Effect of Audit Quality on Organizational Performance in Nigeria

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Abstract

The study examined the effect of audit quality on Organizational performance in Nigeria. The study adopts ex-post research design and simple random sampling method. The total sample of 10manufacturing companies, quoted on the Nigerian Stock Exchange (NSE) for the period of 10years from 2009- 2018.Secondary data was collected from financial statements and the data was analyzed using Ordinary least square Regression analysis to test the hypothesis. The results reveal that audit quality (number of employee in audit companies) has a significant effect on companies' performance as represented by return on equity. The study concludes that there is a great significant positive relationship between the numbers of employee in audit firms and the performance achieved in terms of return on equity. The study recommends that number of employee is one of the great determinant of audit quality of audit assignment performed by the auditors and Nigerian companies must ensure that audit firm that has enough employee in all areas of audit are employ to enhance the company's performance.

Keywords: Audit quality, Companies' performance, Number of employee, Auditor, Return on equity, Audit firm

INTRODUCTION

The separation of ownership from management of a company has led to possible conflict of interest between the shareholders (principal) and the directors (Agent).The financial statements prepared by the agents is always seen to be doubtful and in most cases manipulated. In order to lead credence to the financial statements, the shareholders subject the stewardship accounts prepared by the agent to the scrutiny of the auditor as to attest to the validity and legality of the financial statements. For an auditor to perform this task, auditing of client's company must be carry out with the highest quality required by rules and regulations. The right environment must be in place that would improve the sustainability of audit quality in all organization for the enthronement of good corporate governance practices. The relationship that exists between managers and shareholders is that of transparency and fairness. The auditor must ensure that the audit quality are maintained and improved upon by ensuring that financial control mechanisms, implementation of acts, rules and regulations are strictly adhere to. Ghadhab, Matrood and Hameed (2019) suggested the need to strengthen the role of external auditing through various means such as the issuance of instructions, guidelines, and controls to develop the profession, both in the field of accounting and auditing.'

Farouk and Hassan (2014) in their study explained that the quality of financial reporting is based on the role that the external audit plays in enhancing the quality of financial reporting of quoted companies. They also stated that the audit of financial statement by the external auditor is a monitoring mechanism that helps to lessen information asymmetry and defend the interests of the various stakeholders to ensure that financial statements are devoid of material misstatements. International Auditing and Assurance Standards Board (IAASB) Framework recognised the term "audit quality" but did not provide a definition of audit quality that has achieved universally acceptable recognition. The IAASB identified that audit is to provide degree of confidence of users of the financial statements and that can only be achieved by auditors gathering sufficient and appropriate audit evidence which assist him to express an opinion on financial statements in accordance with the applicable financial reporting framework. The rate of audit failures all over the world has created a dislike to investors and would-be investors including other users of financial statement for decision making. Audit team with longer tenure has the tendency to issue fraudulent financial report (Adeyemi & Okpara 2011).The Enron scandal in the USA led to the enactment of SOX Act in 2002 which changed the accounting profession worldwide. The Act was enacted to improve accounting standards and practices, with long-lasting repercussions in the accounting /auditing practice all over the world. The SOX Act (2002) imposed grievous penalty for manipulating financial records. The Act also forbid audit firms for doing consulting services for the same clients (Bondarenko, 2001). The auditing scandal is not only an international affairs, the Nigeria environment has its own share. The collapsed of Cadbury Plc. in Nigeria was attributed to virtually the compromised of all watchdog institutions and as were as the system (Chukwunedu & Okafor, 2011).While the business world is still subject to more failure, Tsipouridou and Spathis (2012)stated that the compulsory adoption of International Financial Reporting Standards (IFRS) in Greece in January 1, 2005 was principally to improve quality of financial reporting, which has been under constant criticism as a result of the practice of earning management and ineffectiveness of the external auditing.

