

**AUDIT INDEPEDENCE AND FINANCIAL REPORTING QUALITY:  
EVIDENCE FROM NIGERIAN DEPOSIT MONEY BANKS**

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**A PROJECT SUBMITTED TO THE DEPARTMENT  
OF ACCOUTANCY, SCHOOL OF BUSINESS STUDIES,  
AUCHI  
POLYTECHNIC, AUCHI, EDO STATE.**

**IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR  
THE AWARD OF HIGHER NATIONAL DIPLOMA (HND) IN  
ACCOUNTANCYCHAPTER ONE**

**INTRODUCTION**

**1.1 Background to the Study**

The need to generate quality financial reports has acquired great responsiveness over the world. Firstly, the high-quality financial reporting information is essential because its not only to observe the performance of corporations in terms of their productivity and effectiveness in using resources, but also to

provide information to all necessary interest groups on their economic resources and obligation (Herath & Albarqi, 2017). Secondly and most importantly, quality financial report becomes relevant in the 21st century era because the pursuit of personal material gains at the expense of organizations has emerged into pressure for fraudulent activities in the corporate world (Omoolorun & Abilogun, 2017). Consequently, the universal increase in accounting scandals in the early 21st century has disclosed faults in financial reporting quality.

Thus, the substantial weakness in the financial disclosure has generated the demand by investors, regulators, and other stakeholders to build up the financial information quality and to strengthen the control of management by putting up suitable governance structures (Alzeban, 2018). Corporate governance provides the system to supervise and control the affairs of the companies in the best interest of key stakeholders. Moreover, it supplies the basic framework or structure through which rights and obligations are defined and protected to satisfy key stakeholders such as shareholders, management, lenders, and employees (Hashmi, Salahudin & Nawaz, 2019).

The role of auditors is a key internal corporate governance technique recognized by the corporate governance code (Hassan, Hijazi & Naser, 2017). Ahmed and Dulleman (2011) contend that poor financial reporting of firms relies on the conduct of auditors. A weak auditing system therefore, enlarges the chances of more abnormal accruals and reduce the quality of financial information because

abnormal accruals make future earnings and cash flows unpredictable and could be more vulnerable to earnings manipulation due to reporting irregularities (Hashmi *et al.*, 2019). Consequently, auditors' independence has been known as an important technique in reducing information imbalance (Wakil, Alifiah & Teru, 2020). This is because it makes sure that the auditor presents objective views, which are reliable and truthful about the financial reports produced by managers (Yiosese, 2020). The auditors' independence comprises of several substitutes, which includes auditor tenure (years), size of the audit firm (Big 4 or smaller audit firms) and non audit fees. Currently, Big 4 are the four internationally renowned audit companies, consisting of Pricewaterhouse Coopers (PwC), Deloitte Touche Tohmatsu (DTT), Ernst & Young (EY) and KPMG.

Auditor tenure is the duration that an auditor or an audit company has worked with the present client. Clients change their auditors for different reasons, one of which is to acquire a lower audit fee from a new audit firm as the new auditors may render services at a discount to secure a new client. The auditor would then need to retain client for several years to be able to retrieve the initial costs of initiating the audit (Al-Thuneibat, Al Issa & Baker, 2011). Some clients also change auditors due to the rise in ethical issues. There are two conflicting opinions on the effect of auditor tenure on financial reporting quality. The first

category is of the opinion that as the auditor-client relationship becomes stronger, the auditor may develop close relationship with the client and may act in the interest of management and thus decreases financial reporting quality (Sulanjaku, & Shingjergji, 2015). The second category is of the opinion that the longer the auditor tenure, the further he gains understanding of his client and his knowledge and competence in the field will be one which leads to the increase in financial reporting quality (Salehi, Moradi & Paiydarmanesh, 2017).

The audit firm size is another element that affects auditor's independence which in turn influences financial reporting quality (Herath & Pradier, 2018). There are several distinctions between large and small audit firms which includes the quantity of responsibility, the size and reputation of the clients and the superiority of the staffs (Purnamasari & Negara, 2019). Larger audit firms are more reliable and better than smaller audit firms in terms of modern and improved audit due to better and innovative research facilities, technology, non-audit fees, and skilled labor because they manage audits from bigger firms (Nzewi, 2020). Pressures from management will influence smaller firms on the other hand larger firms are able to withstand all the pressures since they have different variations for client exposure.

Another variable in the auditor independence model is non-audit fees. Auditing firms renders both audit and non-audit services to their clients. Non-audit services include management consulting, audit firm size consulting, tax advice

etc. However, some of the non-audit services performed by the auditing firms may be regarded as a potential conflict of interest to the auditors (Lu-Andrews & Yu-Thompson, 2018). Non-audit services are claimed to be one of the main concerns because of the various financial scandals that have occurred in the last decade. The extent of non-audit fees paid to auditors may be because managers have less fear to command consultative services from their auditors (Pucheta, Bel Oms & Lima, 2018). However, these fees can lower auditors' independence and financial reporting quality, as auditing literature recommends (Dobler, 2014), mostly because this shows a greater economic dependence from auditors on their clients and, as a result, it may influence negatively audit quality and financial reporting quality (Pucheta, et al., 2018). Generally, based on this background, it is necessary to inquire into the impact of auditor independence on financial reporting quality of listed deposit money banks in Nigeria

## **1.2 Statement of Problem**

Several unethical behaviors and financial crises that have happened in this modern day accounting in distinguished companies, has undermined investors' trust regarding the financial reports and have put in place various criticisms about financial reporting quality (FRQ) (Babatunde, Akeju & Malomo, 2017). Majority of these accounting scandals transpired because the firms were manipulating earnings and reporting poor-quality financial information (Sadiq, Mohamad, & Kwong, 2019). In Nigeria, there are also series of well publicized

cases of accounting indecencies. The most eminent in Nigeria is that of Oceanic Bank Plc. The bank overstated its gross earnings in the 2008 annual reports. Instead of reporting a loss suffered it reported profit and equally understated its non-performing loans. This overstatement led to the reassertion of 2008, 2009 and the first quarter of 2010 reports (Orji & Ofoegbu, 2017). The Central Bank of Nigeria (CBN) and the Nigerian Deposit Insurance Corporation (NDIC) special examination showed that the restatement revealed that after-tax profit previously reported as N9.6bn resulted into a loss of N234.6bn; Non-performing Loans previously reported as N54.5bn was reinstated as N443.3bn (Adewale, 2010). This evidence shows that auditor's independence may have been compromised.

