# EFEECT OF AUDIT CHARACTERISTICS ON FINANCIAL REPORTING QUALITY OF BANKS IN NIGERIA

**BY**

**SOLANKE MOYOSORE**

**Matric No: 15020101033**

**A PROJECT REPORT SUBMITTED TO THE DEPARTMENT OF ACCOUNTING AND FINANCE, COLLEGE OF HUMANITIES, MANAGEMENT AND SOCIAL SCIENCES, MOUNTAIN TOP UNIVERSITY, OGUN STATE, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE BACHELOR DEGREE (B.Sc.) IN ACCOUNTING.**

**JULY, 2019**

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## CERTIFICATION

This is to certify that this research project report titled **"EFFECT OF AUDIT CHARACTERISTICS ON FINANCIAL REPORTING QUALITY OF BANKS IN NIGERIA"** was carried out by **SOLANKE MOYOSORE**, with matriculation number 15020101033. This project report meets the requirements governing the award of Bachelor of Science (B.Sc.) Degree in Accounting, Department of Accounting and Finance of the Mountain Top University, Ogun State, Nigeria and is approved for its contribution to knowledge and literary presentation.

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**(Head of Department)**

# DEDICATION

I dedicate to Almighty God for given me life, time, opportunities and sustaining me throughout my period of my studies.

## ACKNOWLEDGEMENTS

For Him alone deserve to be praised for the gift of life and for how far He has brought me, am really grateful to God Almighty, without whose grace and mercy has been sufficient for me. This research work would not have been completed without the support of others, I wish to show gratitude to those whose efforts and constructive criticisms have enriched the work in many ways.

I owe a special debt of gratitude to my supervisor, Mr. Taleatu Taofeek whose excellent guidance has enabled me produce this work. May the good Lord bless you abundantly for the excellent counsel you accorded me in the course of this research.

To my parents and siblings for the support both financially and morally, your efforts and inputs though unquantifiable, I will forever be indebted for your courage, mentorship, understanding, motivation and guidance and love.

I want to say a very big thank to the Head of Accounting Department Dr. Akinyomi, O.A and other lecturers in accounting & finance department for their constructive criticisms and suggestions so also to all the Lecturers of the Accounting Department for their inputs in this work. I want to appreciate all my classmates who at one time or the other helped who has helped me to put this work together appropriately.

Finally I want to appreciate the chaplaincy unit of mountain top university for their ultimate support and unending prayers. May God continue to bless you.

# ABSRACT

The effect of audit characteristics on financial reporting quality of deposit money banks was investigated in this study. This study aims to assess whether the published annual financial statements of Nigerian banks pass the required quality as to guide users in their decision making. For the purpose of this study, secondary data was explored, while the sources of the data include the financial statements (statement of comprehensive income, statement of financial position, statement of cash flows and non-financial information) of the sampled deposit money banks for the period 2012 to 2018. This study adopts correlational research design to investigate the relationships as well as the effects of the audit firm characteristics on the financial reporting quality of banks in Nigeria. The finding from this study reveals that audit firm size has significant positive effect on financial reporting quality of banks in Nigeria. Further result from this study indicates that audit fee has significant effect on financial reporting quality of banks in Nigeria. Another outcome of this study is that joint audit has no significant effect on financial reporting quality of banks in Nigeria. Hence, the study concluded that audit firm size, audit fees and joint audit have significant effects on financial reporting quality of deposit money banks sampled for this study. The study recommended Shareholders of deposit money banks in Nigeria should ensure that big size audit firms like the "big four" is the leading auditor of their banks to guarantee higher financial reporting quality. The study recommends further. The directors of deposit money banks in Nigeria should maintain the service of their auditor regardless of the magnitude of audit fee to guarantee higher audit quality that can translate to higher financial reporting quality.

**Keywords: Audit Firm Size, Audit Fees, Joint Audit, Financial Reporting Quality.**

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# CHAPTER ONE

# INTRODUCTION

## 1.1 Background to the Study

The quality of financial reporting is important for the efficient allocation of resources in the capital market. Published financial report of banks is expected to provide reliable data to various stakeholders, shareholders, stock brokers, creditors, management, employees and potential investors which will assist them in making effective and efficient decisions. The main objective of financial reporting is to provide high quality financial information about economic entities that is useful for economic decision making. The primary objective of financial reporting is to provide high-quality financial reporting information concerning economic entities, primarily financial in nature, useful for economic decision-making (Seyad, 2014). Providing high quality financial reporting information is important because it will positively influence capital providers and other stakeholders in making investment, credit, and similar resource allocation decision enhancing overall market efficiency (IASB, 2008). Financial reporting in banks is essentially the responsibility of directors and this is carried out by accountants and verified by auditors. Financial statements should be capable of revealing relevant, reliable, comparable and comprehensive information and this primarily possible by the effective and efficient working of audit.

Financial reporting is the means of communicating information on the activities of the company to the users of accounting information; and the quality of financial reporting is a function of the quality of accounting standards and the corresponding regulatory enforcement of the standards (Adebiyi, 2017). For corporate information to beneficial, IASB argues that a key prerequisite quality in financial reporting is the adherence to the objective and the qualitative characteristics of

financial reporting information (Al-dmour, Abbod & Al-dmour, 2017). Qualitative characteristics are the attributes that make financial information useful and consist of relevance, faithful representation, comparability, verifiability, timeliness and understandability.

The issue of quality financial reports is of tremendous concerns not only for the final users, but the entire economy as it affects economic decisions which may have significant impact. Many accounting scandals and financial crises happened lately in numerous distinguished firms have undermined investors' trust concerning the financial reports and have introduced several criticisms about financial reporting quality (Akeju & Babatunde, 2017). Moreover, most of the Chief Executive Officers (CEO) and Managers of the collapsed entities are also found involved in earnings management through structuring and artificial transactions with related parties which affected earnings and financial reporting adversely (Shen & Hsiang-lin, 2007). The foregoing developments and the global financial and economic crunch have resulted in increased attention to improve and enforce financial reporting disclosures worldwide in order to reform the global economy. Nigeria is recently taking steps to align all corporate reports to the International Financial Reporting Standards (IFRSs) as a means of enhancing full disclosure and strengthening stakeholder confidence (Adeyemi & Asaolu, 2013). The main indicators of financial information quality from the perspective of the developers of accounting standards are relevance and reliability, which make information useful for decision makers (Nwaobia, Kwarbai & Ajibade, 2016).

In Nigeria major cases of financial and accounting scandal include the collapse of the banking sector with 26 banks liquidated in 1997 and the falsification of the company financial statements in Cadbury Nigeria Plc in 2006 (Olusa, 2007; Amao & Amaeshi, 2008) and the more recent post

consolidation banking crises of 2009 in Nigeria when 10 banks were declared insolvent and 8 executive management teams of the banks removed by the CBN. All of these events had their deep impacts on the psyche of stakeholders (loss of employment for thousands of employees and loss of value or total investment to shareholders and other creditors).

Companies have gone into liquidation for reasons bordering on ineffective or non-existing system of corporate governance. Examples are Onwuka Hitech, Abacus Merchant Bank and others (Dabor & Tijjani, 2010). Furthermore, Nyor (2010) provide evidence that Nigerian firms comply with standards governing the publication of their financial statements. This means that financial reporting quality by Nigeria firms is given a pass mark and their financial statements are seen as transparent and reliable. Since the aforementioned works rely on the annual reports and accounts of the companies to examine their compliance with accounting standards and also provide some evidence of quality financial reporting. Hence, firms must prepare financial information with higher quality (Asegdew, 2016). That is, information disclosed must be reliable and relevant to assist users of financial reports in the decision-making (Fathi, 2013). This high- level of disclosure quality is valuable for the firm as it has the prospective to reduce the expense of the debt and raise the stock price (Soheilyfar, Tamimi, Ahmadi & Takhtaei, 2014; Savina, 2016).

Audit is playing an important role in developing and enhancing the global economy and business firms. Auditors express an opinion on the fairness of financial statements. This is important for the users of financial statements to gain assurance that the data are being reported, properly measured, and fairly presented. Auditors must raise their skills in order to increase the probability to rely more on the auditor's report and audited financial statements which are more relevant, unbiased

and accurate for the decision makers. In the past few years auditors had been blamed due to their role in the mega corporate scandals such as Enron, World Com, Global crossing, Imclone system and Tyco international and in Nigeria such as Cadbury (Nig) Plc, African Petroleum (Nig) Plc Lever Brother Nigeria Plc, Intercontinental bank and Oceanic bank. Daily activities of the firms are within the control axis of the managers, who may or may not have any shareholdings of significant value in the firm, the ownership of the firms lies in the hands of the investors who are the shareholders (Abdul-Rahman**,** Benjamin & Olayinka, 2017). In recent times, research about the quality of audit report has increased tremendously, several factors were found to have contributed to this fact, stemming from the growing importance of good corporate governance mechanism following the highly publicized accounting scandals in Nigeria and across the globe.

