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RESEARCH ARTICLE

AUDIT QUALITY AND FINANCIAL PERFORMANCE IN QUOTED CONSUMER GOODS COMPANIES IN NIGERIA

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ABSTRACT

This study examined the impact of audit quality on financial performance of consumer goods companies in Nigeria. The specific objectives are: to determine the effect of audit independence, audit tenure, audit firm size on the financial performance of consumer goods companies in Nigeria. The study is theoretically predicated on stakeholder's theory, agency theory, contingency theory and lending credibility theory. Descriptive and cross sectional research design were adopted to investigate the relationship between variables of audit quality and financial performance of quoted firms in Nigeria over a period of 5 years. Secondary Data were obtained from annual reports of five selected quoted consumer goods firms. Panel Least Square Regression Model was used to test the formulated hypotheses. Findings showed that all the independent variables jointly and strongly have significant impact on the financial performance of the selected firms in Nigeria measured by return on assets except audit firm size. It is concluded that audit quality has significantly and positively impacted the financial performance of consumer goods companies listed on the Nigerian Stock Exchange. The study then recommends among others, the need for firms to adopt effective internal control processes and practices that address key auditing practice for effective audit quality.

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INTRODUCTION

The financial statement audit helps to reduce information asymmetry and protect the interests of the various stakeholders by providing reasonable assurance that the management's financial statements are free from material misstatements (Heil, 2012). In the same vein, Miettinen (2011) asserted that the societal role of auditors should be a key contribution to financial performance, in terms of reducing the risks of significant misstatements and by ensuring that the financial statements are elaborated according to established rules and regulations. He also opined that, lower risks on misstatements increases confidence in capital markets, which in turn lowers the cost of capital for firms. An auditor has the responsibility for the prevention, detection and reporting of fraud and other illegal acts and errors. This is one of the most contentious issues in auditing and a debated area amongst auditors, politicians, regulators and the public. This debate has been highlighted by the collapse of small, medium and large business organizations across the globe (Ajani, 2012).

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Okolie (2014) viewed audit quality as detecting misstatements and errors in financial statement and reporting these material misstatements and errors. Due to the fact that these characteristics are largely unobservable, different proxies have been used by researchers to measure audit quality like: audit size, audit hours, audit fees, reputation, litigation rate and discretionary accruals. According to Salehi and Mansoury (2009), audit quality is subject to many direct and indirect influences as its perceptions of vary amongst stakeholders depending on their level of involvement in audits and on the perspective through which they assess audit quality. They believed that audit quality is recognized to influence financial reporting and strongly impact on investors' confidence. Therefore, conventionally, external auditors play critical and highly challenging roles in assuring the credibility of financial reports and quality of audit exercise. In recent years, corporate accounting scandals coupled by an outcry for transparency and integrity in financial reporting have given rise to logical outcomes. Audit skills are now critical in resolving the complicated accounting manipulations which have muddled financial statements (Hussainey, 2009). In addition, public outcry for change and regulatory actions have modified the face of corporate governance. As a result, the bar of ethical and legal scrutiny has been raised for agents of companies working for the principals. These outcomes are jointly responsible for addressing investors' anxieties about the financial reporting system (DeAngelo, 2011). Tighter regulations and enhanced standards for accounting and governance of firms have been the result of the occurrence of financial scandals. The corporate auditing accountability and responsibility Act was enacted in 2002 in the USA after the Enron scandals (Craswel, Stokes & Laughton, 2002). These scandals were caused by weak financial controls and ineffective audit practices that the Act tries to address. Thus, it is evident that there is a need for research on audit quality and the financial performance of organizations especially quoted consumer goods companies in Nigeria.

Review of Literature/Conceptual Clarifications

Audit Quality: De Angelo (2011) defined audit quality as the market-assessed joint probability that a given auditor will discover a breach in client's accounting systems, report such breach. The auditor's ability to detect any error is related to the auditor's competence, and confidence to report the errors is also related to the auditor independence. He further explained audit quality as the probability that an auditor will not release an audit report with unqualified opinion for a financial statement that contains any material misstatement. Hussainey (2009) viewed that audit quality as the accuracy of information an auditor provided for the investors. He sees audit quality as auditor capabilities to detect and eliminate any misstatements and manipulations in financial statements. Moreover, Volosin, (2007) suggested that audit quality is determined by the auditor competence and capability in discovering and reporting any errors in corporate financial statements. Ismail, Isklandar & Rahmat, (2008) asserted that the most common errors made in financial statements are discretionary accruals which 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 controlling and creating accounting policies in their favour. An auditor is obligated to disclose non-fair discretionary accruals to prevent misstatement of financial statement.