Most recently, in 2005, the Financial Reporting Council of Nigeria (FRC) again issued a regulatory order thereby suspending the Stanbic IBTC Holdings Plc Chairman and its CEO for contention of concealment, accounting manipulations, and insufficient disclosures in the financial reports, which are contrary to the provision of section 62 of the FRC (Bala, 2019). The audit firm (KPMG) has been suspended by the FRC for the approach it adopted that could not detect the infractions in the two accounting periods (Odunsi, 2015; Bala, 2019). This generated a doubt as to the integrity of their financial statement and

questioned the independence of the auditors. However, despite the existence of auditors and the audit committee, corporate scandals still exist.

Thus, the universal failure in the financial disclosures required regulatory bodies such as Securities and Exchange Commission (SEC) to lay out the rules and standards that solved the topic of auditors and their activities (Fehntoluwa & Omolara,2019). The CBN also has a regulatory agency of the banking sector issued a Code of Corporate Governance for Banks in Nigeria Post Consolidation effective from 3<sup>rd</sup> April, 2006 (Majiyebo, Okpanachi, Nyor, Yahaya & Mohamed, 2018). These regulatory bodies took this action with the hope that the norms and standards provided would help to increase the value of financial reporting and discourage manipulation (Oji & Ofoegbu, 2017).

Therefore, it is important that all firms present an understandable, wide-ranging and dependable representation of their financial performance (Yiosese, 2020). This has therefore, traced the necessity for growing efforts by both researchers and other stakeholders to reflect on the crucial responsibility that the independence of auditors plays in achieving financial reporting quality. This is particularly evident in the current global financial crisis, which resulted in an extreme debate on the impact of independence of auditors on financial reporting quality, resulting in consideration of potential trade-offs between the

independence of the auditors and financial reporting quality (Olatunji & Weihang, 2017).

A methodical summary of prior studies have confirmed that several studies have been carried out on audit characteristics and financial reporting quality mostly in developed countries such as United States of America and United Kingdom (Monday & Nancy, 2016; Elsiddig, 2020). These empirical studies on financial reporting quality focus mainly on non-financial companies (Ohaka & Tom Abio, 2018; Ifeanyichukwu & Ohaka, 2019; Oyedokun, Okwuosa & Shehu, 2020). Most of these studies relates to specific characteristics of audit committee including audit independence, audit committee size, audit committee expertise. Company include leverage, firm size, profitability, size of audit firm, and the status. In addition, these studies produced inconsistent results on the relationship between audit independence and financial reporting quality.

In spite of its numerous studies on financial reporting quality in the western context, financial reporting quality research is still in its formative years in developing countries (Monday & Nancy, 2016). The scarcity of research in this area is even more obvious in the banking industry (Akhor & Oseghale, 2017). In Nigeria, previous studies on the audit committee paid less interest on the role of auditor's independence. Consequently, this study has considered some precise aspects of auditor's independence that were not explored by preceding studies in Nigeria.



At the same time, the era covered by the previous studies has left a gap. The works of Purnamasari and Negra (2019), for instance, covered the period from 2013 to 2017. Almaquoshi and Powell (2020) covered the period of 2002 to 2013 and Otuya (2019) covered the period of 2013 to 2017. These periods can be considered as not too recent as a lot of activities have taken place in the Nigeria banking sector since then, which include the impact of Covid 19 pandemic. Some of the findings of these studies may not be relied on, particularly at this present time upon since the studies have been taken over by the changes in the business environment. Therefore, this study aims to inspect the impact of auditor independence (audit tenure, audit firm size and non-audit fees) on financial reporting quality of listed deposit money banks in Nigeria within the period from 2010 to 2019.

### **1.3 Objectives of the Study**

The major objective of this study is to determine the impact of auditor independence on financial reporting quality of listed deposit money banks in Nigeria. The specific objectives of the study are to:

- i. Ascertain the effect of audit tenure on financial reporting quality of listed deposit money banks in Nigeria.

- ii. Determine the effect of audit firm size on financial reporting quality of listed deposit money banks in Nigeria.
- iii. Examine the effect of non-audit fees on financial reporting quality of listed deposit money banks in Nigeria

#### **1.4 Research Questions**

- i. To what extent does audit tenure affect financial reporting quality of listed deposit money banks in Nigeria?
- ii. To what extent does audit firm size affect financial reporting quality of listed deposit money banks in Nigeria?
- iii. To what extent does non-audit fees affect financial reporting quality of listed deposit money banks in Nigeria?

#### **1.5 Hypotheses**

Based on the above objectives, the following hypotheses were derived:

**H01:** Audit tenure has no significant effect on financial reporting quality of listed deposit money banks in Nigeria

**H02:** Audit firm size has no significant effect on financial reporting quality of listed deposit money banks in Nigeria

**H03:** Non-audit fee has no significant effect on financial reporting quality of listed deposit money banks in Nigeria

## **1.6 Significance of the Study**

The findings of this study are expected to be valuable to the regulators, practitioners (auditors and forensic accountants), and board of directors who are responsible for promoting the oversight of companies, thereby dropping the chances of management engaging in accounting manipulations. In the same vein, it will also serve as a basis for the formulation of laws and policy implications. In this regard, the result of the study is important to the authorities, such as policymakers and regulatory agencies such as Central Bank of Nigeria.

Finally, the results of the study will contribute towards filling the knowledge gap on the subject matter. The findings of the study might be beneficial additions to the literature in the field of resources for crime prevention. Hence the results of the study, based on its objectives, might become valuable for those existing and prospective investors as well as financial analysts.

## **1.7 Scope of the Study**

The study focused on the impact of auditors' independence and how it affects financial reporting quality. Auditor independence shall be measured by Auditor tenure (years); Size of the Audit Firm (Big 4 or non-big 4); and non-audit fees. The dependent variable, financial reporting quality shall be measured by

discretionary accruals or provisions. The study covered the period of nine years from 2010 to 2019. The choice of the period (2010-2019) was as a result of many changes in the economy of Nigeria due to the global health pandemic. The data was purely from a secondary source through the annual reports of listed deposit money banks in Nigeria.

### **1.8 Limitation of the Study**

Firstly, the findings of this study will be drawn from financial services hence generalization may not be possible. Thus, the findings of the study might not be applicable to the non-financial sector as financial services have their own unique characteristics and regulations.