One of the critical roles of auditors is that, they assure confidence to financial statements users about the reported information. Audit services have been critical to financial reporting quality since industrial revolution. Auditors must raise their skills in order to increase the probability to rely more on the auditor's report and audited financial statements which are more relevant, unbiased and accurate for the decision makers. However some regulators and small audit firms claimed that audit firm size does not affect audit quality and therefore should be irrelevant in the selection of an auditor. Big audit firms will have the potential to lose their clients if they show a lack of independence in their judgment. Additionally, large firms have more resources and are able to take steps to publicize their services and develop a reputation.

Compensation to auditors is found to be related with financial reporting quality (DeAngelo, 1981); according to this belief, quality may decrease with fee dependence if marginal forces associated

with managerial influence overwhelm those associated with the scope of activities involved (Frankel, Johnson & Nelson, 2002). Moreover, increase in audit fees as a result of non-audit services may enhance auditor's incentives to stay independence. The global financial crisis has put many companies under severe pressure to embark on cost reduction. This has invariably affected the audit fees, probably with the intention to share the pain traceable to the cost (Abdul-Rahman *et al.*, 2017). In the current economic conditions external auditors continue to be faced with more difficult judgments in areas such as assessing going concern, impairments of assets and fair values. While it is possible for auditors to maintain audit quality with a marginal reduction in fee, the audit committee of companies should ensure that they inform the Board of any risks associated with reductions in audit fees. Audit firm characteristics with respect to clients include the joint audit, to ensure objective financial reporting and financial reporting quality as well. A joint audit refers to an audit in which two independent auditors audit the financial statements with shared audit effort, sign a single auditor report, and bear joint liability in case of an audit failure (Ratzinger-Sakel, Audousset-Coulier, Kettunen & Lesage, 2012). Joint audits is having another auditor review the work can increase the probability of detecting problems. Although joint audits are of considerable interest to policy makers and investors, academic research on joint audits is limited (Lobo, Essec & Casta, 2017).

Therefore, this study is motivated by the critical role that the auditors have in corporate financial reporting with regard accounting irregularities and misstatements which impair, financial reporting quality and threaten the going concern of corporate entity. The study however, focuses on the major audit firm attributes (audit remuneration, audit firm size and the provision of joint audit). The credibility of financial statement is essential to the growth of the economy, which is why

auditors are expected to be independent and objective in carrying out their duties. The oversight function of the auditor is placed under scrutiny when a business whose financial statement shows no indication of the becoming bankrupt suddenly. In Nigeria, the banking sector is highly regulated because of the past incidence of poor corporate governance and poor quality of financial reporting, hence, making it susceptible to scandals and failure. Banks and other financial institutions decree, 1999, section 25, requires all banks to release in a daily newspaper printed and circulated in Nigeria and approved by the bank copies of their statements of financial position, income statements and other relevant financial statements showing their financial position, structure and performance (Imeokparia, 2013), Therefore, the need for quality financial reports in the recent times and the negative consequences of poor quality reporting prompted the study of financial reporting quality of money deposit banks in Nigeria.

### 1.2 Statement of the Problem.

Financial reports are supposed to provide relevant information to the external parties of an organization. It is thus important that financial reports provide truthful and accurate financial information to enable shareholders and other interested parties to make decision wisely. In spite of its flourishing in the western context, FRQ research is still in its infancy in developing countries (Monday & Nancy, 2016). However the statement of the research problem identified in this study are, firstly, Money Deposit Banks in Nigeria have published audited financial statements which posted huge returns and presented such banks to the public as sound and healthy but quite unfortunately they have been subsequently declared as ailing or failed and bankrupt Shareholders are worried about the safety of their investments entrusted in these Money Deposit Banks in Nigeria and this has led to doubts as to whether or not to invest in the banks (Dandago & Rufai,

2014). This is method of deceiving shareholders can also be called window dressed account. Most of the accounts prepared and published by banks does not show the true view of the banks instead it shows what will attract the shareholders.

Another problem is that, the investigation of the annual reports encompasses a degree of subjectivity that could decrease the reliability of the findings. The annual report is subjected to what we can see, there is a limit to what the auditor can discover about the annual report. That is why it is important and essential to appoint an independent and capable auditor. The shareholders should not be influenced by anyone or anything in making an independent decision in selecting the external auditor. Another problem is the increase of the case of merger and acquisition in the banking industry. Over the years it has been noticed that a lot of banks cannot cope on their own for long without having to face a lot of financial issues and have to merge with a more capable bank. Recently Diamond bank and Access bank merged, there was also a threat to take over GTBank.

The credibility of financial information is vital to the growth of any economy. Auditors on their part are expected to be independent and objective in the discharge of their responsibilities (Adelaja, 2009). However despite the regulatory bodies put in place to act as watch dog to banks there are still various scandals and poor quality of audited financial reporting quality in banks. Few studies such as Adeyemi, Okpala & Dabor (2012), Jayeola and Taofeek (2017) and Umar (2014) used data from emerging economies such as Nigeria. There have not been a lot of studies on effect of audit characteristics and financial reporting quality of banks in Nigeria. This study will fill the gap and will also be useful to other researcher and audit practitioners.

## 1.3 Objective of the Study

The main aim of this study is to examine the effect of audit characteristics on financial reporting quality of banks in Nigeria. This objective is broken down into three;

1. To determine the effect of audit firm size on financial reporting quality of banks in Nigeria.
2. To ascertain the effect of audit fee on financial reporting quality of banks in Nigeria.
3. To examine the effect of joint audit on financial reporting quality of banks in Nigeria.

## 1.4 Research Question

In order to ascertain the above objective it is important to know the following research questions;

1. What effect does audit firm size have on financial reporting quality of banks in Nigeria?
2. Of what significance is the effect of audit fee on financial reporting quality of banks in Nigeria?
3. What effect does joint audit have on financial reporting quality of banks in Nigeria?

## 1.5 Research Hypothesis

In this research the following hypothesis were tested for validation or rejection.

(1) $H_0$: Audit firm size has no significant effect on financial reporting quality of banks in Nigeria.

(2) $H_0$: Audit fee has no significant effect on financial reporting quality of banks in Nigeria.

(3) $H_0$: Joint audit has no significant effect on financial reporting quality of banks in Nigeria.

### 1.6 Significance of the Study

This study is significant in light of the recent search by regulators for measures that could protect and improve the financial reporting quality in the corporate world. Moreover, the IAASB framework for audit quality attributed the primary responsibility for performing quality audits to auditors, and emphasized that audit quality is best achieved in an environment where there is support from other participants in the financial reporting supply chain. Hence, this study is an effort towards such direction (Umaru, 2014). The study is also significant as it focused on issues related to audit firm characteristics that are threatening the survival of audit firms of all sizes, on one hand and the going concern of corporate entities on the other hand.

Therefore, the study is of importance in ensuring the credibility of financial information not only for the purpose of pointing the tendencies of corporate scandals, but most importantly the survival of their accounting and audit profession and the development of healthy financial and capital market. The findings from this study could assists auditors in their duties and responsibilities with regards financial reporting, as to the factors that are of eminent importance in achieving high audit quality and high financial reporting quality. The study will also offer important input to serve as a strong base for the regulators and professional accounting bodies to establish policies relating to type of audit firm characteristics, audit fees, non-audit services and joint audit. This is important because most of the issues in this area are based on anecdotal evidence, particularly in Nigerian context since evidence regarding these issues has been relatively limited.

The Central Bank of Nigeria (2006) has identified inadequate disclosure and transparency about financial position of banks as one of the major factors in all known banks and financial institutions' distress and eventual failure (Adeyemi *et al.,*2013) In this vein, (Okezie, (2010) noted that there is no evidence of any early warning systems being used by regulators or bank management in the monitoring of banks' health in Nigeria. Unfortunately, the mega banks resulting from the consolidation process of the 2005 have evidently been inadequate to forestall distress in the banks (CBN, 2010). This can be seen from the avalanche of revelations that preceded the sacking of a number of executive management teams of some otherwise high flying banks in 2009. Consequently, the survival of any bank is beyond the size of the bank even though survival of the banks is a vital ingredient for the general growth of the economy. The basic reason for the rigorous regulatory and supervisory regime on the banks is to forestall bank failure and ensure their stability. There is a seeming failure of examination approach in ensuring a sustainable financial system and this work will attempt to look at the available options.

There is a growing interest in published accounts of companies in Nigeria and worldwide owing to the collapse of giant firms like Enron etc. The distress phenomenon in the banking sector which led to the fall in share prices on the floor of many stock exchanges has heightened the quest for qualitative financial reports, hence, the need to assess public perception of the quality of annual reports being released by firms (Nyor, 2013). Furthermore, Nyor (2010) provide evidence that Nigerian firms comply with standards governing the publication of their financial statements. This means that financial reporting quality by Nigeria firms is given a pass mark and their financial statements are seen as transparent and reliable.