Different research studies have examined the effect of audit quality on the firm performance**.** Different proxies have been used for audit quality such as audit firm size, audit committee/ audit committee size**,** audit committee independence, audit committee meeting, audit opinion type (Qualified vs. Unqualified)auditor experience, auditor independence **(**Ogbodo & Akabuogu (2018)**,** Muotolu, Chikwemma & Nwadialor, (2019), Abid, Shaique & Anwar (2018), Zayol&Kukeng (2017**).** Tyokoso and Ojonimi (2017) represented audit quality with auditor tenure, client importance, audit firm size and auditor specialization. In spite of the importance of these two issues and their significant advantages as well as robust national and international literature, there is a paucity of literature in Nigeria, also among the above mentioned research non has used the no of employee in the audit firm to measure audit quality in relation to organizational performance. Furthermore, controversial result has been arrived at by other researchers and none has used manufacturing companies in Nigeria. Base on the above breaches, this research has been carried out to examine the effect of audit quality on organizational performance in Nigeria. Therefore, the main objective of the study is to examine the effect of audit quality on organizational performance in Nigeria. The following hypothesis in null form is thus formulated:
H01: Audit quality does not have any significant effect on companies' performance.

LITERATURE REVIEW

Conceptual Framework

Concept of Audit quality

Audit quality is arguable but difficult to understand (Knechel 2013), because an audit process involves application of testing procedures that could not be experimental by users of the financial statement (DeAngelo, 1981; Hussainey, 2009). DeAngelo (1981) defines audit quality as the market-assessed joint probability that a given auditor will both (a) discover a gap in client's accounting systems, and (b) report the gap. The auditor capacity to detect any error is related to the auditor competence, and willingness to report the errors is related to the auditor independence (Shafie, Wan –Hussein, Yusuf & Hussain, 2009)**.** Hussainey (2009) defined audit quality as the accuracy of information an auditor provided for the investors**.** Suleiman, Yasin and Muhamad (2018) posit that there are three main perspectives related to audit quality which add to our understanding of the factors affecting audit quality in practice. First they identified multifaceted concept of the term audit quality. Second, that audit quality is affected by both internal factors within the accounting firms and contextual factors affecting the accounting firm operations. Third, earlier researches adopted old approach which limits information about the understanding of audit quality.

In this research, audit quality is defined as the capability of auditor in discovering and reporting any errors in a financial statement. The most common errors made in financial statement are aggressive income or discretionary accruals. Discretionary accruals are accruals that could be manipulated by management and usually intended to achieve a desired profitability or income. This is caused by the management that has an authority in control and creating policies, including those company accounting policies that favor their position as managers. An auditor is obligate to disclose non-fair discretionary accruals to prevent misstatement of financial statement. Audit quality (AUDQ) is the independent variable contained in this study which is measured by logarithm of total number of staff audit firm.

Concept of Companies' performance

Organizational performance is concern with the 'health" of an organization which is generally measured in terms of financial and non-financial performance. The financial measurement could be in term of return on equities, return on assets, or return on investment etc. According to Cho and Dansereau (2010); it is referred to the performance of a company as compared to its goals and objectives. In addition, Tomaland Jones (2015) define organizational performance as the actual results or output of an organization as measured against that organization's intended outputs. The effectiveness of an organization consists in the efficiency of each of its individual employees, role of the external auditor and other factors. According to Lebans and Euske (2006), one significant advantage of accounting-based performance measures is that they are not requiring an exchange listing thus; also private and small business may be examined. Furthermore, they are easy to interpret. Return on equity is used as proxy to measure performance in this study. Return on Equity (ROE) helps to measure the return generated on shareholders' equity. It is the value created to owners of a company when the return on the equity is more than the cost of the equity to the owners of the company. It is calculated by taking the profit less preference share dividends and taxes of a particular year divided by ordinary shares of that same year. Equity is defined here as ordinary shares of an entity.

The formula of ROE = $\frac{\text{Profit after preference divided and Tax}}{\text{Total Equity}}$

Audit quality and Performance

It has been established by some studies that there is great link between audit quality and organizational performance, also this has been confirmed by agency theory. Some of these studies used auditor experience, audit fees, auditor rotation and auditor independence as proxies for audit quality (Woodland& Reynolds 2003; Nam 2011; Bouaziz 2012; Farouk & Hassan 2014; Matoke & Omwenga 2016). Nam 2011 examines the association between audit fees as a measure for auditor independence and audit quality of firms in New Zealand. The study discovered that the condition of non-audit services by the auditors of a firm compromises the auditor's independence. Farouk and Hassan (2014) investigate the effect of audit quality on the financial performance of quoted cement firms in Nigeria. They aimed at determining the impact of auditor independence and audit firm size as proxies for audit quality on financial performance using multiple regression analysis. Findings show that audit firm size and auditor independence have significant impacts. However, auditor independence is more influential than auditor size on firm financial performance.