Finally, this study has focused on auditor independence and financial reporting quality. Auditor independence shall be measured by auditor tenure (years), size of the audit firm (Big 4 or non-big 4); and non-audit fees. The dependent variable, financial reporting quality, shall be measured by discretionary accruals or provisions. However, there are several proxies that could be used to measure these variables. Yet, these above limitations highlight room for improvement in future study of financial reporting quality.



## **CHAPTER TWO**

### **REVIEW OF RELATED LITERATURE**

#### **2.1 Conceptual Review**

##### **2.1.1 Financial Reporting Quality**

According to International Accounting Standard Board (IASB), financial reporting quality determines fundamental qualitative characteristics and enhances qualitative characteristics (IASB, 2015). The board defined fundamental qualitative characteristics as the relevance and faithful representation of the financial statements' information. It explained enhancing qualitative characteristics as comparability, verifiability, timeliness, and understandability of financial statements. Moreover, financial reporting quality refers to financial and non-financial information useful for decision making (Herath & Albarqi, 2017).

Financial reporting quality according to Dandago and Rufai (2014) is obtained by a process of identifying and administering the activities needed to achieve the quality objectives of audit work. Users, auditors, regulators and other stakeholders in the audit report process may have very different opinion as to what constitutes financial reporting quality, which will influence the type of indicators one might use to assess financial reporting quality (Enofe, Mgbame, Adeyemi & Ehi-Oshio, 2013). As expected, financial reporting quality is dire to

investor confidence as well as transparency is unswervingly reliant on the quality of the audit opinion and the financial report. Financial reporting quality is of tremendous concern not only to the final users, but to the entire economy as it affects economic decisions which may have significant impact (Ahmed 2018). However, managerial opportunistic behaviors as well as unethical accounting practices are identified as major challenge to the quality of accounting earnings and financial reporting quality (Shen & Hsiang-Lin, 2007). The decline in the confidence in financial reporting and auditing arising from corporate collapses and audit failures in a number of countries including Nigeria is the background of reforms in audit independence and quality control.

### **2.1.2 Audit Tenure**

This concept refers to the length of the auditor-client relationship period and includes the period (measured in years) that the audit firm issued audit reports on the entity. It has an impact on client's company, such as the auditor independence and competence, emotional relationships between auditor and clients, fees, and so forth (Priyanti & Dewi, 2019). A lot of debates have evolved in the academic literatures and accounting profession on the relationship between audit tenure and financial reporting quality (Jenkins & Vermeer, 2013; Blandon & Bosch, 2015). The center of the argument is the issue of auditor's independence in the auditor-client relationship; which is the ability of auditors to maintain an unbiased position in performing their audit

assignments, issuing audit opinion and ensuring high quality audit report (Odia, 2015). There have been two opposing views on the effects of audit tenure on financial reporting quality. Some are of the view that as the auditor-client relationship lengthens, the auditor may develop a close relationship with the client and impair independence which will eventually result in poor financial reporting quality (Becker, DeFond, Jiambalvo & Subramanyam, 2013). The other view is that as audit tenure lengthens, auditors increase their understanding of their clients' business and develop their expertise during the audit exercise and gain better insights into the clients operations and business strategies as well as internal control over financial reporting which will result in higher audit quality (Arens, Elder & Beasley, 2015; Ling & Nopmanee, 2015).

Prior studies found that auditor tenure is one of the main factors that may affect auditor independence because of auditor compromises on their clients reporting choices in order to retain a long-term auditor-client relationship. Consequently, long auditor tenure negatively affects financial reporting quality. There are researches which find a positive relationship between audit tenure and the quality of financial reporting measured by the discretionary accruals. Hence, imposing mandatory rotation of partner, which limit the auditor partner's tenure, can lead to decrease in financial reporting quality. Conversely, other studies had found a negative relationship between the quality of audit and extended tenure of audit partners. Hence, the effect of the rotation of audit partner on audit



quality is still inconclusive. Therefore, where investors notice long audit tenure, they seem to be skeptical about such company's financial statements as there is every possibility that the auditor might not be independent in the opinion about the credibility of their client's financial statements which can affect the company's stock negatively in the market (Otuya, 2019).

### **2.1.3 Audit Firm Size**

This refers to whether the company's financial statements are audited by a big or small auditing company. Audit firm size is about how large or small an audit firm is. In Nigeria, audit firms are broadly categorized into big and small audit firms. The big audit firms often referred to as the Big-4 include PricewaterhouseCoopers (PWC), Klynveld Peat Marwick and Goerdeler (KPMG), Akintola Williams & Deloitte, and Ernst & Young (EY). While the small audit firms also referred to as the non-Big-4 include all audit firms other than the Big-4. According to Okolie (2014), the size of audit firm suggests reputation, international affiliation and integrity of the audit firm; qualities which underscore the quality of audit report issued by the auditor. Some researchers argued that the big audit firms usually provide better quality audit than their smaller counterparts. This is because large audit firms can make huge investment in the provision of training courses and other resources to improve the competency of all staff which will translate to high quality audit services with less interference by client (Sawan and Alsaqqa, 2013).

In a study, Albeksh (2016) argued that to measure audit firm size in relation to financial reporting quality, geographical spread of the firm has to be considered. They advocated that firms with larger geographical spread are more independent. This position clearly supports the view that the bigger or larger an audit firm is, the more independent it could be from the client and therefore provide better quality financial reports. Audit firm size may also interact with the level of competition in the audit environment (Jerry & Saidu, 2018). Because of its smaller revenue base, a small firm may not be able to withstand the effects of competition as well as a larger firm. It is usually at a disadvantage because of (1) the prestige associated with larger firms, and (2) the superior financial resources available to larger firms (Priyanti & Dewi, 2019).