This study aims to assess whether the published annual financial statements of Nigerian firms pass the required quality as to guide users in their decision making. A stable banking system is of paramount interest to the economy holistically where everyone is a stakeholder. Specifically, this study is of prime interest to government, depositors, shareholders and the general public. On the other hand, shareholders (owners) are more interested in their banks' profitability, soundness and good health while the workers are interested in their sustained employment through the continued existence and profitability of their employer-banks. The findings from the study could educate both existing and potential shareholders of building material firms in Nigeria on the audit firm characteristics that improve the quality of financial reporting (with respect to audit firm characteristics). The study is also of great importance to researchers, as it provides empirical evidence on the relationships between audit firm characteristics and the quality of financial reporting from money deposit banks in Nigeria.

## 1.7 Scope of the study

This study is motivated by the current state of the banking industry in Nigeria where some ostensibly sound, stable and profitable banks were suddenly found to be weak and terminally distressed by the CBN. The study then examined the quality of financial reporting practices in the Nigerian banking industry and the effects on their financial stability. This study focuses on audit firms' characteristics and the quality of financial reporting, within the context of money deposit banks in Nigeria. The study covers the period of ten years, from 2008-2018. Financial reporting quality is also represented by earnings quality which is proxied by absolute discretionary accruals of money deposit banks during the period covered by the study. On the other hand, audit firm characteristics in this study covers audit fees, audit firm size and joint auditors.

### 1.8 Limitation to the Study

This study only considers three audit characteristics out of the numerous characteristics. Also, this study is limited to only secondary data, gotten from newspapers, internet and journals. Out of the 21 deposit money banks only 10 is considered in this study, that were in existence over the selected sample periods and whose published annual reports and financial statements and other necessary information were available and accessible over the time frame of the study.

### 1.9 Definition of Terms

**Audit Characteristics:** These are the features of the auditors and audit firms that may exert significance effect on financial reporting quality. They include audit firm size, audit fee and joint audit.

**Audit Fee:** This is the amount of fee received by auditors for their professional services based on such factors as the complexity of the services, the level of expertise, and many other factors.

**Audit Firm Size**: It refers to the size of the audit firms in terms of whether they are being audited by one of the big four audit firm or not.

**Financial Reporting Quality:** This is depicted by faithful representation of financial statement as measure of qualitative characteristic of financial statement.

**Joint Audit**: It refers to audit in which financial statements are audited by two or more independent auditors. In a joint audit, two or more different audit firms form an opinion about a client's financial statements.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.0 Introduction

Literature review covers conceptual, theoretical and the empirical reviews. Concepts underpinning the study were critically examined to arrive at suitable variables for the study. Contending theories were also reviewed to provide a suitable theoretical framework for this study. Previous empirical studies were also reviewed to arrive at gaps in literature and provide basis for discussion the outcomes of this study.

## 2.1 Conceptual Review

Concepts reviewed include financial reporting quality, audit firm size, audit fees and joint audit.

### 2.1.1 Financial Reporting Quality

The theory of firm reporting quality was first posed by financial analysts and Stock Exchange market agents (Umaru 2014). They inferred that the reported profit does not show the firms' profitability as it is purporting. However, financial reports is broad, several definitions of the term financial reporting quality have been expressed, based on the objectives of each research. The main objective of financial reporting is to provide information concerning business entity, primarily financial in nature, and useful for economic decision-making (Yurisandi & Puspitasari, 2015).

Financial reporting is a process of reporting financial activities of business on a formal way. It has been considered as an essential resource for any market participant. It also reduces the mystery

and the conflict in opinion between all interested users; such as managers, investors, regulatory agencies, society and other stakeholders (Al-dmour *et al.,*2017). Everyone participates in this process, even each operation related to this process should be submitted carefully, especially the disclosure process, all transactions, the accounting policies, and all judgments and opinions made by the staff involved in this process (Gaynor, Kelton & Yohn, 2016). The concept of firm reporting quality considers two characteristics for quality determination which includes profitability in decision-making and the relationship between firm reporting quality and economical profit. In other words, earnings quality is an honest expression of the reported profit (Umaru 2014).

According to Kythreotis (2014) states that "since 2005 all listed companies are required to prepare and present the consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS)". To achieve this objective, the Commission establishes those standards that lead to the increase in the degree of relevance, faithful representation, comparability, timeliness, verifiability and understandability in financial statements. The Commission stresses that the financial statements must reflect the specific characteristics, as defined by the Conceptual Framework, so that the information which is provided is useful. These characteristics are divided into two; fundamental and enhancing. The two fundamental characteristics are relevance and faithful representation, while comparability, timeliness, understandability and verifiability are under enhancing. The main difference between the fundamental and enhancing characteristics is that the enhancing characteristics cannot single-handedly generate useful information (Kythreotis, 2014).

Moreover, researchers have also argued that the quality of an external auditor is an important factor effecting financial reporting quality, whereby a high quality external auditor is expected to have an influence on the quality of financial reporting (Umaru, 2014). According to the prior researches, specific-firm characteristics- firm size, profitability, industry, firm leverage, firm age, liquidity, auditor type and listing status –and certain attributes of corporate governance-board composition, board size, ownership structure, CEO duality, board meeting- have been tested to affirm they impact financial reporting quality (Mahhboub, 2017).

Relevance means that financial statements can influence the decisions of users. In other words, they can be used as predictive values and/or confirmatory values. Information becomes relevant when it is provided to the users before it loses it stability to influence the decision-making process A quality of accounting information is expressed as being capable of making a difference in a decision by helping users form predictions about the outcome of past, present and future events, or to confirm or correct expectations. Relevance has three other aspects of predictive value, feedback value and timeliness (Nyor, 2013). Faithful representation is the second fundamental quantitative characteristic in the standard. Financial statements should present faithfully the economic events, also they should not be the product of any prejudice whatsoever that is to be neutral. It should present the economic substance of economic events unconstrained by legal aspects and decisions taken by the management regarding uncertain events which require the exercise of judgment must be taken with caution and finally, the financial statements ought to be Complete.

Comparability means the ability that the information has in explaining and identifying similarities in and differences between two common sets or transactions of economic phenomena (IASB, 2008, p. 39). During the process of preparing financial report the user may find similar situations which are presented the same, and in some cases different situations which are presented differently. Comparability could be arrived by attaining consistent information by companies. This could happen by enforcing the company to use the same accounting policies and procedures (Al-dmour *et al.,* 2017). By increasing the degree of comparability between the financial statements at both national and international level, investors are able to identify more easily investment opportunities arising from the comparison of the financial statements of two or more banks (Kythreotis, 2014). Degree of comparability both at national and international level creates an additional source of information to users, helping them in making investment decisions and increasing the usefulness of financial statements. Timeliness has one of the characteristic of financial report means having information available to decision makers before it loses its capability to influence decisions. In specific terms, timeliness relates to the decision usefulness of financial reports. It refers to the time it takes to reveal the information in annual reports. It is usually measured in terms of the number of days it takes the auditor to sign the accounts after book-year end (Al-dmour *et al.,* 2017).

Understandability is the third fundamental qualitative characteristic it referred to the process of classifying, characterizing, categorizing, then presenting the financial information clearly and concisely. It is when the quality of information enables users to comprehend their meaning. Understandability means assuring financial information transparency and clearness, this process needs relating to some financial measures. These qualitative characteristics enhance the facilitation of assessing the usefulness of financial reports, which will also lead to a high level of quality. In

spite of the obvious merits of this framework especially the fact that it aligns strongly with the International Financial Reporting Standards (IFRS), many researchers in recent studies still prefer to use the indirect method, especially discretionally accrual (earnings management) as a proxy for financial reporting quality (Al-dmour *et al.,* 2017).

### 2.1.2 Financial Reporting Quality of Banks in Nigeria

Financial reporting is no longer perceived or seen as a mere recording of transactions or an ordinary bookkeeping activity. It is now seen as a crucial tool in managing a company under good corporate governance principles (Uwuigbe, Emeni, Uwuigbe & Ataiwrehe, 2016). The main objectives of preparing financial statements are to enhance the quality of the decisions made by the users, however, users can only make quality decisions with the availability of quality financial information (Uwuigbe et al., 2016). Timely financial reporting is an essential ingredient for proper functioning of the capital market (Akhor & Oseghale, 2017). In Nigeria, the need for high quality and timely financial information has become imperative due to the increasing exposure of Nigerian business organizations to international capital markets and the adoption of International Financial Reporting Standards (IFRS). Financial reporting in banks is essentially the responsibility of directors and this is carried out by accountants and verified by auditors (Onyabe, Okpanachi, Nyor, Yahaya & Mohammed, 2018).

