

## ANALYSIS OF AUDIT QUALITY AND INVESTORS PERCEPTION: THE CASE OF LISTED NON-FINANCIAL COMPANIES IN NIGERIA

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### Abstract

The study sets to examine the effect of audit quality on investors' perception amongst listed non-financial companies in Nigeria. The study employed a purposive sampling technique to select 32 companies from a population of 107 listed non-financial companies in Nigeria as at 31<sup>st</sup> December 2021. Secondary data were sourced from the annual reports of the companies from 2012 to 2021 (a period of 10 years). By way of utilizing the panel regression in testing the study hypotheses; the findings established that, audit tenure and audit rotation does not significantly affect investors perception measured through market share price of listed non-financial companies in Nigeria. On the other hand, audit firm size does significantly affect the investors' perception amongst listed non-financial companies in Nigeria. Based on the conclusion, the study recommends that, the audit firms employed for audit services by Nigeria's listed non-financial companies should not be retained for more than ten years as this does not signal the right perception for investors about the company. In addition, the audit firms retained by the entities should be rotated on a five-year basis. This will strengthen the level of audit quality by avoiding overfamiliarity in the

relationship between the audit firm and the company's management, which may impede audit independence and, as a result, cause investors to lose confidence in the audited reports of the companies when making market investment decisions.

**Keywords:** Audit quality, investors' perception and the signaling theory.

### Introduction

Financial scandals have called into question the quality of audit and the audit process's ability to create quality accounting reports that is deemed to be of quality for investment decisions, particularly in Nigeria (Badawi, 2008). Due to low audit quality, investors that relied on false financial reports have made poor investment decisions in the past such as; the Eron Case. Recent corporate financial failures and scandals offer a significant challenge to audit quality and how it affects investors' perception. As a result, companies' audit quality is now more scrutinized by investors. An apprehension about audit quality and its relationship investors' perception have been addressed partly by authors like Almaharmeh, Shehadeh, Iskandrani and Saleh (2021). However, the extent to which the audit quality affect investors' perception amongst listed non-financial companies in the context of Nigeria is still a debate amongst scholars.

Hoti, Ismajli, Ahmeti, and Drmaku (2012) asserted that, investors perception is measured through market price of shares, which is driven not only by the broader economy but how investors react to perceived information about the company. In this regard, investors perception can be termed the value relevance of audit quality.

According to Hoti et al. (2012), information flow and investors' perception influences stock prices. When there is an excess demand for a stock, the price rises; when there is an excess supply or fraud, the price falls. Investor demand for a company's stock, according to Okolie and Izedonmi (2021), is driven by firm-specific qualities such as favorable or negative news revealed by auditors about earnings reports. Additionally, non-financial issues such as new laws, government regulations, and changes in corporate governance procedures, all of which fall within the scope of external audit, might influence market pricing (Safdar, Chaudhry, Mirza & Yu, 2019).

Audit quality is crucial to a financial reporting system's success and efficiency since external audit provides investors with confidence in the integrity of financial reports and improves trust in company affairs (Ishaku, Musa & Garba, 2020). The goal of external auditing is to provide reasonable assurance about whether the financial statements as a whole are free of material misstatement, whether due to fraud or error, allowing auditors to communicate an opinion on whether the financial statements are provided, in all material respects, in accordance with the applicable reporting framework, so that investors who intend to use the reports in making investment decisions are not misled. To achieve this goal, the external auditor must be objective and competent (Eneisik & Akani, 2021). Audit tenure, audit rotation, and audit firm size, according to Iliemena and Okolocha (2019), are major factors of audit quality necessary to meet objective external audit obligations that affect investors perception. Audit tenure is the number of years a client stays with an audit firm, whereas audit rotation is the exchanging of audit services between one or two audit companies. Writers such as Wijaya

(2020) suggested that the Big four audit companies in the globe are thought to be more competent than other audit firms because of their scale (Wibowo & Rossieta, 2009) thus, audit firm size known in extant literatures as the Big 4s are measures of audit firm size.