#### **2.1.4 Non-Audit Fees**

Riccardi (2019) defined non-audit fees as any fees paid for services rendered to the listed issuer or its subsidiaries other than for statutory auditing work. The amount of fees paid for non-audit services are not delimited or restricted under any legislation or act. However, the amount incurred should be included or disclosed in the annual reports. Therefore, the public listed companies are required to disclose non-audit fees paid to corporations which are owned by the external auditors or their partners. The aims are to protect shareholders' interest and to increase corporate transparency. Non-audit fees are fees paid to the auditor for non-audit services which are services offered by audit establishment

which does not cover audit such as bookkeeping, tax evaluation, advisory functions containing investment banking aids, corporate strategic planning, human resource planning, computer hardware, software setting up, implementation as well as internal audit subcontracting (Istrate, Bunget & Popa, 2020). Non-audit services refer to all accounting services provided by the professional accountant other than statutory audit function. However, significant non-audit services revenue can cause conflict of interest since it diminishes public opinion on audit quality for the financial reporting. This has more influence on auditor's autonomy because when the auditor is covering both audits as well as non-audit services to a particular client; this could result to conflict in interest and reduce the autonomy of the auditor (Abiahu, Egbunike, Udeh, Egbunike & Amahalu, 2019). Consequently, this raises another debate in the audit profession whether an audit firm can maintain both their autonomy and objectivity when providing audit services as well as non-audit services. In fact, research by Aamir and Farooq (2011) indicates that the provision of non-audit services increases auditor's independence. Tepalagul and Lin (2015) support this position by maintaining that the auditor combining the statutory audit function and rendering non-audit services increases knowledge about the client that reduces risk and increases auditor's independence.

Fee is any fess established for the performance of any service pursuant to an arrangement (Bala, Amran & Shaari, 2018). In most studies, audit independence

is surrogated by the relative magnitude of the audit fee as against the non-audit fee received from a particular audit client. Non-audit services fees are fees paid for services other than statutory audit services. Riccardi (2019) defined non-audit fees as any fees paid for services rendered to the listed issuer or its subsidiaries other than for statutory auditing work. The amount of fees paid for non-audit services are not delimited or restricted under any legislation or act. However, the amount incurred should be included or disclosed in the annual reports. Therefore, the public listed companies are required to disclose non-audit fees paid to corporations which are owned by the external auditors or their partners. The aims are to protect shareholders' interest and to increase corporate transparency

## **2.2 Theoretical Framework**

This paper aims to examine the main issues surrounding audit independence and financial reporting quality of deposit money banks in Nigeria. The theories used in this research are Agency theory, Lending credibility theory and Policeman theory.

### **2.2.1 Agency Theory**

Agency theory was developed by Jensen and Meckling (1976) and it deals with the people who own the business and those that are interested in it, which are the shareholders. Jensen and Meckling (1976) suggest that managers of other

people's money cannot be expected to watch over it with same anxious vigilance one would expect from owners and that negligence and profusion, hence must always prevail in the management of the affairs of such a company. To curtail such behaviour, effective control of the board would greatly help. The effectiveness of the board depends among others, on subcommittees of the board (Kibiya, Che-hmad & Amran, 2016). Also Shi and Zhou (2012) argue that board audit as a sub-committee and their financial expertise are found to affect the level of the way managers manipulate earnings to achieve corporate or personal benefit. Agency theory is considered to be contract between shareholders (principals) and external auditors to control the work of other agents (management). Shareholders (principals) delegate task to be performed by management (agents). Tasks mainly cover operating the organization on behalf of shareholders to meet their objectives. Auditors exercise and intermediary role between shareholders and management.

The most important basis of agency theory is that the managers are usually motivated by their own personal gains and work to their own personal interests rather than considering shareholders' interests and maximizing shareholder value. Similarly, Dhaliwal, Naiker and Navissi (2010) posit that the ability to adequately supervise the activities and constrain opportunistically managed earnings lies with effective internal corporate governance mechanisms. Internal governance mechanisms involve among others, the formation of an independent

audit committee that would supervise the activities of managers and ensure strict compliance with the financial regulations. However, the effectiveness of the committee depends on its composition and the expertise of its members. Also, the impact of high status industry experience (Kibiya, Che-Ahmad, & Amran, 2016), accounting expertise and industry experts (Cohen, 2014) have been subject to conflicting findings.

### **2.2.2 Lending Credibility Theory**

Lending credibility theory was developed by Limperg in the year 1920 to inspire confidence in financial statements of an organization. This theory suggests that the primary function of the audit process is to add credibility to the financial statements. The theory assumes that assurance in financial statements is increased upon relying on audited financial statements rather than the unaudited financial statements presented by the management team of the organization (Kamau, Boiywo & Kiprop, 2018). As explained by the Lending credibility theory, in order to satisfy organizations' stakeholders, the financial statements have to be audited (Kruger & Rooyen, 2016). The stakeholders who are the users of the financial statements to make decision in regard to the activities of the organization, gain benefits from the increased credibility of financial statements. The proponent of lending credibility therefore argues that the need for the credibility in the financial reporting should act as a motivating factor for any organization and effective audit committee. Independent,

diversified and competent audit committee will ensure quality is upheld in financial reporting. Kabiru and Rufai (2014) found that audit quality is often related to the competence and independence of audit committees as being able to detect material misstatements and being prepared to issue appropriate audit reports to reflect their findings. The theory fits in the study by ensuring that financial reporting under the audit committee's scrutiny is as accurate as possible and this adds credence to the financial statements. This gives confidence to all the stakeholders on the performance of the organization as represented in the financial reports (Hayes, 1999).

### **2.2.3 The Policeman Theory**

The policeman theory claims that the audit and assurance process is responsible for searching, discovering and preventing fraud. This was the case in the early 20<sup>th</sup> century. Like a policeman, the major aim of this process has been to give reasonable assurance and verify the true and fair view of financial reporting. The detection of fraud is, however, still a serious topic for debating on the auditors independence and various events where financial statement fraud have been revealed, the expectation increases on the responsibilities of auditors in detecting fraud and manipulation of financial information. Under this theory an auditor acts as a policeman focusing on arithmetical accuracy and on prevention and detection of fraud in the company (Rosyadi & Budding, 2017). According to this theory, the audit committee should put in place mechanisms to detect

fraud before it happens just like a policeman tries to prevent crime from happening. In terms of quality of financial reporting, audit committee is viewed to perform the duty synonymous to that performed by the policeman such as to check and detect any instances of fraud in the organization. As mentioned earlier policeman theory claims that the audit and assurance process is responsible for searching, discovering and preventing fraud, therefore audit committees acting as organization policeman go a long way in ensuring quality financial reporting.

## **2.3 Empirical Review**

This section reviewed literature from prior scholars on the relationship between Auditor Independence and Financial Reporting Quality of Listed Deposit Money Banks in Nigeria.