Audit Independence: Audit Independence is an auditor's unbiased mental attitude in making decisions throughout the audit and financial reporting process. Independence refers to the quality of being free from influence, persuasion or bias, the absence of which will greatly impair the value of the audit service and the audit report (Sweeney, 2014). An auditor's lack of independence increases the possibility of being perceived as not being objective. This means that the auditor will not likely report a discovered breach. In Craswel, Stokes and Laughton (2002), it was argued that in a situation where public disclosure of audit fee and non-audit fee is mandatory, auditors may be willing to issue qualified audit opinions irrespective of the economic importance of the client to the auditor and issue unqualified opinion if otherwise. Institute of Internal Auditors, (2007) states that independence is an expected auditor behaviour that directs an auditor who does not have personal interest in doing his/her jobs, because it will be contrary to integrity and objectivity principles. If a public accountant is not independent of the client, his/her audit opinion will be useless because the purpose of this opinion is to increase the credibility of financial statement as a management assertion.

Audit Tenure: Okolie, (2014) defined audit tenure in his study as the length of the auditor-client relationship. He explained that too long association between the auditor and his client may constitute a threat to independence as personalties and familiarity may develop between the parties, which may lead to less vigilance on the part of the auditor. Aside from this threat to independence, the audit engagement may become routine over time, and if so, the auditor will devote less effort to identifying the weaknesses of internal control and risk sources.

Audit firm size: As noted by Salehi and Mansoury (2009), the size of an audit firm has been used as a substitute for audit quality, meaning that larger audit firms have a bigger reputation to safeguard and therefore will ensure a more independent quality audit service. It was explained that these large firms have better financial strengths, research facilities and services, superior technology and more experienced employees to undertake large company audits. Their larger client portfolios enable them to resist management pressure, whereas smaller firms provide more personalized services due to limited client portfolios and are expected to succumb to management requirements.

Theoretical Framework

Stakeholder Theory: The stakeholder theory evolved from the agency theory. The agency theory sees any modern organization as an aggregation of the interactions between the principals and their agents. The principals are the shareholders who are the owners of the entity while the agents are the managers who are usually the experts with control over the day-to-day affairs of the entity. This relationship, as is observed by analysts, creates information asymmetry with the managers having information advantage. This creates the need for proper monitoring which has brought to the fore role of the auditor, who is required to provide an independent examination of the affairs of the entity so as to be able to express an opinion on the financial statements of the entity. Such expressed opinion by the auditor is basis for "faith" and "confidence" in the financial statements ((Freeman, 1984). The stakeholder theory is a natural extension of the agency theory. The theory holds that every entity involves the interactions of more than the principals and their agents. Such relationships will also involve the interaction of everyone with a stake in the affairs of the entity: the host community, creditors, bankers, government and others. This means that there is greater information demand on the entity; this therefore places greater demands on the auditor to ensure the representativeness of the financial statements (Donaldson & Preston, 1995).

Agency Theory: According to Adams, (1994), agency theory is concerned with resolving problems that can exist in agency relationships; that is, between principals (such as shareholders) and agents of the principals (for example, company executives). The two problems that agency theory addresses are: the problems that arise when the desires or goals of the principal and agent are in conflict, and the principal is unable to verify what the agent is actually doing and the problems that arise when the principal and agent have different attitudes towards risk. Because of different risk tolerances, the principal and agent may each be inclined to take different actions.