Matoke and Omwenga (2016) test the relationship between audit quality and financial performance through the proxies of auditor independence, audit team attributes auditor experience and net profit margin of listed firms in Kenya. The study analyzed data by applying multiple linear regression analysis. This investigation found that the effect of audit quality on financial performance is positive and significant and the higher the degree of auditor independence, the more likely the firm is to have higher profitability. Woodland and Reynolds 2003 examined the relationship between indirect measures of audit quality and financial statement analysis using multivariate regression analysis. They discovered that there is no proof that auditor size, tenure or industry specializations associate with audit quality. Bouaziz

(2012) studied the association among auditor size and financial performance on a sample of 26 Tunisian firms registered on the Tunis Stock Exchange. The outcome shows that auditor size has a substantial impact on the financial performance of firms concerning Return on Assets (ROA) and Return on Equity (ROE). Having looked at other variables that other researchers have used in measuring audit quality and performance, this study use number of employee in audit firm to measure audit quality and return on equity to measure organizational performance.

Empirical Framework

Putra and Fito-Mela (2019) examined the relationship between audit quality and earning management: Informative and opportunist perspective in Indonesia. The study used samples of 615 firm-year of manufacture companies listed in Indonesian Stock Exchange for the period of 2013-2017. Audit quality is measured by a proxy of the big 4 while earnings management is by discretionary accruals. Analysis method uses logistic regression was used to measures the relationship. Result of the study shows that high audit quality increases informative earnings management and reduces opportunist earnings management. The result aligns with the role of auditor in reducing asymmetric information between managers and shareholders. Muotolu and Nwadilor (2019) explored the effect of audit quality on the financial performance of deposit money banks in Nigeria. The study examined 14 banks from the listed 22 deposit money banks in Nigerian Stock Exchange. The data collected were analysed using the simple regression and correlation analyses. The result of the study reveals that Audit Committee Size (ACSIZ) has a positive but insignificant effect on the financial performance of Deposit money banks in Nigeria. Further findings show that while Auditor's Size (BIG4) has a positive and significant effect on the financial performance of quoted banks in Nigeria; Audit Committee Independence (ACIND) and Audit Committee Meetings (ACM) both have a negative and insignificant effect on the financial performance of quoted deposit money banks in Nigeria. The study recommends that management of deposit money banks in Nigeria should use the services of the big audit firms and where the services are not available; they should employ other firms with character and integrity that is beyond question.

Elewa and El-Haddad (2019) investigated the effect of audit quality on firm performance: A panel data approach in Egypt. Audit quality is measured by a proxy of the big 4 and audit independence while companies' performance was measured by return on assets and equity. The study uses financial statements of thirty non –financial firms listed as EGX 100.The study covered a period of 2010-2014. Data panel analysis was deployed to measure the data. The findings reveal that the BIG 4 and Auditor rotation have an insignificant impact on the return on assets and return on equities of the firm. The study recommended that users of financial statement may benefit from the study when dealing with high-profit firms. Khan, Abdul and Ntim (2019) explored the Impact of board diversity and audit on firm performance in Pakistan. The study looked at board diversity in terms of its nationality and gender as a proxy for audit quality. The study sample comprises of listed companies in Pakistan Stock Exchange (PSE) 100 Index. PSE-100 index is selected on the basis of sector representation and highest market capitalization. Data collected span from 2008 to 2017 and quantitative techniques from econometrics on panel data was deployed. The finding suggests that the presence of female board members contribute to firm performance while the number of female board members does not contribute to firm performance.