Thus, the business organizations are being obliged to satisfy the information demands of foreign investors and to provide them with more timely information in annual financial reports. According to International Standard on Auditing (ISA, 570), audit procedures are carried out when there is evidence of uncertainties of the going concern. This means that the auditor has a responsibility to

extend audit assignment in order to confirm going concern uncertainties. (Akhor *et al.,* 2017). Bank size as a control variable plays an important role in determining the kind of relationship the firm enjoys within and outside its operating environment. The larger a bank is, the greater the influence it has on its stakeholders. In Nigeria, the need for high quality and timely financial information has become imperative due to the increasing exposure of Nigerian business organizations to international capital markets and the adoption of international financial reporting standard (IFRS).

### 2.1.3 Audit Characteristics

Auditors are intermediaries between the management of a firm and external parties who are interested in the firm. According to the consultative council of accountancy body (CCAB) Audit is defined as an independent examination of and expression of opinion on the financial statement of an enterprise by an appointed auditor, in pursuance of that appointment and in compliance with any relevant statutory obligation (Onaolapo, Ajulo & Onifade, 2017). The concept of audit is an assurance in the engagement that is involved in the objective process of obtaining and evaluating evidence with regard to financial statements, in order to form an opinion that published financial statements are free from material misstatements and intentional errors, and is in accordance with relevant laws, standards and legislations (Umaru, 2014).

#### 2.1.2.1Audit Firm Size

Another audit firm characteristic commonly associated with the financial reporting quality is audit firm size (that is, Big 4) (Umaru, 2014). Larger audit firms are often considered to be more able to resist pressures from management (Adeyemi *et al.,* 2011). More audit services and time are needed

to audit large size companies than small ones. They also have enough financial resources to recruit big international audit firms. Auditor size can be determined by the assets held by the audit firm, market share of the auditor and the total workforce of the auditor (Musah, 2017). The size of auditee has a direct impact on the auditors' work, and the time spent in the auditing process.

#### 2.1.2.2 Audit Fees

Audit fees refer to the remuneration payable to an auditor for audit services rendered. Large size of audit fees is normally associated with a higher risk of losing the auditor's independence (Adeyemi *et al.,*2011). Low audit fees can restrain audit firms, by restricting compensation to audit staff (Kiptum, 2013). The amount of fees paid to external auditors is of great importance to a number of stakeholders that is why disclosure practices requires that such information be disclosed in the financial statements of companies (Kikhia, 2014). According to Suryanto (2014), there are three determinants of audit fees: the client attribute, auditor attribute, and engagement attribute.
The amount of audit fee can vary depending on the complexity of services, assignment risk, and the cost structure of Public Accountants Firm, the required level of expertise, and other professional considerations (Onaolapo *et al.,* 2017). Audit fee is affected by Audit firm attributes (like size, reputation, experience, competition, industry specialization and whether it is a big four) or by the client's company characteristics (audit attributes like size, complexity, risk, and profitability) (Kiptum, 2013).

#### 2.1.2.3 Joint Audit

A joint audit can be defined as an audit in which financial statements are audited by two or more independent auditors (Ratzinger-Sakel *et at.*, 2013). In a joint audit, two different audit firms form

an opinion about a client’s financial statements (Okaro, Okafor & Ofoegbu, 2018). Joint audits create more differences in auditor choice and potentially in the level of earning quality than under non-joint audit. On the other side, opponents of joint audit (Marmousez, 2009; Zerni, Elila, Jarvinen & Liemi, 2012; Alsadoun & Aljaber, 2014; Deng, Dana, Yu 2014) argue that the practice of Joint Audit could reduce audit quality for the following reasons. First, it could result in Free Riding problem because the small audit firm has fewer resources than the big audit firm, so it will have an incentive to withhold its limited resources and free ride the big audit firm's effort. Second, joint audit could result in Opinion Shopping problem because management may offer to purchase the audit opinion of the small audit firm, and the small audit firm may accept this offer because, in this case, the big audit firm will bear the reputation costs alone. Third, joint audit may result in insufficient information exchange, resulting in compromising audit quality because auditors from competitive audit firms may not have an incentive to cooperate while conducting the audit (Mahmoud, 2015). Joint audits are conducted in the same manner as single audits.

In a joint audit, two different audit firms jointly form an opinion of a client’s financial statements. Both audit firms are also jointly liable for the issued audit opinion (Zerni *et al.,* 2012). Proponents of joint audits argue that joint audits have the potential to safeguard auditor independence. Joint audits are currently required in several countries and are voluntary in others. In France, joint audits are mandatory for all companies preparing consolidated financial statements. Some countries mandate joint audits for a subgroup of firms. For example, India requires joint audits for state-owned enterprises and Saudi Arabia and Algeria mandate joint audits for banks. Joint audits are voluntary in Denmark, Sweden, and Germany.

The notion that joint audits will cost more than a single audit is rationalized by the fact that two or more auditors will cost more in terms of fees, because of coordination costs among the auditors. Also, in a first audit, start-up costs will be incurred because the auditor will first need to familiarize himself/herself with the business activities and environment of the company (Okaro *et al.,* 2018). A small number of developing countries also have made policies on joint audits. These include Algeria, Congo, Morocco, India, and Tunisia. In Nigeria, in 2010, the president of the Institute of Chartered Accountants of Nigeria (ICAN) called for mandatory joint audits in Nigeria to address the structure of the Nigerian audit market, which appeared to be dominated by the Big Four audit firms (Ajaegbu, 2014). The Big Four audit firms are, however, opposed to mandatory joint audits in Nigeria, preferring instead a voluntary joint audit regime (Ejoh, 2015). On 17 October 2016, the Financial Reporting Council of Nigeria (FRCN) introduced a unified code of corporate governance for the Nigerian private sector (FRCN, 2016). One of the provisions of the code was mandatory joint audits for firms. The code led to much criticism from investors and other interest groups for some of its provisions, including mandatory joint audits. The Nigerian government was eventually compelled to suspend the implementation of the code (The Guardian, 2016).

Some Nigerian studies have recommended mandatory joint audits as a solution to auditing market concentration in Nigeria (Okaro & Okafor, 2013; Asien, 2014; Olowookere, 2016). Olugbenga *et al.*, (2016) examined whether the introduction of a joint audits would lead to the improved audit and earnings quality of listed companies in Nigeria. The study failed to establish such relationship, but recommended voluntary joint audits in Nigeria for a number of reasons, including increased opportunity for growth for small and medium-sized accounting practice. However, a positive significant relationship was established between joint audits and earnings management in Nigeria’s

listed deposit money banks (Jayeola *et al*., 2017). Although joint audits are deemed to be more costly than single audits in the Nigerian environment (Asien, 2014), the mandating of joint audits in Nigeria would help in tackling the problem of those in the political elite, who run companies that retain only the non -Big Four audit firms, for fear that better audit quality may reveal some aspects of their transactions that they would not like to disclose (Abdulmalik, Shittu & Ahmad, 2016).

However, the audit market in Nigeria remains weak. The disciplinary machinery of the various professional bodies, and even the regulators, appears to be ineffective and weak. For example, auditors who were responsible for audit failures in some Nigerian banks unearthed in 2009 were never sanctioned by their professional bodies. The Nigerian Securities and Exchange Commission imposed a fine of N20 million on the offending accounting firms, but took no further action, such as prosecuting the indicted partners of the firm (Okaro, Okafor, Ofegbu, 2018). The same applies to the auditing firms indicted in the Cadbury (Nig) accounting and the Nigerian Stock Exchange scandals. Most of the companies accused were those audited by the Big Four accounting firms. (The Big 4 accounting firms operating in Nigeria are PricewaterhouseCoopers, Deloitte/Akintola Williams, Ernst and Young, and KPMG)

#### 2.1.2.4 Audit Tenure

For effective and quality financial reporting, the audit-firm tenure is also considered because it is of great influence. Audit-firm tenure is the length of the audit-firm-client relationship as of the fiscal year-end covered by the audited financial statements (Adeyemi *et al.,* 2012). The familiarity that exists between the auditors and their clients as a result of long audit tenure encourages failure

in auditor independence (Eyenubo, Mohamed & Ali, 2017). Audit tenure and financial reporting quality have mixed and conflicting results some of the studies opines a decrease in the financial reporting quality when there is an increase in the audit firm tenure (Gunny, Krishna & Zhang, 2007). The familiarity that exists between the auditors and their clients as a result of long audit tenure encourages failure in auditor independence. Longevity of audit firm tenure has also been linked with fraudulent financial reporting. Long-term audit relationship may impair the auditors' independence or inversely improve the auditors' conditions of the work exercise (Smii, 2016). However, An audit firm's tenure, which is the length of time it has been filling the audit needs of a given client, has been mentioned as having an influence on the risk of losing an auditor's independence (Adeyemi & Okpala, 2011).

There is conflicting evidences on the relationship between audit firm tenure and financial reporting quality. Short audit tenure provides high financial reporting quality while longer audit tenure produces a low financial reporting quality. Audit tenure has a direct impact on fraud commission and financial reporting quality (Eyenubo *et al.,* 2017).