Contingency Theory: The goal of an audit is to test the reliability of a company's information, policies, practices and procedures. Government regulations require that certain financial institutions undergo independent financial audits, but industry standards can mandate audits in other areas such as safety and technology. Regardless of the audit subject, various factors impact a company's final results, and the contingency theory takes these factors into account during the audit process (Wallace, 1987). According to Daft, (2010), the contingency theory of leadership and management states that there is no standard method by which organizations can be led, controlled and managed. Organizations and their functions depend on various external and internal factors. The functions of audits are themselves, types of organizations that are affected by various factors in the environment. The presence of such factors is why auditing can be managed by applying the contingency theory, with a recognition that processes and outcomes of audits are dependent on variable and contingent factors.

Lending Credibility Theory: Volosin, (2007) in his book mentioned that the lending credibility theory is similar to the agency-theory and it states that audited financial statements can enhance stakeholders faith in management's stewardship. The business world consists of different groups that are affected by, or participate in, the financial reporting requirements of the regulatory agencies. They are shareholders, managers, creditors, employees, government and other groups. The major recipients of the annual reports are the shareholders, including individuals with relatively small shareholding and large institutions such as banks or insurance companies. Their decision is usually based on the financial reporting and the performance of the company's management, who have a responsibility to act in the interests of investors.

Empirical Literature: Adeyemi, Okpala and Dabor (2012) investigated the factors affecting audit quality in Nigeria. The primary data were supplied by 430 respondents across several stakeholders in the fields of financial reporting and auditing. The secondary data were generated from the financial statements of forty annual reports of companies quoted on the Nigerian Stock Exchange. The test of hypotheses and other analysis of data were done using SPSS, version 17. Their tests revealed that among others, multiple directorships is the most significant in affecting audit quality in Nigeria. In addition, it is found that provision of non-audit service would likely have a significant effect on the audit quality in Nigeria. However, the study did not find audit firm rotation to be a significant factor for enhancing audit quality in Nigeria. The study recommends efforts should be made to strengthen audit quality if the quality of financial reporting was to be improved. Also, regulatory authorities should ensure that the same firm do not render audit services and offer management advisory services in the same company simultaneously.

Matoke and Omwenga (2016) sought to establish the relationship between audit quality and financial performance of listed companies in Nairobi Securities Exchange. The specific objectives were: to examine the influence of size of the audit firm on the financial performance of listed companies in NSE, to determine the effect of auditors independence on the financial performance of listed companies in NSE, to establish the effect of attributes of the audit team on the financial performance of listed companies in NSE and to establish how the auditor's experience influences financial performance of listed companies in NSE. The theoretical framework encompassed a review of the auditors' theory of inspired confidence, agency theory and stakeholders' theory. Their study adopted a descriptive research design. The sampling frame of this study was drawn from directories of the Nairobi Securities Exchange Limited; consisting of all the 9 listed companies in Kenya. Data from the ICPAK indicate that there are a total of 826 CPAs working in the 9 listed companies in Kenya. The study used simple random sampling to select 89 respondents since the study population was homogenous. Both primary and secondary data was used. Piloting was carried out to test the validity and reliability of the instruments. To establish the validity of the research instruments the researcher sought the opinion of experts in the field of study. Their study used Cronbach (Alpha – α) model to test the reliability of the data. Quantitative and qualitative data that was collected using questionnaires was inspected for errors and gaps. The data was then well examined and checked for completeness and comprehensibility. After inspection, the data was coded and analyzed by the use of descriptive statistics using SPSS. Data was analyzed by multiple linear regression analysis. Findings of the study indicate that the effect of audit quality on financial performance is positive and significant and the greater the degree of an auditors independence, the greater the propensity of a firm making substantial net profit margins. The impact of auditor size was also positive and significant, although, its impact was lesser that of auditor independence. It is recommended that the management of listed parastatals should employ the services of one of the big audit firms and where this is not possible, management should go for an audit firm whose character and integrity is beyond question. Due to the importance of having high quality audit, further studies should explore the areas that relate to audit quality such as customer service satisfaction, customer loyalty, auditors switching and auditors turnover. This will go along incorporating quality and independence of management and board membership; internal audit considerations.

