + e$……. Model 4

$EP = \beta_0 + \beta_1 AF_{it} + e$……. Model 5

$LQ = \beta_0 + \beta_1 AF_{it} + e$……. Model 6

Where; AF = audit fee (Log of audit fee paid); NI = Net income (Log of net income of the banks at a time); LQ= Liquidity (Net cashflow from operation); EP = Earnings per share (Log of reported earnings per share); β_0 =Intercept term; β_1 =Slope co efficient e = error term.

Decision rule: Accept the null hypothesis if the calculated significance level is greater than 0.05

Data analysis and discussion of results

The data used in this study is placed in appendix II at the end of the study where it can be assessed. This is due to the large volume of the data.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
AF	65	7.26	8.78	8.1770	0.45268
NI	65	6.34	8.77	7.1628	0.73090
EPS	65	.06	8.60	2.0143	2.07840
LQ	65	5.00	10.87	0.18752	1.51187

Valid N (listwise)	65

Source: SPSS Version 21 Output appendix ii

The table above presents the descriptive statistics of all the variables. N represents the number of observations and therefore the number of observation for the study is 65.

The result revealed the value of 8.1770 and 0.45268 as mean and standard deviation values for Audit Fee (AF). It also revealed a minimum and maximum value of 7.26 and 8.78 respectively for AF. The standard deviation of audit fee paid across the DMB is low compared to the mean. This depicts a uniform audit fee paid by the banks which means there is a standard audit fee paid by the banks thus entrenches an independent high quality audit service.

For net income (NI) the minimum value is 6.34 while the reported maximum value is 8.77. Also, the mean value recorded is 7.1628 with a standard deviation is 0.73090. The financial performance measured by the reported earnings per share (EP) has a mean of 2.0143 with a deviation of 2.07840. The EP also revealed a minimum and maximum value of 0.06 and 8.60. Finally, liquidity (LQ) reveal that the minimum value is 5.00 while the reported maximum value is 10.87. Again the mean value recorded is 0.18752 with a standard deviation is 1.51187.

Table 2: Regression of the Estimated Model Summary

Stat.	**Model 1 (NI)**	**Model 2 (EP)**	**Model 3 (LQ)**
R Value	0.114	0.443	0.380
R^2	0.013	0.197	0.144
R Adj.	**-0.003**	**0.184**	**0.131**
F Change	0.823	15.417	10.637
F. Sig (Prob)	0.368	0.000	0.002
Coef.	**0.114**	**0.443**	**0.380**
DW	0.256	0.668	0.505
Const.	5.664	-14.632	18.449

Source: SPSS Version 21 Output appendix ii

The table above presents the regression result between audit fee, net income, earnings per share and liquidity. From the model (s) summary table above, the following information can be distilled. The R value (s) of 0.114, 0.443 & 0.380 shows that, there is a weak relationship between AF and financial performance (NI, EP & LQ) at 11.4%, 44.3% and 38% respectively. Also the R^2 stood at 0.013, 0.197 & 0.144. The R^2 otherwise known as the coefficient of determination shows the percentage of the total variation of the financial performance (NI, EP & LQ) that can be explained by audit fee. Thus the R^2 value (s) indicates that 1.3%, 19.7% and 14.4% of variation in the financial performance (NI, EP & LQ) of DMBs can be explained by a variation in audit quality (Audit fee) while the remaining 98.7%, 80.3% and 85.6% (i.e. 100-R^2) could be accounted by other variables not included in this model.

The adjusted R^2 of -0.003, 0.184, and 0.131 indicates that if the model (s) is adjusted and other factors considered for this study, this result will deviate from it by only 0.016, 0.013, and 0.013 (i.e. R square – Adjusted R). This means there will be a deviation from the current result by 1.6%, 1.3% and 1.3% for the three models respectively. This deviation is not too high above the error term of 5% to say that the result of this study does not reflect the true nature of the effect of audit quality on financial performance of deposit money banks in Nigeria.

The table further shows the Fisher significant value of 0.368, 0.000, and 0.002 with a variation of change at 0.823, 15.417 and 10.637 units for each model (NI, EP & LQ) which indicates that the set of independent variable is as a whole contributing to the variance in the dependent variables. Thus, the NI model is statistically insignificant while both the EP and LQ model are statistically significant.

Furthermore, the regression result as presented in table 4.2 above to determine the relationship between AF and financial performance (NI, EP & LQ) shows that when the audit fee is held stationary; the NI, EP and LQ variable(s) is estimated at 5.664, -14.632 and 18.449. This simply implies that given intercept only model, there will be a 5.664, -14.632 and 18.449 unit increase/decrease in the financial performance (NI, EP & LQ*)* of listed deposit money banks occasioned by factors not considered. Adjustment for audit fee, will lead to increase in NI, EP and LQ by 11.4%, 44.3% and 38%.

Discussion of finding

Given that the accepted significant level is 0.05 and the calculated value for audit fee (0.368) is greater than the significant level, the study therefore accepts the Null hypothesis and reject the alternative thus; audit fee has no significant effect on net income of deposit money banks in Nigeria.

Given that the accepted significant level is 0.05 and the calculated value for audit fee (0.000) is less than the significant level, the study therefore rejects the Null hypothesis and accepts the alternative thus; audit fee has a significant effect on net income of deposit money banks in Nigeria.

Given that the accepted significant level is 0.05 and the calculated value for audit fee (0.002) is less than the significant level, the study therefore rejects the Null hypothesis and accepts the alternative thus; audit fee has a significant effect on liquidity of deposit money banks in Nigeria.

Conclusion and recommendations

Following the test hypotheses, the study found that:

i. Audit fee has a positive relationship with net profit of listed deposit money banks in Nigeria. But audit fee has no significant effect on net profit of listed deposit money banks in Nigeria.
ii. Audit fee has a positive relationship with earnings per share of listed deposit money banks in Nigeria. But audit fee has a significant effect on earnings per share of listed deposit money banks in Nigeria.
iii. Audit fee has a positive relationship with liquidity of listed deposit money banks in Nigeria. But audit fee has a significant effect on liquidity of listed deposit money banks in Nigeria.

Based on the findings of this study from the test of the three research hypotheses earlier formulated in the study, the study concludes that: audit fee has a positive insignificant effect on net income of deposit money banks in Nigeria. Audit fee has a positive significant on earnings per share of deposit money banks in Nigeria while audit fee has a positive significant effect on liquidity of deposit money banks in Nigeria. The study therefore recommends that the banks should go beyond their external audit to strengthen the internal audit of the banks. This is imperative because reliance on external audit alone has not proven to influence the net income of the banks despite the fee paid get quality audit services; again, the banks should take note paying the right audit fee entrenching quality audit service. This is because the benefit of quality services results reflects in the confidence of investors and customers which spurs the liquidity base of the banks and as a result increases the net income and earnings on shares invested.

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