The extant empirical literatures reviewed on audit quality and investors perception have focused have shown mixed evidence and are not specific about the non-financial sector. For example, Ishaku et al. (2020), Amahalu and Obi (2020), Monametsi and Agasha (2020), Ado, Rashid, Mustapha, and Ademola (2020) found that, audit quality proxies such as big4 auditors, tenure, and fees have no effect on share market price. Audit quality, according to Ugwu, Aikpitanyi, and Idemudia (2020) and Iliemena and Okolocha (2019) affects market share prices. Due to these authors evidence, there is need for research in the non-financial sector to dissect how investors react to information about audit quality of companies. To this end, the study seeks to investigate the effect of audit quality on investors' perception amongst listed non-financial companies in Nigeria. The specific objectives of the study are to:

- i. Ascertain the effect of audit rotation on share price of listed non-financial companies in Nigeria.
- ii. Examine the effect of audit tenure on share price of listed non-financial companies in Nigeria.
- iii. Assess the effect of audit firm size on share price of listed non-financial companies in Nigeria.

## Literature review

### The Signaling Theory

This research is based on Michael Spence's Signaling theory, which was formulated in 1973 to explain asymmetric information in

the market. The signaling theory explains how information asymmetry is used as signals to investors in the market. The signaling theory provides a novel idea that explains the value relevance of audit quality information (De las Heras, Caibano, & Moreira, 2012). A signal, according to Alina and Loan-Bogdan (2008), is a visible activity or structure that acts as an indicator of quality. The information disclosed by companies about the audit quality can be viewed as a signal to the markets, intended to alleviate the information asymmetry and to influence investors' perception about the company through patronage of share (Eneisik, 2022).

Authors like Irungu (2013), Phan et al. (2020) and Shubita (2021) have demonstrated that investors' perception and market opinion about the quality of a firm's auditor effects the share price of that company. Partly, directors and management may wish to convey to stakeholders that their interests are being closely observed through publishing information about the audit quality (Alina & Loan-Bogdan, 2015). Accordingly, signaling should therefore theoretically influence audit quality demand in addition to the monitoring function. The positive signal of openness and credibility it sends to the market, as well as the assurance it provides to stakeholders regarding the quality of earnings performance disclosures, shows that there is a positive relationship between market price per share and audit quality.

Signaling through audit quality is based on the agency preposition and is a method for managers and/or directors to communicate additional information about their firm and their personal conduct to the market (Okolie & Izedonmi, 2021). According to signaling theory, companies that have quality audits use the information released about such audit

quality to send signals to the market, which may alter investors perception and the price of companies shares.

### **Concept of Audit Quality and Investors Perception**

Other researchers link audit quality to the dependability of financial statement data. Shubita (2021) supports this viewpoint, claiming that audit quality increases the dependability of financial statement information which swings investors perception and allows investors to make more precise investment decisions. Accordingly, Mahdi, Zimon, Tarighi, and Gholamzadeh (2022) proposed that, audit quality improves the accuracy of reported accounting information, implying that financial statements audited by high-quality audit are unlikely to contain major misstatements which explains the notion of audit quality.

Although audit quality is not a new concept in accounting literature, there is no single widely accepted definition for it. Many authors accepted DeAngelo's (1981) definition of audit quality, which states that "the quality of audit services is the market-assessed joint chance that a given auditor would both (a) detect and report a breach in the client's accounting system." This concept is based on the external auditor's competence and independence. Competence is related to an auditor's ability to discover violations of accounting standards in a client's accounting system. Independence, on the other hand, refers to the auditor's capacity to report discovered breaches in a client's accounting system. This definition is supported by Tyokoso and Tsegba (2016) who affirmed that audit quality is the joint probability that the auditor detects and reports questionable accounting practices of the company.

Researchers such as Mahdi et al. (2022); Safdar et al., (2019); and DeFond and Zhang (2014), presented an audit quality measurement utilizing audit firm size, such as a corporation audited by the major four companies or otherwise. Furthermore, Matoke and Omwenga (2016) created an audit quality measurement using various proxies such as auditor tenure, auditor company size, auditor experience, and audit rotation. Mohammed et al. (2021) confirm that a higher quality audit increases the likelihood that the financial statements accurately reflect the organization being audited financial status and results of operations. According to Hassan et al. (2014), corporations audited by internationally associated audit firms (Big 4) are more likely to disclose extensive information than those audited by local audit firms. The reasoning is that internationally associated audit firms are larger and offer more competence than local audit firms. Based on earlier academic work, this analysis finds audit company size, auditor tenure, and audit rotation as proxies for audit quality.