### **2.3.1 Audit Tenure and Financial Reporting Quality**

Riccardi (2019) examined how audit firm tenure is associated with charges in financial reporting quality due to mandatory adoption of International Financial Reporting Standards. The author argued that auditors were integral in proper implementation of IFRS and could have mitigated potential negative consequences associated with IFRS adoption. The study findings suggest that short audit firm tenure was associated with a decrease in quality, relative to those with medium and long tenure are generally not significant. Other results



show that companies with a big auditor firms had greater improvements, or smaller decreases, in reporting quality relative to smaller audit clients. The study results do not support concerns that longer tenure impairs audit quality. The study is also important to standard setters as they evaluate the results of IFRS adoption. Mgbame, Eragbhe and Osazuwa (2012) noted that an audit firm's tenure can result in a loss of an auditor's independence. A long audit-client relationship could lead to an alignment of the auditor's interest and that of its client which makes truly independent behaviour of the auditor less of a probability. Existing studies show that a positive relationship exists between audit tenure and financial reporting quality (Alsmairat, 2019). An extensive literature review shows confounding evidence on the relationship between audit tenure and financial reporting quality. Carp and Istrate (2021) estimated the impact of auditor's tenure on financial reporting quality using panel data of 558 firms from the Tehran Stock Exchange for 2011-2016. The findings showed that there is a significant and positive relationship between audit tenure and financial reporting quality. At the same time, some authors argued that short audit tenure gives high financial reporting quality because it prevents familiarity with the management, which can impair auditors' independence and affect objectivity; others argued that long term audit tenure allows auditors to understand the clients' operation better and produce a high-quality financial report (Eyenubo et al., 2017). In like manner, the analysis of 280 non-financial firms in Pakistan shows a negative relationship between audit tenure and financial reporting

quality. This result implies that the longer the audit tenure, the lower the financial reporting quality (Kalabeke, Sadiq, & Keong, 2019). Another empirical investigation of the relationship between audit tenure and the quality of financial reporting of 80 listed companies on the Nigerian Stock Exchange for seven years indicates a significant relationship between audit report and financial reporting quality. Still, the study suggests no significant relationship exists between audit tenure and financial reporting quality (Osamudiamé, Nwadiador, & Imuentinyan, 2018).

### **2.3.2 Audit Firm Size and Financial Reporting Quality**

Eyenubo, Mohamed and Ali (2017) examined the relationship of audit size and financial reporting quality in Nigeria. The empirical study has been performed using a sample of 189 companies and 664-year observation from the period of 2011-2015. One of the necessary features of corporate governance is to enhance financial reporting quality for facilitating efficient and effective resources allocation of economic decision making by corporate managers. Panel data regression was adopted and audit firm size was found positive and significant with financial reporting quality. Ilaboya and Ohiokha (2014) empirically examine the impact of audit firm size on financial reporting quality. They proxy the dependent variable (financial reporting quality) using the usual dichotomous variable of 1 if big 4 audit firm and 0 if otherwise. Data for the study were sourced from the financial statements of 18 food and beverage companies listed

on the Nigerian Stock Exchange within the period studied (2007-2012). They adopted multivariate regression technique with emphasis on Logit and Probit methods in analyzing their data. Their study revealed there is a positive relationship between firm size and financial reporting quality whereas there is a negative relationship between auditor's independence, audit firm size, audit tenure and financial reporting quality. The panel correlation analysis of 91 firms on the Teheran stock exchange after systematic elimination shows a weak and inverse association between audit firm size and financial reporting quality, but no relationship exists between auditors' rotation and financial reporting quality (Kaklar, Kangarlouei & Motavassel, 2012). However, in Thailand, the outcome of the panel fixed effect model of listed companies on Thailand stock exchange from 2008-2012 shows that audit firm size has a significant relationship with financial reporting quality as financial accounting reports complied with generally accepted accounting standards (Kamolsakulchai, 2015). In Nigeria, an empirical investigation of 15 listed deposit money banks on the Nigerian stock exchange reveals a significant and positive relationship between the audit firm size and financial reporting quality (Ugwu, Aikpitanyi, & Idemudia, 2020).

### **2.3.3 Non-Audit Fees and Financial Reporting Quality**

Onulaka (2019) investigated the extent to which the provision of Non-Audit Services (NAS) by external auditors to audit clients affects auditors' independence and the audit expectation gap in Nigeria. The study embraces an interpretivist approach. Thirty semi structured, face-to-face interviews were conducted to explore the views expressed by audit partners and pension fund managers in Nigeria; group responses were evaluated and presented separately. After transcribing the interview audio recordings, a thematic data analysis of the two groups' responses was performed. Interpretation of the interview responses indicates that the provision of NAS by audit firms to their clients is regarded by auditors as a matter of economic necessity. Nevertheless, it is also perceived as impeding auditors' independence and increasing the gap between the auditor and public expectation. Therefore prior research leads us to improve the prevalent regression (one equation) approach by setting up a system of equation containing many of the same exogenous variables to better handle endogeneity concerns. The use of abnormal accruals as a proxy for audit quality because a common assertion in the business environment is that fees for non-audit services may induce auditors to allow clients to get away with accounting chicanery, part of which might be reflected in abnormal accruals, that is discretionary income or expenses that are yet to be realized but are recorded in the account book (Pedro, Alexandre, & Carlos, 2014). According to Ruddock

and Taylor (2005) the provision of NAS has recently been the focus of attention, with the widely accepted view being that non-audit services are provided at a higher profit margin than audit services. Frankel (2002), finds evidence of a positive association between non-audit fees and financial reporting quality. He interpret this connection as evidence that auditors are more willing to tolerate aggressive client reporting whenever the client pays higher non-audit fees to the auditors. Most recently Asthana, Khurana and Raman (2018) examine non-audit fees among Big 4 auditors and financial reporting quality, using the panel correlation data analysis of 83 firms. They show that fees competitions are valued as essential mechanism for enhancing financial reporting quality in the vastly concentrated audit market. In the same vein, Knechel, Mintchik, Pevzner and Velury (2018) examine the impacts of the widespread trust and community cooperation on non-audit fees among different countries in the world, using the regression method of data collection within the period 2008-2018 and therefore find a significant relationship between non-audit fees and financial reporting quality.