Ezejiofor & Erhirhie (2018) investigated the effect of audit quality on financial performance: evidence from deposit money banks in Nigeria. Secondary data collected from the annual reports and accounts of quoted Nigerian deposit money banks was used for the study. Regression analysis and coefficient correlation were employed to test the variables of interest. The results of the investigation revealed that audit quality has a significant effect on the financial performance of Nigerian deposit money banks. The study, therefore, recommends that Nigerian money deposit banks should increase the number of its foreign directors in its management cadre and especially those with the requisite skill, experience who have integrity to protect. Ogbodo and Akabuogu (2018).The duo explored the effect of audit quality on the financial performance of selected banks in Nigeria. The study represented audit quality by audit firm size and audit committee independence. The objectives of their study were to examine the effects of audit firm size on company assets and to determine the extent of audit committee independence on profit margin. The sample of study consists of sixteen deposit money banks in Nigeria quoted on the Stock Exchange. The data of the study covered a period of 2008-2017.Regression statistical tool using the Scientific Package for Social Science (SPSS) version 20 was employed for the data analysis. The result reveals that firm size has significant effects on return of asset of quoted Nigerian banks. Another finding is that Audit Committee Independence has significant effect on the return of equity (ROE) of quoted Nigerian banks. The study recommended that company should use the services of audit firms with impeccable records of audit quality and possibly of high reputation. Abid, Shaique and Anwar (2018) examined whether big four auditors always provide higher audit quality in Pakistan. Sample of secondary data of 183 firms listed on the Karachi Stock Exchange was used covering a period of 2009-2013.The study deployed signed discretionary and performance-adjusted discretionary accruals as proxies for earnings management, and audit firm size (Big 4 vs. Non-Big 4) and audit opinion type (Qualified vs. Unqualified) as measures for audit quality. The finding reveals that there is no significant difference between earning management of firms audited by big 4and non Big 4 auditors.

Tyokoso, U-ungwa and Ojonimi (2017) examined the Effect of Audit Quality on Performance of Deposit Money Banks (DMBs) in Nigeria. Secondary data extracted from annual report and accounts of 8 DMBs were analyzed. Panel multiple regression technique was used in the analysis. The result shows that auditor tenure which serve as a proxy for audit quality has a significant effect on Tobins Q (Total market value of the firm /total assets value of the firm) of DMBs in Nigeria. Conversely, client importance has a significant negative relationship with Tobins Q while audit firm size and auditor specialisation respectively have insignificant positive and negative effect on Tobins Q of DMBs in Nigeria. The study recommends tenure of three years and above for auditors in order to enhance the performance of the deposit money banks in Nigeria. Zayol and Kukeng (2017) investigated the effect of auditor Independence on audit quality: A review of literature in Nigeria. The study employed ex post facto research design .Secondary data from journals, text books and other internet materials were used. The finding shows that there is strong relationship between auditor's independence and audit quality. Further findings reveal four threats to auditor independence, which are client importance, non-audit services (NAS), audit tenure, and client's affiliation with firms. The study recommended that more study should be carried out in the four threats in other sector of the economic such as manufacturing, transport, media, education etc. Motoke and Omwenga (2016) assessed audit quality and financial performances of companies listed in Nairobi Securities Exchange (NSE) violet. The study's objectives were to determine the effect of auditor's independence, effect of audit team, auditor's experience on financial performance. Sample of data was drawn from the nine listed companies in Kenya. The study employed both primary and secondary data. Descriptive statistic using SPSS was adopted. Data was analysed by using multiple linear regression analysis. The findings reveal that audit quality and financial performance is positive and significant, audit size was also positive and significant but audit independence is of lesser impact. The study recommended that management of listed company should employ the services of one of the big audit firms; and where management cannot reach the firm; they should consider other firms with good characteristic and integrity that is beyond question.

Okoye, Okaro and Okafor (2015) examined corporate governance and audit quality in Nigeria. Secondary data was used for the study and the data were analysed using binary logistic regression model. The secondary data was extracted from the annual financial reports of a sample of 104 companies randomly selected from a population of 134 non-bank companies listed in the Nigerian Stock Exchange. While the dependent variable of the study is audit quality, independent variables included Board size, Board independence, Board diligence, Audit committee size, Audit Committee diligence and audit committee independence. The major findings reveal that small board size and greater board diligence impact positively on audit quality. Afza and Nasir (2014) examined audit quality and firm value: A case of Pakistan. The objective of the study was to examine the influence of audit committee characteristic on the financial performance of firms. The study used Audit Committee (AC) as a proxy for audit quality. It identified four audit committee characteristics which are audit committee size, independence, activity and quality of external audit to study their impact on firm financial performance. The study employed panel data which showed that audit committee size and external audit quality have a strong and significant positive impact on Return on Assets and Tobin's Q while audit committee independence and audit committee activity remain insignificant to return on assets. The study recommended that all regulators, policy makers and stakeholders should adopt audit committee characteristic to improve the financial performance of the organisation. The result of the study is consistent with other similar study carried out in other countries.