Choi, Kim, Kim and Zang (2010) in their study about market reaction posited that, investors are concerned with information about the company which influences their perception and how they patronize the market shares of companies. This means, the share prices of companies are measures of investors perception about the company. The market price per share is the price at which a stock can be easily bought or sold in the present market (Carp & Istrate, 2021). The market price of share might change from time to time due to changes in the stock market and information about the company (for example, investors reaction on the market due to the Eron case). The market price per share is influenced not just by the overall economy, but also by investors' thoughts and such

expectations (Choi et al. 2010). Information about the quality of audit can influence the law of demand and supply for share price which has a considerable influence on the price of a shares due (Leland & Toft 1996; Irungu, 2013; Phan, Lai, Le & Tran, 2020; and Shubita, 2021).

Erasmus and Micah (2021) investigated the association between audit quality measures and the market price per share of Nigerian listed deposit money institutions. The study findings reveal that audit fees have a negative and insignificant impact on share price using panel least squares regression. Furthermore, the audit tenure had a negative and significant effect on the share price. Eneisik and Akani (2021) conducted an empirical investigation on the relationship between audit quality and market value of Nigerian listed banks. Audit fees, audit tenure, and audit company size were used to estimate audit quality, whereas market value was estimated using market price per share. The study found that, audit fees have a negative and minor impact on market price per share using panel least squares regression. According to empirical evidence, audit tenure has a negative and considerable impact on market price per share. Further research reveals that the size of the audit company had a negative and small impact on the market price per share.

Previous authors, such as Mohammed et al. (2021), have claimed that audit fee alone cannot be considered the greatest possible measure of audit quality. This is due to the authors' failure to create a compelling average sector fee that best characterizes a quality audit. Almaharmeh, Shehadeh, Iskandrani, and Saleh (2021) investigated the impact of audit quality on the degree to which company-specific information is integrated with a company's share price, which is defined inversely by stock price

synchronization. Their research subjects are non-financial enterprises registered on the Amman Stock Exchange (ASE). After analyzing 810 company-year observations from Jordanian industrial companies listed on the ASE during the study period, the study discovered that firms using one of the BIG4 professional platforms for auditing have less synchronous and more informative stock prices, implying that high-quality audit improves governance and reduces information asymmetry between companies' insiders and investors, enhancing the capitalization of company-specific information into the stochastic market.

Afifa et al. (2020) explored the link between audit quality and stock price in Jordan, an emerging market. In the study model, they also employed the role of earnings quality as a mediator element. The study sample includes all Jordanian industrial public shareholding businesses that were registered on the Amman Stock Exchange between 2010 and 2018. As a result, the study employs a panel data analysis of financial disclosures. According to the study, a high audit quality and a high earnings quality both boost the share price.

## Method

The ex-post facto research design is adopted for the study. The study's population comprises of 107 non-financial companies listed on the Nigerian Exchange Group (NGX) while the sample is made up of 32 companies chosen by way of a purposive sampling technique. The audit quality data is derived from each sampled company's audited annual report, which are published on NGX. The data for the share price, on the other hand, is derived from the published yearly average share price for each firm at Investing.com-Nigeria.

The panel regression model evaluates the relationship between audit tenure, audit rotation, audit firm size and market share price of listed non-financial companies in Nigeria. Firm size is used as the control variable since the data is pooled from different sectors. The model is presented below:

$$MPS_{it} = \alpha + \beta_1 ATN_{it} + \beta_2 ART_{it} + \beta_3 AFS_{it} + FSZ_{it} + U_{it}$$

Where;

MPS = Market Price of Shares (The published yearly average value of market share price of each company)

ATN = Audit tenure (The number of years an audit company is engaged by a client (company))

ART = Audit rotation (Audit rotation in Dummy (1,0) is computed as; "1" for the year the company changes from one external audit firm to another; and "0" when there is no change/rotation)

AFS = Audit Firm Size (Big 4 Auditors in Dummy (1,0) is computed as "1" for Companies that use PWC, Deloitte, E&Y and KPMG as external auditors and "0" otherwise)

FSZ = Firm Size (Total assets of the companies in their Naira value)

$\alpha$  = Constant

$\beta_1 - \beta_3$  = Slope Coefficient

$\mu$  = Stochastic disturbance

i = i<sup>th</sup> company

t = time-period

## Analysis and Discussion

### Descriptive Analysis

In this section, the study examines the descriptive statistics for both the dependent and independent variables of interest. Each variable is examined based on the mean, standard deviation, maximum and minimum values. The table below displays the descriptive statistics for the study.