## **2.4 Summary of the Review**

As seen in the review of empirical literature, auditor independence remains an important element when conducting an audit. Auditor independence ensures an unbiased perspective and allows financial statements to be more reliable. Firms face a risk of damaging their reputation once auditors fail to report mistakes in

their audit. In this literature review, we examined several determinants that influence auditor independence either directly or indirectly of which are audit tenure, audit firm size and non-audit services. It is however evident that independence remains a going concern when discovering how reliable and credible financial statements are to investors.

<b>S/N</b>	<b>Author</b>	<b>Date</b>	<b>Objectives</b>	<b>Methods</b>	<b>Findings</b>
1	Eyenubo, Mohamed and Ali	(2017)	They examined the relationship of audit size and financial reporting quality	Panel data regression was adopted	Audit firm size was found positive and significant with financial reporting quality
2	Ilaboya and Ohiokha	(2014)	They empirically examined the impact of audit firm size on financial reporting quality.	Multivariate regression technique with emphasis on Logit and Probit methods	Their study revealed there is a positive relationship between firm size and financial reporting quality
3	Carp and Istrate	(2021)	Estimated the impact of auditor's tenure on financial reporting	Using panel data of 558 firms from 2011-2016.	The findings showed significant and positive relationship

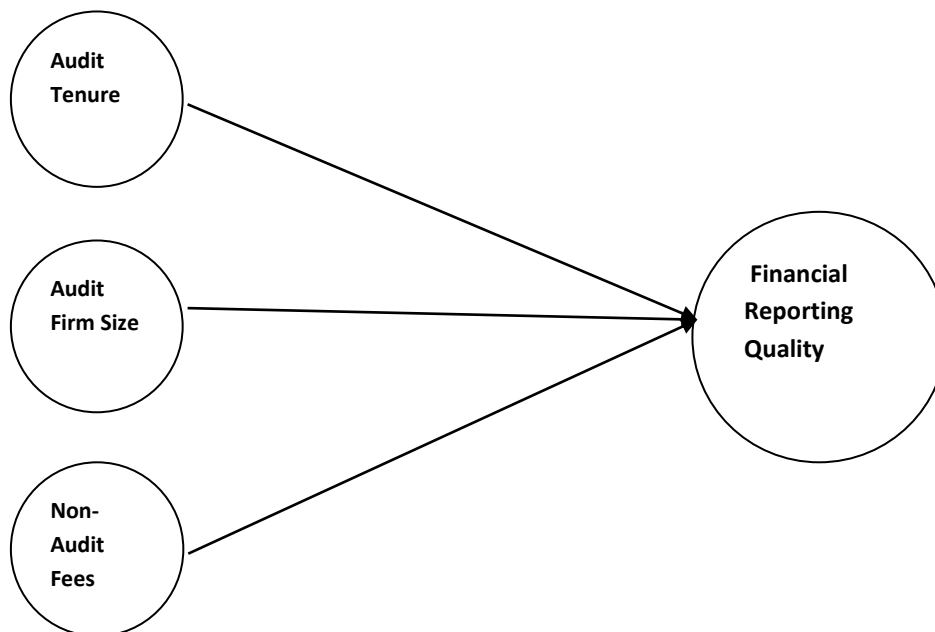
			quality		between audit tenure and financial reporting
4	Knechel et al	(2018)	Examined the impacts of the widespread trust and community cooperation on non-audit fees among different countries in the world	Using the regression method of data collection	Finds a significant relationship between non-audit fees and financial reporting quality
5	Kamolsakulchai	(2015)	Studied the relationship between audit firm size and financial reporting quality	The panel fixed effect model	Audit firm size has a significant relationship with financial reporting quality
6	Asthana, Khurana and Raman	(2018)	They examined non-audit fees among Big 4 auditors and financial reporting	Using the panel correlation data analysis	Fees competitions are valued as essential mechanism for enhancing

			quality		financial reporting quality
7	Osamudia me, Nwadiolor, & Imuentinya n	(2018)	empirical investigation of the relationship between audit tenure and the quality of financial reporting	Analysis of 80 listed companies on the Nigerian Stock Exchange for seven years	Indicates a significant relationship between audit report and financial reporting quality
8	Onulaka	(2019)	investigated the extent to which the provision of Non-Audit Services (NAS) by external auditors to audit clients affects auditors' independence	The study embraces an interpretivist approach	Indicates that the provision of NAS by audit firms to their clients is regarded by auditors as a matter of economic necessity
9	Kalabeke, Sadiq, & Keong	(2019)	To investigate the relationship between audit tenure and financial reporting quality	The analysis of 280 non-financial firms in Pakistan	Shows a negative relationship between audit tenure and financial reporting quality



10	Riccardi	(2019)	Examined how audit firm tenure is associated with changes in financial reporting quality due to mandatory adoption of International Financial Reporting Standards	The author argued that auditors were integral in proper implementation of IFRS and could have mitigated potential negative consequences associated with IFRS adoption	The study findings suggest that short audit firm tenure was associated with a decrease in quality, relative to those with medium and long tenure are generally not significant.
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## 2.5 Conceptual Framework



**Source: Researcher's Conceptualization**

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Research Design**

This study is designed as a quantitative study, aiming to understand the influence of auditor's independence on financial reporting quality in Nigeria. To achieve the objectives of this study, data were collected from annual reports of selected firms and used during the research period.

#### **3.2 Population**

The population of the study comprises of the 21 deposit money banks (DMBs) in Nigeria as at 31 December 2019 (Appendix I). Selected banks were purposively selected based on availability of those with complete information and consistently listed at the stock market as at the time of the study (Appendix II).

#### **3.3 Sample Size and Sampling Technique**

The sample size of this study comprises of the selected DMB in Nigeria, over a period of nine (10) years from 2010-2019. The reason for adopting the sampling technique used in this study is due to data availability.

### 3.4 Method of Data Collection

The method of data collection for this research work is the secondary data which is the annual reports of selected DMBs under study for the period 2010 to 2019.

### 3.5 Method of Data Analysis

The data obtained from secondary sources were analyzed using E-Views Computer Software. Multi regression analysis was used to determine if there was any significant effect on one variable or the other while correlational analysis was used to measure the strength of association between variables.