Theoretical Framework

Agency Theory

Jensen and Meckling (1976) propounded the agency theory. Agency theory is that principle that explains the nature of the agency relationship as a result of separation of ownership from management of a business. The separation of ownership from management of a company could lead to possible conflict of interest between the shareholders (principals) and the directors (agents).The principal (shareholders) appoint the agents (management) to take decision for the running of the business on their behalf. To ensure that the business is being run in the interest of the owners, auditing plays a vital role in reducing information asymmetry by helping to confirm the validity of the financial statements. Information asymmetry relates with the study of decisions in which one party has more or superior information than the other(s).The information asymmetric that exist between the principals and agent in whom the management betray the fiduciary responsibility to the shareholders give opportunity for conflict which betray confidence the principal placed on the management. Therefore, auditors are employed by the principals as a third party in order to strengthen this trust of aligning the interests of agents with the principals. Auditors can only strengthen this interest through a complete mechanism of audit quality. Agency theory, therefore, is a practical economic theory of accountability, which helps to explain the usefulness of audit quality.

Stakeholder Theory

Stakeholder theory was the work of Freema Edward (1984).The theory created awareness of the relationship between a company and its many stakeholders. The theory suggests that a company's stakeholders include people like employees, customers, vendors, contractors, and shareholders, including institutions like banks, government bodies, oversight organisations and the likes. They can be affected by records of the firm or its failure. The theory states that company stakeholders are interdependent and the value created by the company belong to all of them, which mean that the company has obligation to distribute it profit to all stakeholders. A company success is measured in the way the company satisfy all the stakeholders and not just shareholders. Therefore, managers have special obligations to ensure that all stakeholders receive a fair return from stake they hold in the company (Donaldson & Preston, 1995). The auditor is expected to make the audit to accountable to all stakeholders in discharging his legal responsibility of expressing an opinion on the financial statements for decision making. The reliability of the auditors' report to all stakeholders depends on the audit quality exercised by the auditor which invariably impacts the company performance.

Legitimacy Theory

Legitimacy theory is championed by Suchman (1995) which dominates the auditing and accounting literature. Legitimacy theory has the role of explaining the behavior of organisations in developing and implementing voluntary social and environmental disclosure of information which enable them to fulfill their social contract which is the recognition of their objectives and the survival in a turbulent business environment. Organisation's activities are reported in accordance with the expectations of the general society. When organization fails to respect social and moral values, the organization would be sanctioned by the society; these sanctions may even lead to the failure of such organization.It is expected that the organization justify its existence through legitimate economic and social actions that benefit the society in which the organization operates. The environment and economic challenges to the organization means that the organization must respect rules, values and norms of the society and voluntarily disclose social and environmental information to prove compliance. Legitimacy theory has a very rich disciplinary background based on management theory, institutional theory and stakeholder theory. The legitimacy literature suggests that the survival of an organization depends on its legitimating processes and how the ever constant pressures and challenges are managed. Therefore, the legitimacy theory made it necessary for firms to disclose useful information which is vital to the survival of the business. Useful information provided by the firm help to enhance audit quality of the firm. This study is thus, anchored on agency theory credited to Jensen and Meckling (1976).

METHODOLOGY

The main objective of this study is to examine the effect of audit quality on companies' performance. This study uses ex-post facto research design and simple random sampling method to select 10 out of 55 manufacturing companies listed on the Nigeria Stock Exchange that are audited by the big fours. Secondary sources of data were used through published data from the annual reports of the selected manufacturing companies listed on the Nigeria Stock Exchange as at 2018 for the periods of ten (10) years of 2009-2018 and publication provided by the big four audit firms on the internet in getting the number of employees for each of the years under the study. In testing the hypothesis, ordinary least Square regression analysis (OLS) was used to analyze the data collected after using Kolmogorov-Smirnov test to test the normality of the data. The regression model is as follows:

$ROEit= \beta0 + \beta1NOEit + e$

Where: ROE= Return on equity
$\beta0$ =Intercept (constant term)
$\beta1NOEit$ = Number of Employee
e=Error term.