This research work was designed to examine the impact of audit quality on financial performance of quoted firms in Nigeria. The study is descriptive in nature and the correlational and ex-post facto designs were adopted in carrying out this research. Data were obtained basically from the published annual reports and accounts, and notes to the financial statements of the four firms that represent the sample of the study. The data collected were quantified and presented in tables. Multiple regression analysis using the SPSS Version 15.0 was employed in analyzing the data and testing the stated hypotheses. The results of the findings shows that auditor size and auditor independence have significant impacts on the financial performance of quoted cement firms in Nigeria. However, auditor independence has more influence than auditor size on financial performance. The study recommends that the management of quoted cement firms in Nigeria increase the remuneration of auditors in order to improve their financial performance. The study further recommends that management should employ the services of audit firms whose character and integrity is beyond question. Ejoh, &Ejom, (2014) examined the relationship between internal audit function and financial performance in Tertiary Institutions in Nigeria with particular reference to Cross River State College of Education, Akamkpa. Data was collected using questionnaires and interview guide as well as review of available documents and records. The method of analysis employed was survey design while the stratified sampling procedure was adopted in administering the questionnaires. The data were analyzed using simple percentages, tables, correlation coefficient and z-scores. The study revealed that all activities of the College are initiated by the top management.

On the effectiveness of internal audit, the study found that the internal audit department of the College is not sufficiently staffed, does not perform their duties with greater degree of autonomy and independence from management. Also, the study found that there is a flaw of audit model in the College. The study further revealed that internal audit function has no significant effect on the financial performance of Cross River State College of Education. The investigation recommends competence profiling in the internal audit unit of the Institution which should be based on what the College expects the internal audit to do and what appropriate number of staff would be required to do the job. It also recommends that the head of the Internal Audit Department should be a professional or a member of any professional Accountancy body in Nigeria for ethical justification.

RESEARCH METHODOLOGY

This study will adopt ex-post facto research design. Ex-post facto research design is used to establish a cause and effect relationship among the variables that correlate. Correlational and Ex-post factor design for the study was appropriate because it assisted in determining the influence of Audit Quality on Financial Performance of the selected firms.

Population of the Study: A study population is a well-defined or specified set of people, group of things, households, firms, services, elements or events which are being investigated. Thus the population should fit a certain specification, which the researcher was studying and the population should be homogenous. The population for this study comprised of all quoted consumer good companies in Nigeria.

Study Samples and Sampling techniques: A sample is precisely a part of the population. Thus, the sample size of this Study comprised of ten selected consumer goods companies listed on the Nigerian Stock Exchange. The sampling method to be used for this research work is the convenience sampling which is a specific type of non probability sampling.

Data Collection Techniques: Pool of data was retrieved from the annual reports of the selected companies (Unilever Nigeria Plc, Cadbury Nigeria Plc, Nestle Nigeria Plc, 7-Up Bottling and Champion Brew Plc) for the periods 2014-2018 (5years).This was done in order to enhance its validity and accuracy of data collected for the study.

Method of Data Analysis: Data was analysed using E-Views statistical package program. Both quantitative analysis and regression analysis was used as data analysis technique. The data collected was run through the specified models so as to clearly ascertain the impact of audit quality on financial performance of quoted consumer goods companies in Nigeria. The focus of this study was the link between audit quality and performance of quoted firms. The dependent variable was measured through profitability of the firms while the independent variables include; audit independence, audit tenure and audit firm size.

Model Specification: In this study, the model shall contain two equations. Whilst the first is on determinant of audit quality of quoted firms in Nigeria, the second is on impact of audit quality on financial performance of quoted consumer goods companies using Return on Assets (ROA), which represents Firms' financial performance as the dependent variable; the explanatory variables will include Audit Independence (AI), Audit Tenure (AT), and Audit Firms' Size (AFS) which represent indicators of Audit Quality (AQ)

The model used are expressed mathematically as thus:

$$AQ= f\,(AI, AT, AFS) \quad (1)$$

$$ROA= f\,(AI, AT, AFS) \quad (2)$$

Where:

ROA=Return on Assets; AI=Audit Independence, AT=Audit Tenure, AFS=Audit Firms' Size

Multivariate Regression model would be; $Y=\alpha + \beta_1X_1+ \beta_2X_2+ \beta_3X_3 \ldots\ldots\ldots\ldots+\beta nXn+\varepsilon$

$$ROA= \alpha+\beta_1X_1+ \beta_2X_2+ \beta_3X_3 + \varepsilon \quad (3)$$

Where; X_1 = AI, X_2 = AT, X_3= AFS

Y= the value of dependent variables;
α= the constant term;
β= the coefficient of the function;
X= the value of independent variables;
e = error term.