#### 2.1.2.5 Auditor's Independence

The familiarity that exists between the auditors and their clients as a result of long audit tenure encourages failure in auditor independence (Eyenubo *et al.,* 2017). Auditor's independence means that auditor is free from pressure and influence of any external force or bias so as to carry out their duties effectively. Independence is characterized by integrity and objectivity of auditor and

standpoint of opinions in judgment (Eyenubo *et al.,* 2017). To strengthen the independence of statutory auditors and improve the services provided by the auditors, some companies require the existence of two audit firms (Smii, 2016). The existence of two audit firms enables the audited entity to promote the audit quality both in terms of independence and of competence. Letting auditors consult for audit-clients compromises auditors' independence and thus diminishes the quality of earnings reports (Umaru, 2014). Independence is the cornerstone of accountability.

## 2.2 Theoretical Review

Five theories were reviewed for this study. They include policeman theory, the lending credibility theory, the theory of inspired confidence, agency theory and stakeholders' theory.

### 2.2.1 Policeman Theory

This theory claims that the auditor is responsible for searching, discovering and preventing fraud. In the early 20th century this was certainly the case. However, more recently the main focus of auditors has been to provide reasonable assurance and verify the truth and fairness of the financial statements.

### 2.2.2 **The Lending Credibility Theory**

This theory suggests that the primary function of the audit is to add credibility to the financial statements. In this view the service that the auditors are selling to the clients is credibility. Audited

financial statements are seen to have elements that increase the financial statement users' confidence in the figures presented by the management (in the financial statement).

### 2.2.3 **The Theory of Inspired Confidence**

Hayes, Dassen, Schilder & Wallage (2005) quotes Limperg (1932) as pointing out that this theory addresses both the demand and the supply for audit services. The demand for audit services is the direct consequence of the participation of third parties (interested parties of a company) in the company. These parties demand accountability from the management, in return for their investments in the company (Kiptum, 2013). However, since this information provided by the management may be biased, and outside parties have no direct means of monitoring, an audit is required to assure the reliability of this information. With regard to the supply of audit assurance, Limperg (1932) suggests that the auditor should always strive to meet the public expectations. According to Limperg (1932), the demand for audit services is the direct consequence of the participation of outside stakeholders (third parties) in the company (Umaru, 2014). These stakeholders demand accountability from the management, in return for their contribution to the company. Since information provided by management might be biased, because of a possible divergence between the interests of management and outside stakeholders, an audit of this information is required (Umaru, 2014).

### 2.2.4 **Stakeholders theory**

The conflict of interest between managers and shareholders has led to the development of stakeholder's theory. Freeman (1984) noted that stakeholder theory is to address norm and values

of the business ethics and managing the organization. The concept of this theory “stakeholders” refers to managers, shareholders, financial analyst and other users of financial report either indirectly or directly (Eyenubo *et al.,* 2017). The basic ingredients of stakeholder theory is to identify all groups of individuals state, organization and companies in which the firm operates and how beneficial the firm to the corporate society (Anhier, 2005). Different stakeholder should critically examined their actions so as to determine the influence of their action and their effect on the perception of financial reporting quality reason be that audit provide assurance to stakeholders, shareholders, managers, creditors and other investors enhancing confidence on financial reporting quality (Eyenubo *et al.,* 2017). This therefore suggests that the responsibility of directors is to serve various interest groups and individuals.

### 2.2.5 **Agency theory**

The theory adopted for the purpose of this research study is the agency theory. Agency theory provides the framework for the evaluation of the relationship between the various parties in an organization. An agency relationship arises when one or more principals engage another person as their agent to perform their service on their behalf. In order to perform this service, there must be delegation of some decision-making authority to the agent. Such delegation would require the agent placing trust in the principal. But as a result of the breach in trust placed in management, there is the need for an internal auditor who would checkmate and report to the board, the activities of management (Ogundana, Ojeka, Ojua & Nwaze, 2017).

When there are conflicts between the interests of the principal and the agent, the agent may not act in the best interests of the principal. In order to avoid or minimize such divergences from his or

her interests, the principal can establish monitoring systems (Umaru, 2014). Watts and Zimmerman (1979) suggests that the auditor is appointed in the interests of both the third parties as well as the management. A company is viewed as a web of contracts. Several groups (suppliers, bankers, customers, employees etc.) make some kind of contribution to the company for a given price. The task of the management is to coordinate these groups and contracts and try to optimize them: low price for purchased supplies, high price for sold goods, low interest rates for loans, high share prices and low wages for employees (Kiptum, 2012). This therefore introduces the concept of internal auditors as agents of principals. The internal auditor reports to the board of directors or its audit committee and is charged with monitoring the activities of the organization to ensure compliance with procedures and to likewise ensure that management is indeed acting in accordance with the laid down policies established by the board of directors (Ogundana *et al.,* 2017).

According to agency theory, companies need independent audit to reduce the agency costs. Clients with high agency costs may be less willing to obtain non-audit services from their auditors since doing so may result in reduction in perceived independence, audit quality and in monitoring value of the audit service. Consistent with the theory on audit effort and litigation, audit fees tend to increase with an increase in the client's size (Simunic 1980), risk (Stice 1991), complexity (Hackenbrack & Knechel, 1997), and profitability (Hay *et al.,* 2006). In accordance with the agency theory, the leader is supposed to follow an opportunistic behavior to maximize his utility function. To cope with such opportunistic behavior, the shareholders use a third party (external auditor) to monitor the managers and check the quality of the disclosed information (Smii, 2016). Within the framework of theoretical reflection, the role of the external audit, as a means of

controlling and reducing the agency costs, is twofold: it helps, on the one hand, reduce the information asymmetry and, on the other hand, strengthen the mechanisms of corporate governance (Smii, 2016). In line with this, firms are expected to disclose more information in financial statements in order to satisfy the interest of various stakeholder groups (not only shareholders' interest) (Umaru, 2014).

These stakeholders demand accountability from the management, in return for their contribution to the company. Since information provided by management might be biased, because of a possible divergence between the interests of management and outside stakeholders, an audit of this information is required (Umaru, 2014). According to Umaru (2014) he explains that there should be a level of that the auditor should provide and he should act in such a way that he does not disappoint the expectations of his clients. He further explains that the function of auditing is to mitigate information asymmetries among related parties. High audit quality should be related to low levels of information asymmetry and low levels of "uncertainty concerning performance." Therefore, audit quality should be negatively related to earnings management. It is therefore on the framework of the above theories that this study attempt to investigate the relationships among financial reporting quality and audit firm characteristics of banks in Nigeria. Agency theory links shareholders and the management who are the providers of financial statements to be audited by audit firms and the latter anchored managers and audit firms that plays a prominent role in ensuring quality of financial reporting.

## 2.3 **Empirical Review**

Extant empirical literature on the relationship between audit firm characteristics and financial reporting quality from different part of the world provide mixed results.

### 2.3.**1 Audit Firm Size and Financial Reporting Quality**

The most common and well researched indicator of audit characteristics is whether an audit firm is one of the "Big 4" (DeFond *et al., 2014*; and Carcello, 2005). The motivation for such a hypothesis varies from study to study. DeAngelo (1981) suggests that since these larger audit firms are not as financially dependent on the fees from any one client, they are less likely to be subject to pressure from clients to "look the other way" in the event of discovering accounting irregularities. Large audit firms (the Big Four for example) can devote much investment to the provision of training courses and other resources necessary to ensure their staff are competent, able to audit to a high standard, and are less likely to be compromised by actions of clients (Francis and Yu, 2009; Dopuch, 1984; Behn et al. 2008; Wilson and Grimlund, 1990; Rusmin, 2010; Lawrence et al, 2011).

Reynolds, and Francis, (2001) found that audit fee does have a negative relationship with earnings quality, and thus improve the quality of financial reporting Umaru, 2014). It was found that the Big Eight or Big Five, now the Big Four (Ernst & Young, Deloitte, PricewaterhouseCoopers (known as PwC) and KPMG) audit firms receive premium fees in many countries compared to non-Big Four (Palmrose, 1986; Francis & Simon, 1987; Butterworth & Houghton, 1995). Chalmers and Godfray & 2004) show that the Big 4 help, on the one hand, reduce the problem of the information asymmetry between the managers and the shareholders, and on the other hand, improve the quality of the accounting income of their customers. Large size companies would be involved in more activities than small ones. They are usually more publicly visible and they tend to disclose more information than small companies.

(Choi, Kim, & Zang, 2010) analyzed the relationship between the size of the auditor, quality of audits and corresponding fees. They established that large audit firms charge a premium for their high-quality audits. Big audit firms charge high audit fees (Francis *et al* 2004). Similarly, studies have shown the positive relationship between auditor size and the quality of its services (Hassan & Naser, 2013). Auditor size can be determined by the assets held by the audit firm, market share of the auditor and the total workforce of the auditor (Musah, 2017). The audit quality is not independent in relation to the size of the company carrying it out; the larger the audit firm – measured by the number of clients – the smaller incentive for an auditor to perform inappropriately for establishing or maintaining a client (DeAngelo, 1981).