### 3.6 Model Specification

The dependent variable is a linear function of the independent variable. The model is applied in the study is shown below:

$$FRQ = f(AI)$$

Functional Relationship:

$$AI = f(RAF, AT, AFS, \& ANA).....(1)$$

Econometric Equation:

$$FRQ = \alpha_1 + \beta_1 AT + \beta_2 AFS + \beta_3 ANA + \epsilon \tau.....(2)$$

Where,

FRQ = Financial reporting quality

AI = Auditors independence

AT = Auditors tenure

AFS = Auditors firm size

ANA = Auditors non-audit fees

$\alpha_1$  = constant term

$\beta_1, \beta_2$  &  $\beta_3$  = Coefficient of AT, AFS & ANA respectively

$\varepsilon\tau$  = Error term

## CHAPTER FOUR

### DATA PRESENTATION AND ANALYSIS

#### 4.1 Presentation and Analysis of Data

Table 4.1 presents the summary of the descriptive statistics for the dependent and independent variables for one hundred and fifty-nine (159) observations. It shows that earnings management measure has a mean value of about -0.0711 and a standard deviation of about 2.726.

For audit tenure, mean value is 4.802 and standard deviation of 0.728. The corresponding values for the others are: audit firm size, -0.608 and 0.489 respectively; non-audit fee -4.157 and 0.487 respectively. The p-values of the skewness and kurtosis statistics show that in all the cases the data are judged to be normally distributed at 5% level of significance, being 0.0000.

**Table 4.1: Descriptive Statistics**

Variable	Obs	Mean	Std. Dev.	Pr(Skewness)	Pr(Kurtosis)
<b>FINRQ</b>	173	-.0710815	2.726208	0.0000	0.0000
<b>AUDTEN</b>	212	4.801887	.7275201	0.0000	0.0000
<b>AUDFSZ</b>	194	.6082474	.4894049	0.0121	0.0000
<b>AUDF</b>	212	4.157231	.4866864	0.0002	0.0029

Source: Researcher's Computation Using STATA

**Table 4.2: Correlation Matrix**

	<b>FINRQ</b>	<b>AUDTEN</b>	<b>AUDFSZ</b>	<b>AUDF</b>
<b>FINRQ</b>	1.0000			
<b>AUDTEN</b>	0.3050	1.0000		
<b>AUDFSZ</b>	-0.0079	-0.0250	1.0000	
<b>AUDF</b>	-0.0154	0.0898	0.0073	1.0000

Source: Researcher's Computation Using STATA

Table 4.2 shows that there are mixed correlations between the various variables used in the study. The table shows positive correlations between financial reporting quality measure and audit tenure; and but negative between financial reporting quality and the other two. No two of the explanatory variables are perfectly correlated or nearly so. Thus, the problem of multicollinearity is absent in this model.

## **4.2 Testing of Hypotheses**

### ***Test Statistic***

The statistical tool used in testing the stated hypotheses is the regression test procedure which uses the individual significance test (t-test) and the overall significance test (chi-squared-test). The goodness of fit of the model is tested using the coefficient of determination. The estimation of these statistics is done using the STATA computer software.

### ***Significance Level***

The level of significance adopted in this study in testing the stated hypotheses of this study is 5%. This level is usually considered adequate for studies in management and other behavioural sciences.

### ***Decision Rule***

The critical p-value used in these tests is 0.05. Thus, the researcher accepts a given alternative hypothesis as being accepted if calculated p-value is less than or equal to 0.05, otherwise the researcher accepts the null hypothesis that there is no significant effect.

**Table 4.3: Explanatory variable**

<b>Variable</b>	<b>OLS Regression</b>	<b>ROBUST Regression</b>
<b>AUDTEN</b>	1.2285(0.000)	0.0110(0.023)
<b>AUDFSZ</b>	.00058(0.999)	-0.0269(0.047)
<b>AUDF</b>	-.2559(0.574)	-0.0046(0.008)
<b>_cons</b>	-4.9008(0.034)	-0.0810(0.403)
<b>F-Stat</b>	5.45(0.0014)	0.98(0.0038)
<b>N</b>	160	
<b>VIF</b>	1.01	
<b>Heteroscedasticity</b>	74.50(0.0000)	
<b>R-Squared</b>	0.0949	
<b>Adj R-Squared</b>	0.0774	



Table 4.3 shows that the explanatory variable does not account for much of the systematic variations in the dependent variable. The table shows very moderate value of R-squared of 0.0949.

This value of the R-squared statistic shows that the explanatory variables are collectively able to explain a very small proportion of the variations in the dependent variables meaning that other variables are minimally useful in explaining changes in the dependent variable. For the model, the p-value of the F statistic (0.0038) shows that the model overall is suitable for estimating the stated model.

The VIF test (1.01) shows that there is the absence on multi-collinearity and so there is no need to drop any variable. Also, the heteroscedasticity is 8.05 with p-value of 0.0000, showing that there significant heteroscedasticity problem and so the need for a robust regression.

### ***Hypothesis 1***

**H<sub>0</sub>:** Audit tenure has no significant effect on financial reporting quality of listed deposit money banks in Nigeria.

**H<sub>1</sub>:** Audit tenure has a significant effect on financial reporting quality of listed deposit money banks in Nigeria

### ***Computation***

The test statistic is computed by STATA software and the results are as shown in Table 4.4.

**Table 4.4: Regression Results on Audit tenure and Financial reporting quality**

Variable	Coefficient	p-value
AUDTEN	0.0110	0.023

Source: Extracted from STATA Computations

### ***Decision***

With a coefficient of 0.0110 the results indicate that audit tenure positively impacts return on assets, while the probability value of 0.023 indicates that the negative impact is significant. This leads to the rejection of the null hypothesis, thus acceptance of the alternative hypothesis that audit tenure has a significant impact on financial reporting quality of listed deposit money banks in Nigeria, and the impact is positive.

### ***Hypothesis II***

$H_0$  : Audit firm size has no significant effect on financial reporting quality of listed deposit money banks in Nigeria.

$H_1$  : Audit firm size has a significant effect on financial reporting quality of listed deposit money banks in Nigeria.

### ***Computation***

The test statistic is computed by STATA software and the results are as shown in Table 4.5.

**Table 4.5: Regression Results on Audit firm size and Financial reporting quality**

Variable	Coefficient	p-value
AUDFZ	-0.0270	0.047

Source: Extracted from STATA Computations

### ***Decision***

With a coefficient of -0.0270 the results indicate that audit firm size negatively impacts financial reporting quality of listed deposit money banks in Nigeria, while the probability value of 0.047 indicates that the negative impact is significant. This leads to the acceptance of the alternative hypothesis, thus the rejection of the null hypothesis. The researcher accepts that audit firm size significantly impacts performance of listed deposit money banks in Nigeria, and that such effect is negative.