Thus, Regression equation becomes; $\mathbf{ROA= \alpha+ \beta_1\ [AI] + \beta_2\ [AT]+ \beta_3\ [AFS] + \varepsilon}$.

Measurement of Variables

Independent Variables

Audit Independence (AI): This will be measured using Natural log of audit fees paid by the consumer goods companies.

Audit Tenure (AT): This will be measured by Length of auditor-client relationship. The code "1" will be used if the relationship is 3 years and "0" if otherwise.

Audit Firm Size (AFS): This will be measured by the likelihood that a sampled company employs the services of one of the big 4 audit firms in Nigeria. A dummy value of 1 is used if a firm uses any of the big 4 audit firms and 0 if otherwise.

Dependent Variable

Return on Asset: This was measured as ratio of Net Income after Tax to Total Assets.

RESULTS

Descriptive Statistics: This section of the analysis provides an overview on the data set while attempt is also made to describe the main attributes of the data. The descriptive statistics presented in table 4.1 gave a glimpse of the central tendencies, measure of dispersion, minimum and maximum values, degree of peakedness, asymmetric value, and the Jarque-bera statistics of all the series used in the study. The analysis revealed the location of the center of distributions of the series via the average values (mean), the minimum values, maximum values as well as how individual variable values are spread on each side of the centre via the root mean squared deviation (standard deviation), thus revealing the uniformity of the items in the distribution of each variable. The peakedness of each variable is given by the kurtosis statistics, the symmetric nature of the series given by the skewness value while the normality condition of each of the series is given by the Jarque-Bera statistics.

Table 4.1. Descriptive Statistics

	Audit Independence	Audit Tenure	Audit Firm Size	Return on Assets
Mean	44.72000	0.52350	0.6000	0.084891
Median	48.25000	0.77000	0.3000	0.030850
Maximum	64.10000	1.00000	1.0000	0.863000
Minimum	25.50000	0.13000	0.4048	-0.078400
Std. Dev.	11.23466	0.240913	0.5302	0.188631
Skewness	-0.228004	0.014655	0.3940	3.734090
Kurtosis	1.980308	0.787907	0.2044	16.07973
Jarque-Bera	1.039762	0.038202	0.1930	189.0443
Probability	0.594591	0.981080	0.4020	0.000000
Observations	25	25	25	25

Source: Computer Output Eviews 7, (2020).

Minimum and maximum values of audit independence reported in table 4.1 stood at 25.50 and 64.10 respectively. The table reported minimum value of 0.1300 for audit tenure while the maximum value stood at 1.0000. As reported in table 4.2, the minimum and maximum values for the audit firm size were 0.4048 and 1.000 respectively. Return on Assets showed minimum and maximum values of -.07840 and 0.8630 respectively. From the table it was observed that all the variables except audit independence (-0.228004) was skewed to the right, given the corresponding positive skewness statistics of 0.014655, 0.3940 and 3.734090 for audit tenure, audit firm size and return on assets respectively. Notably, the kurtosis statistics revealed that only return on assets was leptokurtic (i.e positive kurtosis values are greater than 3) while audit independence, audit tenure and audit firm size were platykurtic (i.e positive kurtosis values less than 3).

The Jarque-bera statistics reveals that the normality hypothesis does not stand for return on assets while there is evidence that other variables are normally distributed given their corresponding probability values of 0.594591, 0.981080 and 0.4020 respectively.

Test of Hypotheses

Hypothesis One

H_0: Audit Independence has no significant effect on the financial performance of consumer goods companies in Nigeria.

Table 4.2 Hypothesis One Regression Result

Dependent Variable: Return on Assets
Method: Least Squares
Date: 12/12/19 Time: 13:04
Sample: 2014 2018
Included observations: 25

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Audit Independence	0.001176	0.007577	-0.155165	0.0484
C	0.096442	0.086121	1.119846	0.2775

Source: Computer Output, E views 7 (2020)

From Table 4.2, the size of the coefficient of the independent variable shows that a 1% increase in audit independence will cause a 0.001 increase in return on asset. Furthermore, p-value of 0.0484 which shows that the regression result is statistically significant because this is lower than 5%, the level of significance adopted for this study. Therefore, the null hypothesis one which states audit independence has no significant effect on the financial performance of consumer goods companies in Nigeria is rejected. Hence, audit independence has positive significant impact on performance of consumer goods in Nigeria.