The reputation and affiliation with big auditing firms forms the basis of auditor size, this thereby influences the audit fee charged by auditors. As shown by literature on auditing, there were originally eight firms known as “Big Eight” due to their global recognition, reputation and highest market share in terms of number of clients audited. The "Big Eight" consisting of group of eight firms was then reduced to the "Big Six" and then "Big Five" by a number of consolidations (Musah, 2017). The Big Five has also been reduced to the “Big Four” after the demise of Arthur Andersen in 2002, due to its involvement in the Enron scandal (Casterella, Jensen & Knechel, 2010). The superiority these four firms possess in terms of technology and skill in the accounting and auditing field has created room for high audit fees to be charged. The majority of studies show that auditor size is a significant determinant of audit fee (Hay et al. 2006). Moreover, as noted by DeAngelo (1981b), the larger audit firms are not concerned in the same way as are smaller firms, with the

loss of a client, and hence they produce higher audit quality because they are not afraid to be objective.

Additionally, it is confirmed by (Krishnan & Schauer 2000), that the degree of compliance observed is directly correlated to audit firm size, this increasing on a continuum moving from the small non-Big Six to the large non-Big Six to the Big Six. Clients of the Big 4 firms have been shown to have higher accrual quality, typically measured as lower absolute values of discretionary accruals (Becker, Defond, Jiambalvo & Subramonyam, 1998) are less likely to manage earnings, as evidenced by income increasing accruals, small positive earnings changes, or meeting/beating analyst expectations (Becker *et al,* 1998; Nelson, Elliot & Tarpley, 2002).

In addition, the stock market response to an earnings surprise is greater (Teoh & Wong, 1993) and analyst forecasts are, on average, more accurate for clients of Big 4 firms. (Behn, Choi & Kang, 2008) suggesting that higher audit quality contributes to more informative earnings disclosures and better informed analysts. Prior research has shown that audit quality is positively associated with audit firm size

### 2.3.2 Audit Fees and Financial Reporting Quality

Divergent views in literature depict that audit compensation/fees has a relationship with the financial reporting quality to some extent; in that, financial reporting quality usually affected fees paid to external auditors. For instance, quality may be decreased with fees if marginal forces

associated with managerial influence overwhelm those associated with the scope of activities or reputational incentives (Umaru, 2014). Reynolds *et al.,* 2004) found that audit fee does have a negative relationship with earnings quality, and thus improve the quality of financial reporting (Umaru, 2014). Consistent with the theory on audit effort and litigation, audit fees tend to increase with an increase in the client's size (Simunic 1980), risk (Stice 1991), complexity (Hackenbrack and Knechel, 1997), and profitability (Hay et al., 2006).

Audit fees are also used as a measure of audit quality; the perceptions of some researchers behind these studies is that audit fees reflect additional audit effort which leads to a higher level of audit quality (Carcello 2005). Early study like (Francis et al., 2005) examined the association between audit fees and non-audit services fees in order to find evidence of "knowledge spillovers" which are transfers of knowledge from non-audit to audit services and vice versa.

Thus it can be inferred that the results of the studies imply that audit firms receiving higher fees also provide higher actual and perceived audit quality, which translates into greater financial reporting quality of a firm. Audit fee studies by Simunic (1984) have included non-audit fees as explanatory variable for audit fees, and that there is a positive relation between audit and non-audit fees. (Frankel *et al.,* 2009) find some evidence of a positive association between abnormal accruals and the ratio of non-audit fees to the sum of audit fees and non-audit fees.

Thus, empirical evidence suggests there is a web of relations among audit fees, non-audit fees, and abnormal accruals. Therefore, this study is designed to examine the relationships between total audit compensation and financial reporting quality of banks in Nigeria. Much of the existing

research examining the association between audit fees and auditor independence focus on discretionary accruals as a proxy for auditor independence. Francis *et al.,* 2009) test the hypothesis that fee dependence will cause auditors to be more lenient and give clients greater discretion in accounting for accruals (both discretionary and total accruals). They find a negative association between fee dependence and the level of accruals and suggest that reputation protection and litigation avoidance is sufficient incentives for auditors to maintain objectivity. They also find that larger clients (for whom auditors presumably have greater fee dependence) are more likely to receive a going concern audit report. Similarly, DeFond et al. (2002) analyzed financially distressed firms and found no association between audit fees and the propensity to issue a going concern audit opinion.

### 2.3.2 Joint Audit and Financial Reporting Quality

A literature review by DeAngelo (1981) revealed that recent literatures have encouraged joint auditors approach in ensuring objective financial reporting. Some scholars are of the view that the appointment of joint auditors to a firm will enhance its financial reports quality. Joint auditors share the workload and associated fees in conducting the audit process according to quantitative (e.g., number of estimated hours) and qualitative criteria (e.g., expertise required, geographical network of firms).

Moreover, auditors must present a “justification of their assessments” and convey the main reasons for their opinion to external users in the audit report. Auditors generally include about half a page of discussion on the estimates and assumptions made by management, which are mainly related to goodwill impairment, postemployment benefits, and provision for risks (Lobo *et al.,* 2017). Zerni

*et al.,* (2012) argued that the benefits of joint audit do not outweigh the costs. According to the authors, besides the audit costs, there is the need to consider the more significant indirect costs of joint audits: one auditor relying on the work of another (free-riding), which may decrease the precision of the audit evidence and personal opinion shopping, which may compromise auditor independence. Their results also showed that the choice of a joint audit substantially increases the fees paid by the client firm, especially for a higher perceived level of quality audit.

However, research results have also shown that the choice of joint audits can actually decrease audit fees. For example, (Gonthier-Besacier & Schatt 2007) found that the significant factors that determine audit fees in French quoted firms were risk, and size of business audited, and not the presence of Big Four audit firms. Their study revealed that joint audits involving two Big Four audit firms actually reduced audit fees, contrary to expectations of higher costs. The decrease in fees was attributed to the sharing of qualifications and skills, as well as of potential risks, between the two. The audit fees were higher where only one Big Four firm was involved in a joint audit, because the Big Four firm charged an additional fee, owing to the uneven distribution of expertise and reputation (Gonthier-Besacier *et al* 2007).

Results of empirical studies on joint audits are mixed. For example, one study found a positive and significant association between audit fees and joint audits, and an insignificant relationship between abnormal accrual and joint audits, which suggests that joint audits come with additional costs that do not lead to a higher audit quality (Ratzinger-Sakel, *et al*., 2011). In a related study by Lasege, Wechtelr, 2012) that included one of the authors of the above-mentioned research,

insignificant relationships were observed between abnormal accruals and joint audits, confirming the mixed results of the previous study.

Joint audits have been proposed as a remedy for the apparent lack of independence of auditors and low audit quality, as they can stimulate audit market competition (Zerni, *et al*. 2012). Many discourses on joint audits emphasize their effect on audit quality (Deng *et al* 2012; Zerni, *et al*. 2012; Mahmoud *et al*., 2015 & Lesage *et al*., 2012). Lesage et al., (2011) examined the impact of joint audit on both audit costs and audit quality in Denmark during the period of mandatory joint audit (2005-2009). Firms that continue to use joint audit after the 2005 regulation change are associated with significantly higher audit fees compared with firms voluntarily choosing to use a single auditor. There is no significant relationship between voluntary joint audit and total fees. In addition, audit quality, proxied by abnormal accruals, is not significantly different for the joint and single audit firms. Similarly, (Marmousez 2009) examines the impact of joint auditor pairs in France on financial reporting quality, measured by the degree of earnings conservatism. He provides evidence that Big 4–Big 4 auditor pairs are not associated with earnings conservatism whereas Big 4–non-Big 4 auditor pairs are associated with conservatism.

## CHAPTER THREE

## RESEARCH METHODOLOGY

### 3.0 Introduction

This chapter deals with the procedures used in data collection and processing for the purpose of this study. It shows the research design adopted for the study as well as the population, sampling technique and sample size, method of data collection, research instrument, and method of data analysis, model specification and measurement of variables.

### 3.1 Research Design

This study adopts correlational research design to investigate the relationships as well as the effects of the audit firm characteristics on the financial reporting quality of banks in Nigeria. This design is chosen because of its effectiveness in assessing the relationships and the effects of two or more variables (that is, the dependent and independent variables). Thus, the design is consistent with the main objective of this research.

### 3.2 Population

The population of the study consists of 21 deposit money banks (DMBs) in Nigeria.