### ***Hypothesis III***

H<sub>0</sub>: Non-audit fee has no significant effect on financial reporting quality of listed deposit money banks in Nigeria.

H<sub>1</sub>: Non-audit fee has a significant effect on financial reporting quality of listed deposit money banks in Nigeria.

### ***Computation***

The test statistic is computed by STATA software and the results are as shown in Table 4.6.

**Table 4.6: Regression Results on Non-audit fee and Financial reporting quality**

Variable	Coefficient	p-value
NAUDF	-0.0046	0.008

Source: Extracted from STATA Computations

### ***Decision***

With a coefficient of -0.0046 the results indicate that non-audit fee negatively impacts financial reporting quality of listed deposit money banks in Nigeria while the probability value of 0.008 indicates that the positive impact is significant because it is less than 0.05. This leads to the acceptance of the alternative hypothesis, thus rejecting the null hypothesis. The researcher accepts that non-audit fee significantly affect financial reporting quality of listed deposit money banks in Nigeria.

## **4.4 Discussion of Findings**

This study examined the relationships among the variables: e-banking, customer satisfaction, Nigerian economic growth, Nigerian business environment and e-transact; particularly the effect of e-banking on these variables.

The results indicate that almost all the variables are significantly normally distributed at 5% level of significance. The correlation matrix indicates the

variables have mixed relationships. The results also indicate the absence of multi-collinearity.

Essentially, the findings of the study are: with a coefficient of 0.0017 the results indicate that audit tenure positively impacts return on assets, while the probability value of 0.007 indicates that the negative impact is significant. This leads to the rejection of the null hypothesis, thus acceptance of the alternative hypothesis that audit tenure has a significant impact on financial reporting quality of listed deposit money banks in Nigeria, and the impact is positive. The result agrees with consistent with the findings of Riccardi (2019), Mgbame et al. (2012) and Carp and Istrate (2021), but was not consistent with the findings of Kalabeke et al. (2019), Eyenubo et al. (2017), and Alsmariat (2019). This inconclusiveness may have resulted from the existence of varying degrees of institutional backdrops.

Similarly, with a coefficient of -0.0270 the results indicate that audit firm size negatively impacts financial reporting quality of listed deposit money banks in Nigeria, while the probability value of 0.047 indicates that the negative impact is significant. This leads to the acceptance of the alternative hypothesis, thus the rejection of the null hypothesis. The researcher accepts that audit firm size significantly impacts performance of listed deposit money banks in Nigeria, and that such effect is negative. The result agrees with the findings of Eyenubo et al.

(2017), Ilaboya and Ohiokha (2014), Kaklar et al. (2012) and Kamolsakuchai (2015) but not consistent with the findings of Ugwu et al. (2020).

And, with a coefficient of -0.0046 the results indicate that non-audit fee negatively impacts financial reporting quality of listed deposit money banks in Nigeria while the probability value of 0.008 indicates that the positive impact is significant because it is less than 0.05. This leads to the acceptance of the alternative hypothesis, thus rejecting the null hypothesis. The researcher accepts that non-audit fee significantly affect financial reporting quality of listed deposit money banks in Nigeria. The result agrees with the findings of Onulaka (2019), Pedro et al. (2014), Asthana et al. (2018) but not consistent with the finding of Knechel et al. (2018). This might have been as a result of using different industrial sectors.

## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary of Findings**

The major findings discovered having reviewed the study are:

- i. Audit tenure has a significant impact on financial reporting quality of listed deposit money banks in Nigeria and the impact is positive.
- ii. Audit firm size has a significant effect on financial reporting quality of listed deposit money banks in Nigeria and the effect is negative.
- iii. Non-Audit Fee has a significant impact on financial reporting quality of listed deposit money banks in Nigeria and the impact is positive.

#### **5.2 Conclusion**

The effect of auditor's level of independence on financial reporting quality of deposit money banks was investigated in this study. This study reveals that auditor's independence has positive significant effect on the quality of financial reporting in deposit money banks in Nigeria. Further result from this study indicates that non-audit fees have significant negative effect on the quality of financial reporting in deposit money banks in Nigeria. Another outcome of this study is that audit tenure has significant positive effect on the quality of financial reporting in deposit money banks in Nigeria. Hence, conclusion can be

drawn to auditor's independence, non-audit fees and audit firm size have significant effects on financial reporting quality of deposit money banks sampled for this study.

### **5.3 Recommendations**

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

- i. Regulatory bodies and professional bodies should regulate and monitor the type and scope of non-audit services an auditor may engage in from time to time.
- ii. The study recommends that various stakeholders must recognize the role of auditor's independence in financial reporting quality of listed deposit money banks in Nigeria.
- iii. In the same vein, mandatory rotation of auditor of deposit money banks in Nigeria should be enforced by enabling regulatory organs like the Central Bank of Nigeria (CBN), Nigeria Security Exchange (NSE).

### **5.4 Suggestions for Further Studies**

This study concentrated on deposit money banks. Other financial institutions like insurance companies and non financial institutions like agricultural sector,



manufacturing, tourism sector to mention a few, researchers are suggested to find out effects of audit independence on those different sectors.

The variables explored to measure auditor's independence in this research work were limited to audit tenure, audit firm size and non-audit fees. Other variables like audit rotation, joint audit may be considered in further studies.

An interesting area for further research is to assess the impact of auditor education and experience on financial reporting quality. Further research can also be conducted to determine other factors which affect financial reporting quality which were not included in this research.

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## **Appendix I: List of Deposit Money Banks (DMBs) in Nigeria**

S/N	Deposit Money Banks
1	Access Bank
2	Diamond Bank
3	GT Bank
4	Union Bank
5	First Bank
6	Fidelity
7	Skye Bank
8	Wema Bank
9	Polaris Bank
10	Stanbic IBTC Bank
11	Zenith Bank
12	First City Monument

	Bank
13	Keystone Bank
14	Union Bank
15	Sterling Bank
16	Unity Bank
17	Citibank
18	Heritage Bank
19	Suntrust Bank
20	Providus Bank
21	Standard Chartered Bank

**Source: Central Bank of Nigeria (2019); NBS-Banking Sector (2019)**

## **Appendix II: List of Banks Selected**

S/N	Selected Banks
1	Access Bank

2	First Bank
3	GT Bank
4	Zenith Bank