Return on equity is the proxy for companies' performance (dependent variable); Number of employee in the Audit firms (the big four) is the explanatory variable.
Apriori Expectation
It is expected *that* $\beta1 > 0$

RESULT AND DISCUSSION

Table1.
Dependent Variable: LOG(ROE)
Method: Least Squares
Date: 04/28/20 Time: 01:04
Sample: 1 100
Included observations: 100

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	15.96693	5.047738	3.163184	0.0021
LOG(NOE)	-1.063507	0.414438	-2.566140	0.0118

R-squared	0.062964	Mean dependent var	3.015237
Adjusted R-squared	0.053402	S.D. dependent var	0.793473
S.E. of regression	0.771996	Akaike info criterion	2.340122
Sum squared resid	58.40579	Schwarz criterion	2.392225
Log likelihood	-115.0061	Hannan-Quinn criter.	2.361209
F-statistic	6.585075	Durbin-Watson stat	0.492160
Prob(F-statistic)	0.011798		

Source: E-views output (2020)

From the table 1 above, the R2 is 0.062964 while the R which is the square root of R2 that is the coefficient correlation is 0.25093 which show that there is a positive correlation between audit quality and companies' performance. Also the F-statistics which shows the level of significant in which the explanatory variable which is performance is able to explain the outcome variable which is audit quality is 6.585075 , the Pro(F-statistics) which is 0.011798 shows that there is statistically significant relationship between audit quality and organizational performance because the value is less than the alpha value of 0.05.furthermore the value of Dubin-Watson stat is 0.492160 which by rule of thumb is lower than 2, this means that there is a positive serial correlation between audit quality and organizational performance.

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Discussion of Finding

The finding revealed that audit quality does not have any effect on organizational performance and accept our alternate hypothesis that audit quality has effect on organizational performance which supported the result of Motoke and Omwenga (2016)that assessed audit quality and financial performances of companies listed in Nairobi Securities Exchange (NSE) violet and their findings revealed that audit quality and financial performance is positive and significant. Also our result is in line with that of Ezejiofor and Erhirhie (2018) that investigated the effect of audit quality on financial performance of deposit money banks in Nigeria. The results of the investigation revealed that audit quality has a significant effect on the financial performance of Nigeria deposit money banks**.** Moreover, this result is against the findings of Tyokoso, U-ungwa and Ojonimi (2017) that examined the effect of Audit Quality on Performance of Deposit Money Banks (DMBs) in Nigeria. And their result shows that audit firm size and auditor specialization respectively have insignificant positive and negative effect on Tobins Q of DMBs in Nigeria.

CONCLUSION AND RECOMMENDATIONS

Majority of works on audit quality have been carried out outside Nigeria's environment. This study was carried out to investigate the effect of audit quality on some selected companies' performance in Nigeria. The main objective is to investigate the effect of audit quality (proxy by number of employee in the audit firms) on companies' performance (proxy by return on equity)of some selected Nigerian manufacturing companies quoted on the Nigerian Stock Exchange (NSE) for the period of 10 years from 2009- 2018. Ordinary least square Regression analysis was deployed to test the hypothesis. The empirical result revealed that audit quality represented by number of employee in audit firms has a significant positive effect on companies' performance i.e. return on equity in the selected manufacturing companies in Nigeria. The study concludes that there is a great significant positive relationship between the numbers of employee in audit firms and the performance achieved in terms of return on equity. Following the finding of this study, the following recommendations are made:

i. Number of staff in audit firms is a great determinant of audit quality of audit assignment performed by the auditors and Nigerian companies must ensure that audit firm of aged experience with high number of staff are employ to enhance the company's return on equity.
ii. The management of most quoted companies should employ the services of large audit firm that has enough staff in different section with experience in order to enhance its return on equity and create a better image for the company.

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