### 3.3 Sample Size and Sampling Technique

According to Ezejuele & Ogowo (1990), minimum of 10% of the population is considered as adequate sample for a small population below 100. Approximately, 3 banks are the 10% of 21 deposit money banks (DMBs) in Nigeria. However, in order to obtain sufficient panel data for

regression analysis, 10 banks were selected by simple random sampling techniques for this study (Appendix I).

### 3.4 Method of Data Collection

For the purpose of this study, secondary data was explored, while the sources of the data include the financial statements (statement of comprehensive income, statement of financial position, statement of cash flows and non-financial information) of the sampled deposit money banks for the period 2012 to 2018. The use of secondary data in this study is justified based on the fact that the study is based on the quantitative research methodology, and hence requires quantitative data. The period 2012 to 2018 was chosen because it is post IFRS adoption period while pre IFRS adoption period was excluded to avoid the possible confounding effect of IFRS adoption on financial reporting quality of the sampled banks.

### 3.5 Model specifications

The model formulated for the study was expressed in functional form as follows:

$$FRQ = f(AFZ, AF, JA) \quad 1$$

The model could be expressed in equation form as shown below:

$$FRQ = \alpha_0 + \alpha_1 AFZ + \alpha_2 AF + \alpha_3 JA + \varepsilon \quad 2$$

Where:

FRQ = Financial Reporting Quality

AFZ = Audit Firm Size

AF = Audit Fees

JA = Joint Audit

$\alpha_0$ = Intercept

$\alpha_1$, $\alpha_2$, $\alpha_3$ = Regression coefficients

$\varepsilon$ = Error Term

### 3.6 Measurement of Variables

Dependent variable of the study is financial reporting quality. It was proxied with faithful representation (Appendix II) of financial statements as measured by Nice (2009). Independent variables include audit firm size, audit fees and joint audit. Audit firm size was measured with big 4 audit firm coded "1" and non-big 4 "0". Audit was measured as logarithm of audit fees. Joint audit was measured by coding existence of joint auditing of a bank as "1" and non-joint audit as "0".

### 3.7 Method of data analysis

The data was evaluated using descriptive and inferential statistics which includes mean and standard deviation. In line with the research paradigm underpinning this study and in consistent with the objectives of the study, correlation and regression techniques of data analysis were employed. The choice of regression as the tool of analysis in this study is informed by the fact that, the technique is effective in estimating the effect of one variable on another. Thus, the technique is consistent with the correlation research design employed in the study and the objective of this study.

#### 3.7.1 Normality Test

One of the assumptions of regression analysis is normality of data. Therefore, the data collected was subjected to skewness test and kurtosis test. From table 3.1, the skewness values for all the variables are less than 2 and the Kurtosis values are less than 3. Chen (2014) advocated for the use of sample with Skewness ≤ 2 and Kurtosis ≤ 7 in maximum likelihood estimate. Hence, this outcome suggested that the data passed normality test.

**Table 3.1: Normality Test**

| | Skewness | SE of Skewness | Kurtosis | SE of Kurtosis |
|---|---|---|---|---|
| Audit Firm Size | 1.05 | 0.325 | 2.12 | 0.938 |
| Audit Fees | 0.90 | 0.325 | 1.25 | 0.938 |
| Joint Audit | 0.95 | 0.325 | 2.08 | 0.938 |
| Financial Reporting Quality | 1.39 | 0.325 | 2.03 | 0.938 |

**Source: Field Survey (2019)**

In order to assess, the existence of multi-collinearity problem among the independent variables, variance inflation factors and tolerance values were estimated. From table 3.2, all variance Inflation Factors (VIFs) values are less than 4. Meyer, (1990) advanced that VIF greater than 10 indicate possibility of multi-colinearity among the variable of the study. Therefore, this outcome suggests no multi-colinearity problem. Also all the tolerance values are above 0.2. According to Mernard (1993), tolearance values above 0.2 indicate no multi-colinearity. This finding reinforces the earlier suggestion of no multi-collinearity problem among the variables of the study.

**Table 3.2: Multi-collinearity Test**

| Variables | No of items | Tolerance | VIF |
| --- | --- | --- | --- |
| Audit Firm Size | 10 | .523 | 3.385 |
| Audit Fees | 10 | .535 | 3.365 |
| Joint Audit | 10 | .552 | 3.330 |

**Source: Field Survey (2019)**

# CHAPTER FOUR

# DATA ANALYSIS, RESULTS AND DISCUSSION

## 4.0 Introduction

This chapter covers analysis of data, presentation and discussion of results. Data on questionnaire response rate, demographic variables, descriptive and inferential statistics were presented, analyzed and discussed.

## 4.1 Descriptive Statistics

Descriptive statistics include presentation of means and standard deviations of the dependent and independent variables of the study.

Table 4.1 revealed the means of the variables examined in the study. Financial reporting quality has a mean value of 3.9443 (Standard deviation = .66499). It could be recalled that financial reporting quality was operationalized as faithful representation of financial statements in line with the study on Nice (2009). On a scale of 1 to 5, this mean value implies that the faithful representation of financial statements of the sampled banks is high. Average value for audit firm size is .8286 (Standard deviation = .37960). Having coded big four audit firm as "1" and non-big four as "0", it could be deduced that most of the audit firms that are auditing the sampled banks are big four audit firm with large size. Mean value of audit fees is 7.1530 (Standard deviation = 2.65090) which translate to fourteen million, two hundred and twenty-three thousand, two hundred and eighty seven naira, eighty seven kobo (N14,223,287.87). Average value for joint audit is .4857 (Standard deviation = .50340). This outcome indicates that about half of the banks in the industry are being audited by joint auditors.

**Table 4.1: Descriptive Statistics**

| Variables | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Financial Reporting Quality | 70 | 1.00 | 5.00 | 3.9443 | .66499 |
| Audit Firm Size | 70 | .00 | 1.00 | .8286 | .37960 |
| Audit Fees | 70 | .00 | 8.73 | 7.1530 | 2.65090 |
| Joint Audit | 70 | .00 | 1.00 | .4857 | .50340 |
| Valid N (listwise) | 70 | | | | |

**Source: Field Survey (2019)**

### 4.2 Test of Hypotheses

The three hypotheses formulated for this study were tested with correlation and multiple regression analyses.

#### 4.2.1 Correlation Analysis

Table 4.2 shows the results of correlation analysis. Positive significant correlation (r = .575, p-value = .015) was observed between audit firm size and financial reporting quality. This implies that the larger the size of the audit firm, the higher the financial reporting quality of the sampled banks. Specifically, the implication is that auditing of the sampled banks by one of the big 4 audit firm is associated with higher financial reporting quality. Moreover, positive significant correlation (r = .600, p-value = .000) was observed between audit fees and financial reporting quality. This implies that the higher the audit fees received by the auditing firm, the higher the

financial reporting quality of the sampled banks. However, positive non-significant correlation (r = .069, p-value = .570) was observed between joint audit and financial reporting quality.

**Table 4.2: Correlation Results**

| | | FRQ | AFZ | AF | JA |
|---|---|---|---|---|---|
| FRQ | Pearson Correlation | 1 | .575** | .600** | .069 |
| | Sig. (2-tailed) | | .015 | .000 | .570 |
| | N | 70 | 70 | 70 | 70 |
| AFZ | Pearson Correlation | .575** | 1 | -.093 | -.013 |
| | Sig. (2-tailed) | .015 | | .443 | .915 |
| | N | 70 | 70 | 70 | 70 |
| AF | Pearson Correlation | .600** | -.093 | 1 | .105 |
| | Sig. (2-tailed) | .000 | .443 | | .388 |
| | N | 70 | 70 | 70 | 70 |
| JA | Pearson Correlation | .069 | -.013 | .105 | 1 |
| | Sig. (2-tailed) | .570 | .915 | .388 | |
| | N | 70 | 70 | 70 | 70 |

**. Correlation is significant at the 0.01 level (2-tailed).

**Source: Field Survey (2019)**

#### 4.2.2 Regression Analysis

The three hypotheses were tested with multiple regression analysis and t-test. The outcomes of these inferential statistics are presented in the following sub-sections.

##### 4.2.2.1 Hypothesis One

Hypothesis one focused on the effect of audit firm size on financial reporting quality. It was stated in the null form as "Audit firm size has no significant effect on financial reporting quality of banks in Nigeria". Table 4.11 presents the model summary. The R Square (.406) shows that 40.6% variation in quality of financial reporting can be predicted by audit firm size, audit fees and joint audit.

**Table 4.3: Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .637[a] | .406 | .379 | .52404 |

a. Predictors: (Constant), JA, AFZ, AF

**Source: Field Survey (2019)**

Table 4.4 presents ANOVA results. The F-Value is fairly large and significant (F-value = 15.037, p-value = .000. Field (2000) noted that large F-value is an indication of good fitness of a model. Therefore, the model is of good fitness.