**Table 1: Descriptive Statistics**

Variable Dev.	Obs Min	Mean Max	Std.
MPS	320	75.45659	
	258.1078	.21	1556
ATN	320	5.7375	
	3.129368	1	13
ART	320	.196875	
	.3982598	0	1
AFS	320	.509375	
	.500695	0	1
FSZ	320	6.36e+07	
	1.19e+08	412141	
	8.26e+08		

**Source: STATA output**

The number of observations for the study is 320. For the mean of investors perception which is measured as Market Price per Share (MPS), the result reveals a value of 75.46 Naira with a standard deviation of 258.11 Naira. MPS has minimum and maximum values of 0.21 and 1556 Naira respectively.

In the case of the independent variable, the study finds that Audit Firm Size (AFS) has a mean of 0.509375 and a standard deviation of 0.500695. This implies that on the average, about 50.9% of the companies in our sample employed the services of either the big4 or non-big 4 auditors. The minimum value for AFS is 0 while the maximum value is 1.

The study finds that the mean of Audit Tenure (ATN) using the number of years engaged by clients as proxy for audit independence as measured by scholars such as Meldi et al. (2022) is 5.73 years with a standard deviation of 3.12 years. ATN has a minimum and maximum values of 1 and 13 years respectively.

Table 1 also shows that Audit Rotation (ART) has a mean of 0.196875 chances of occurrence with a standard deviation of 0.3982598 chance of occurrence amongst companies. This implies that, there is 39% chances for the companies under study to rotate the services of more than 1 audit company. The ART reveal a minimum and maximum chance of rotation as 0 and 1 respectively.

The Company Size (FSZ) as a control variable records a mean value of approximately 6.36 billion Naira and a standard deviation of 11.9 billion Naira. FSZ also records minimum and maximum values of approximately 412.14 million Naira and 82.6 billion Naira respectively.

### Diagnostic Tests

A number of tests are carried out to ascertain if the data used in this study meets the requirements of the regression technique. They include; data normality test and the multicollinearity test. To test for the level of disparity between the data sect which might disrupt the outcome of the result or to ascertain the fitness of the data used for the study, the probability of Kurtosis test as data normality test is employed. The correlation matrix is carried out to determine the presence or absence of multicollinearity in the data used in this study. The results is presented in table 2 below.

**Table 2: Diagnostics**

	ATN	ART	AFS	SIZE
Prob. Kurtosis				
ATN	1.0000 0.0000			
ART	-0.4589 0.0000	1.0000		
AFS	-0.0985 0.0000	0.1872	1.0000	
FSZ	-0.1936 0.0000	0.0572	0.3754	1.0000

**Source: STATA Output**

From the table 2, the probability of Kurtosis is used as a test of normality; as data is normalized if the probability is less than 0.000. The data set for all the variables reveal probability values that are all significant at <0.05; which means that all the data values are within the accepted range for normality.

The correlation matrix in Table 2 shows the absence of multicollinearity to influence the outcome of another among the explanatory variables. All the variables show a low correlation, with the highest estimated at 0.3754 (between FSZ and AFS). This indicates the absence of multicollinearity in the model, and this means no independent variable should be dropped from the model.

**Estimated model summaries**

A panel regression is done using the data on audit tenure, audit rotation, and audit firm size against the market price per share to test the significance of the model. The estimation result is presented in Table 3.

**Table 3: Regression estimation**

	Statistic	P-value
i.	Hausman Test	0.8174

ii.	Lagrangian multiplier test Decision	0.0000
		Random effect regression
R-sq	0.0363	
Wald	11.8	0.0246
Chi2		
<b>Var.</b>	<b>Coef.</b>	<b>Prob.</b>
MPS		
ATN	-2.690151	0.078
ART	5.911201	0.638
AFS	-40.78061	0.037
FSZ	46.6201	0.035
Const.	-225.8622	0.164

**Source: STATA output**

To enable the study to choose between the pooled model, fixed-effect model, and the random effect model, the Hausman, and Lagrangian test are conducted. The result of the Hausman correlation test from table 3 shows a probability value of 0.8174 > 0.05 which is not significant thus informs the preference of the random-effect model from the Hausman test. To choose between the random effect and pooled model, the Lagrangian test conducted revealed a probability value of 0.0000 which informs the study's final decision to choose the random effect model.