Hypothesis Two

H_0: Audit Tenure has no significant effect on the financial performance of consumer goods companies in Nigeria.

Table 4.3 Hypothesis Two Regression Result

Dependent Variable: Return on Assets
Method: Least Squares
Date: 12/12/19 Time: 13:46
Sample: 2014 2018
Included observations: 25

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Audit Tenure	0.002907	0.003898	0.745731	0.0255
C	0.045094	0.179455	-0.251282	0.8044

Source: Computer Output, Eviews 7 (2020).

From Table 4.3, the size of the coefficient of the independent variable shows that a 1% increase in audit tenure will cause a 0.003 increase in Return on Assets. Furthermore, p-value of 0.0255 shows that the regression result is statistically significant because the value is lower than 5%, the level of significance adopted for this study. Therefore, the null hypothesis two which states audit tenure has no significant effect on the financial performance of consumer goods companies in Nigeria is rejected. Hence, audit tenure has significant effect on the financial performance of consumer goods companies in Nigeria.

Hypothesis Three

H_0: Audit firm size has no significant impact on financial performance of consumer goods in Nigeria.

Table 4.9 Hypothesis Three Regression Result

Dependent Variable: Return on Assets
Method: Least Squares
Date: 12/12/19 Time: 14:06
Sample: 2014 2018
Included observations: 25

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Audit Firm Size	0.018513	0.013006	1.423384	0.0217
C	-0.146953	0.167984	-0.874804	0.3932

Source: Computer Output, E-views 7 (2020)

From Table 4.9, the size of coefficient of the independent variable shows that a 1% increase in audit firm size will cause a 0.019 increase in return on asset. Furthermore, p-value of

0.0217 shows that the regression result is statistically significant because the value is lower than the 5% level of significance adopted for this study. Therefore, the null hypothesis three which states that Audit firm size has no significant impact on financial performance of consumer goods in Nigeria is accepted. Hence, Audit firm size has no significant impact on financial performance of consumer goods in Nigeria.

Summary

The study examined the relationship between audit quality and financial performance of consumer goods companies in Nigeria. The study aimed at ascertaining the impact of audit independence, audit tenure, audit firm size on financial performance of these quoted firms. The study made use of secondary data. Descriptive and cross sectional research design was adopted. Panel least square regression model was adopted in testing the hypotheses formulated. Results from statistical analysis showed that audit independence has positive significant impact on performance of consumer goods in Nigeria; audit tenure has significant effect on the financial performance of consumer goods companies in Nigeria; and audit firm size has no significant impact on financial performance of consumer goods in Nigeria.

Conclusion

The Study concluded that audit quality has significantly and positively impacted the financial performance of consumer goods companies listed on the Nigerian Stock Exchange. The independent variables studied: audit independence, audit tenure and audit firm sizes significantly impacted financial performance except audit firm size which was not statistically significant. The study also discovered that the audit function is important to the growth of firms as it provides essential services for the management of the firms. It is also helpful in bringing a methodical disciplined way to refine the control and governance procedures. It is a vital function and as evidenced by the increasing demand for this service in several organizations. Thus, the audit department is seen as a pertinent factor in the application of accounting systems and the financial reports express the work and quality of activities of the company.

Recommendations

As a result of the conclusion drawn earlier, the study recommends as follows:

- That, there is the need for firms to adopt effective internal control processes and practices that address key auditing practice for effective audit quality.
- In order to implement good internal audit independence, managers need to know that they should be concerned about the inter-relationship between audit quality and financial performance. They should continuously update themselves with the dynamism in audit technological systems and skills. By applying skills in vital instances, as well as building personal and professional credibility, auditors can become indispensable by spreading good governance and enhancing the efficiency of audit practices.
- Management should organize seminars and workshops for auditors to be trained frequently by experts and be updated with the new practice principles.

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