**Table 4.4: ANOVA[a]**

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 12.388 | 3 | 4.129 | 15.037 | .000[b] |
| | Residual | 18.125 | 66 | .275 | | |
| | Total | 30.513 | 69 | | | |

a. Dependent Variable: FRQ

b. Predictors: (Constant), JA, AFZ, AF

**Source: Field Survey (2019)**

With respect to hypothesis one, table 4.5 revealed a beta value and t-test value for audit firm size to be .376 and 2.252 respectively with significant p-value of .028. This outcome revealed positive significant relationship between audit firm size and financial reporting quality of the sampled banks. Hence, the null hypothesis was rejected and the alternative hypothesis was accepted. It can then be concluded that audit firm size has significant positive effect on financial reporting quality of banks in Nigeria.

**Table 4.5: Regression Coefficients**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 2.517 | .242 | | 10.397 | .000 |
| | AFZ | .376 | .167 | .215 | 2.252 | .028 |
| | AF | .155 | .024 | .620 | 6.467 | .000 |
| | JA | .009 | .126 | .007 | .072 | .943 |

**Source: Field Survey (2019)**

#### 4.2.2.2 Hypothesis Two

Hypothesis two stated that "Audit fee has no significant effect on financial reporting quality of banks in Nigeria". The regression output from table 4.5 revealed beta value and t-test value for audit fees as .155 and 6.467 respectively with significant p-value of .000. This outcome revealed positive significant relationship between audit fee and financial reporting quality. Hence, the null hypothesis was rejected and the alternative hypothesis was accepted. It can therefore be concluded that audit fee has significant effect on financial reporting quality of banks in Nigeria.

#### 4.2.2.3 Hypothesis Three

Hypothesis three stated that "Joint audit has no significant effect on financial reporting quality of banks in Nigeria". The regression output from table 4.5 revealed a regression coefficient and t-test value for joint audit as .009 and .072 respectively with non-significant p-value of .943.

Consequently, the null hypothesis was accepted and the alternative hypothesis was rejected. Therefore, it can be suggested that joint audit has no significant effect on financial reporting quality of banks in Nigeria.

**4.4 Discussion**

The finding from this study reveals that audit firm size has significant positive effect on financial reporting quality of banks in Nigeria. This outcome was supported by Hassan and Naser (2013) that positive relationship exists between auditor's size and the quality of its services. Further support was derived from Becker, DeFond, Jiambalvo, & Subramanyam, (1998) and Nelson, Elliott and Tarpley, (2002) that firms being audited by big four audit firms are less likely to manage earnings, as evidenced by income increasing accruals, small positive earnings changes, or meeting/beating analyst expectations.

Further result from this study indicates that audit fee has significant effect on financial reporting quality of banks in Nigeria. This result derived support from Francis and Ke, (2003), Reynolds and Francis (2004) and Umaru (2014) that audit fee does have a negative relationship with earnings quality, and thus improve the quality of financial reporting.

Another outcome of this study is that joint audit has no significant effect on financial reporting quality of banks in Nigeria. Lasege *et al*., (2012) that observed insignificant relationship between abnormal accruals and joint audits. This result was also supported by Marmousez (2009) that provided evidence that Big 4–Big 4 auditor pairs are not associated with earnings conservatism. Further support was obtained from Ratzinger-Sakel, *et al*. (2011) that an insignificant relationship exists between abnormal accrual and joint audits.

# CHAPTER FIVE

# SUMMARY, CONCLUSSION AND RECOMMENDATIONS

## 5.0 Introduction

This chapter consists of summary of the work done, conclusion drawn from the findings of the study, recommendations that follow from the conclusion as well as suggestions for further studies.

## 5.1 Summary of Work Done

This study centered on the relationship between audit characteristics and the financial reporting quality of deposit money banks (DMBs) in Nigeria. Chapter one consists of background to the study, statement of the problem, research objectives, research questions, research hypotheses, significance of the study, scope of the study and definition of terms.

Chapter two focused on conceptual, theoretical and empirical reviews. Variables examined in the study include audit firm size, audit fee, joint audit and financial reporting quality. From the empirical review, gaps in literature were identified. These gaps include variable exclusion (joint audit which is not well researched) and a new proxy for financial reporting quality, faithful representation of financial statement as operationalized by Nice, (2009) which this study proceeded to fill.

Chapter three focused on research design, population of the study, sampling technique and data collection. In order to obtain sufficient panel data for regression analysis, 10 banks were selected from 21 deposit money banks in Nigeria as at 31$^{st}$ December, 2018 by simple random sampling

techniques. Secondary data were collected from the annual reports of the sampled deposit money banks for the period 2012 to 2018.

In chapter four, the secondary data obtained from the annual reports were subjected to descriptive and inferential statistics. The descriptive statistics includes means and standard deviation while the inferential statistics includes regression and correlation analyses.

The current chapter comprised summary of work done, conclusion, recommendations and suggestions for further studies. Major findings were outlined while policy implications of these findings were also highlighted.

**5.2 Conclusion**

The effect of audit characteristics on financial reporting quality of deposit money banks was investigated in this study. This study reveals that audit firm size has significant positive effect on financial reporting quality of banks in Nigeria. Further finding from this study indicates that audit fee has significant effect on financial reporting quality of banks in Nigeria. Another outcome of this study is that joint audit has no significant effect on financial reporting quality of banks in Nigeria. Hence conclusion can be drawn that audit firm size and audit fee have significant effects on financial reporting quality of deposit money banks sampled for this study while joint audit does not.

## 5.3 Recommendations

Based on the conclusion of this study, the following recommendations were drawn:

1. Shareholders of deposit money banks in Nigeria should ensure that big size audit firms like the "big four" is the leading auditor of their banks to guarantee higher financial reporting quality.
2. The directors of deposit money banks in Nigeria should maintain the service of their auditor regardless of the magnitude of audit fee to guarantee higher audit quality that can translate to higher financial reporting quality.

## 5.4 Suggestions for Further Studies

Limitations of this study include limited data source and manageable size of variables. This study concentrated on deposit money banks. Other financial institutions like insurance companies and non-financial institutions were excluded. Future studies may focus on other financial institutions like insurance industry or companies in the non-financial sector of the economy.

The variables explored to represent audit characteristics in this research work were limited to audit firm size, audit fees and joint audit. Other variables like audit tenure, audit firm rotation and non-audit services may be considered in further studies.

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**Appendix 1: Overview of the measures used to operationalize the fundamental and enhancing qualitative characteristic (including themeasurement scale**

| **Faithful representation** | | | | |
|---|---|---|---|---|
| **Question no.** | **Question** | **Operationalization** | **Concept** | **Literature** |
| F1 | To what extent are valid arguments provided to support the decision for certain assumptions and estimates in the annual report? | 1 = Only described estimations<br>2 = General explanation<br>3 = Specific explanation of estimations<br>4 = Specific explanation, formulas explained etc.<br>5 = Comprehensive argumentation | Verifiability | e.g. Jonas and Blanchet, 2000; Maines and Wahlen, 2004 |
| F2 | To what extent does the company base its choice for certain accounting principles on valid arguments? | 1 = Changes not explained<br>2 = Minimum explanation<br>3 = Explained why<br>4 = Explained why + consequences<br>5 = No changes or comprehensive explanation | Verification | e.g. Jonas and Blanchet, 2000; Maines and Wahlen, 2004 |
| F3 | To what extent does the company, in the discussion of the annual results, highlight the positive events as well as the negative events? | 1 = Negative events only mentioned in footnotes<br>2 = Emphasize on positive events<br>3 = Emphasize on positive events, but negative events are mentioned; no negative events occurred<br>4 = Balance pos/neg events<br>5 = Impact of pos/neg events is also explained | Neutrality | e.g. Dechow *et al.*, 1996; McMullen, 1996; Beasley, 1996; Razaee, 2003; Cohen *et al.*, 2004; Sloan, 2001 |
| F4 | Which type of auditors' report is included in the annual report? | 1 = Adverse opinion<br>2 = Disclaimer of opinion<br>3 = Qualified opinion<br>4 = Unqualified opinion: Financial figures<br>5 = Unqualified opinion: Financial figures + internal control | Free from material error, verification, neutrality, and completeness | e.g. Maines and Wahlen, 2006; Gaeremynck and Willekens, 2003; Kim *et al.*, 2007; Willekens, 2008 |
| F5 | To what extent does the company provide information on corporate governance? | 1 = No description CG<br>2 = Information on CG limited, not in apart subsection<br>3 = Apart subsection<br>4 = Extra attention paid to information concerning CG<br>5 = Comprehensive description of CG | Completeness, verifiability, and free from material error | e.g. Jonas and Blanchet, 2000 |

**Appendix 2: List of all Banks Sampled**

1. Eco Bank
2. Access Bank
3. Diamond Bank
4. Fidelity Bank
5. First Bank of Nigeria
6. United Bank of Africa
7. First City Monument Bank
8. Guaranty Trust Bank
9. Union Bank of Africa
10. Zenith Bank