The result presented in Table 3, shows the regression result between ATN, ART, AFS and MPS controlled by FSZ. From the model summary table above, the following information can be distilled.

The overall R<sup>2</sup> which measures the level of variation of the dependent variable caused by the independent variables stood at 0.0360. The R<sup>2</sup> otherwise known as the coefficient of determination shows the percentage of the total variation of the dependent variable (MPS) that can be explained by the independent or explanatory variable (ATN,

ART & AFS) and controlled by FSZ. Thus, the  $R^2$  value of approximately 0.0363 indicates that 3.63% of the variation in the market price per shares of listed non-financial companies can be explained by a variation in audit quality measures, and controlled by company size while the remaining 96.4% (i.e.  $100-R^2$ ) could be accounted by other variables not included in this model.

The regression results show that, when the independent variables are held stationary or without the variable intercept model (Constant); the MPS variable is estimated at -225.8622. This implies that, when all independent variables are held constant, there will be decrease in the MPS of listed non-financial companies up to the tune of 225.8622 units occasioned by factors not incorporated in this study. Thus, a unit increase in ATN will lead to decrease in MPS by 2.690151, however this increase is not significant as the p-value of  $0.078 > 0.05$ . Also, a unit change in ART will lead to a change in MPS by 5.911201 but this change is also not significant as the associated p-value of 0.638 is greater than the accepted 0.05 p-value. A unit change in AFS will lead to a change in MPS by -40.74061 but this change is also significant as the associated p-value of 0.037 is less than the accepted 0.05 p-value.

A unit change in FSZ will increase MPS by 46.6201, this increase is significant because the associated p-value is  $0.037 > 0.05$ . Finally, the result shows that there is a significant variation of Wald chi-statistics (11.18) at a probability value of 0.0246 which means the model as a whole is statistically fit.

### **Discussion of results**

Objective one set out to evaluates the effect of audit tenure on market share price of listed non-financial companies in Nigeria. The

result of the data analyses has revealed no significant effect of audit tenure on market share price of listed non-financial companies in Nigeria. This shows that, the audit tenure practice of listed non-financial companies in Nigeria does not conform with the signaling theory proposition alluded by Spence (1973). This contradicts the findings of Erasmus and Micah (2021) who investigated the relationship between audit quality and the market price per share of Nigerian listed deposit money banks. They found that, audit tenure had significant effect on the share price. The reason for the contradiction could be as a result of the difference in the sectors examined by both studies.

In line with the second objective of the study, the result analyzed revealed that, audit rotation has no significant effect on market share price of listed non-financial companies in Nigeria. In testing the signaling theory, the result from the study contradicts the proposition of information asymmetry that is expected to be cushioned by audit quality. To Spence (1973), information in the form of audit quality serves as signals to the market intended to cause investors reaction in patronizing the market shares of the company.

Result from the third objective analyzed revealed that, audit company size has a significant effect on market price of listed non-financial companies in Nigeria. This result is similar to the findings of Mohammed et al. (2021) who assessed the relationship between and impact of core competence of audit companies and earning quality of audited companies in Iraq. Their result reveals the existence of a significant relationship and influence of the quality of audit in terms of competence on earnings quality of banks in Iraq. The findings of these

study support the preposition made in the theory of inspired auditors' confidence; wherein it is argued that, investors perception about the audit quality in terms of audit firm size boast the confidence of investors in patronizing the shares of these companies.

### Conclusion/Recommendation

From the findings established, the study concludes that, audit tenure and audit rotation does not significantly affect investors perception amongst listed non-financial companies in Nigeria. On the other hand, audit firm size does significantly affect the investors' perception amongst listed non-financial companies in Nigeria.

Based on the conclusion, the study recommends that, the audit firms employed for audit services by Nigeria's listed non-financial companies should not be retained for more than ten years as this does not signal the right perception for investors about the company. In addition, the audit firms retained by the entities should be rotated on a five-year basis. This will strengthen the level of audit quality by avoiding overfamiliarity in the relationship between the audit firm and the company's management, which may impede audit independence and, as a result, cause investors to lose confidence in the audited reports of the companies when making market investment decisions.

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