

AUDIT QUALITY AND FIRM FINANCIAL PERFORMANCE

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Abstract: *The study examines the relationship between audit quality and firm financial performance. The study focuses on two financial performance measures, namely return on assets (ROA) and earnings per share (EPS). It employed Auto Regressive Distributed Lag (ARDL) and Dynamic Ordinary Least Square (DOLS) techniques for analysis of data. The research utilizes secondary time series data covering the period from 1981 to 2021. In Model 1, which explores the effect of audit quality on return on assets, the findings reveal both short-run and long-run effects between audit quality and ROA. The study indicates that audit independence has a positive but insignificant impact on ROA. On the other hand, auditor tenure has a negative effect on ROA, though it is also statistically insignificant. Audit firm size demonstrates a statistically significant negative effect on ROA. In Model 2, which examines the effect of audit quality on earnings per share, the results show that audit independence has a negative but insignificant impact on EPS. Surprisingly, auditor tenure has a positive effect on EPS. However, this effect is statistically insignificant. Similar to Model 1, audit firm size has a statistically significant positive effect on EPS. In summary, the study reveals a significant short-run and long-run effect of audit quality on return on assets (ROA) in Nigeria. However, audit quality does not have a lasting impact on earnings per share (EPS) over the long term. These findings suggest that companies with higher audit quality experience improved profitability (ROA) in the short and long term, while EPS is not significantly affected by audit quality in the long run.*

Key words: *Audit Quality, Firm Financial Performance, Return on Assets, Earnings per Share.*

JEL Classification: *M42, L25.*

1. Introduction

Audit quality and firm performance are two critical aspects in the field of accounting and finance that have garnered significant attention from researchers, policymakers, and practitioners alike. The quality of financial reporting and external audits plays a crucial role in ensuring the reliability and transparency of financial information provided by companies to their stakeholders. At the same time, firm performance represents the overall success and efficiency of an organization in achieving its strategic objectives.

Audit quality refers to the extent to which external audits provide credible and reliable information about a company's financial statements. High-quality audits are essential for maintaining investor confidence, as they enhance the trustworthiness of financial information and reduce the risk of misstatement or fraud. The main objective of an external audit is to express an opinion on whether a company's financial statements are presented fairly in accordance with the applicable accounting standards and regulations. Several factors contribute to audit quality, including the competence, independence, and objectivity of the audit firm and its professionals. A well-performed audit involves thorough testing and verification of financial data, adherence to professional standards, and effective communication with company management and audit committees (Ayora & Ogeto, 2022).

Firm performance is a comprehensive measure of how well an organization is achieving its business objectives and creating value for its stakeholders. It encompasses various dimensions, such as financial performance (profitability, liquidity, and solvency), operational efficiency, market share, customer satisfaction, and overall competitive advantage. Strong firm performance not only attracts investors but also ensures the company's sustainability and growth in a dynamic and competitive market environment. The relationship between audit quality and firm performance is an intriguing and complex area of research. A well-conducted audit is expected to provide greater confidence to investors, creditors, and other stakeholders, which can positively influence a company's reputation and

access to capital. The assurance provided by high-quality audits can reduce information asymmetry between management and external parties, leading to improved decision-making and resource allocation (Ivungu et al., 2019).

Moreover, higher audit quality may also have a positive impact on firm performance through various channels. For instance, it can mitigate the agency problem between shareholders and management by aligning their interests. Additionally, transparent financial reporting resulting from high-quality audits can lead to better access to credit and lower financing costs for the company. On the other hand, a lack of audit quality can have adverse effects on firm performance. Misstatements or errors in financial reporting may lead to incorrect assessments of a company's financial health and future prospects, thereby affecting investor decisions and stock prices negatively (Soyemi et al., 2021; Ozegbe and Jeroh, 2022).

Numerous studies have been conducted to explore the correlation between audit quality and firm performance, recognizing their significance. This research aims to add to the existing knowledge by examining how audit quality influences firm performance, specifically focusing on the case of First Bank of Nigeria from 1980 to 2021. By studying this relationship within a specific context, we hope to provide valuable insights that can benefit regulators, auditors, investors, and company management, potentially influencing policies and practices in the Nigerian banking industry. It is worth noting that, according to the researcher's knowledge, only a limited number of studies have attempted to decompose dependent variable against explanatory variables to investigate determine if the results align with previous well-regarded studies or differ from them.

This research aims to address the following inquiries: What is the notable impact of audit quality on the financial performance of firms? What is the significant influence of auditors' independence on the financial performance of firms? What is the significant effect of audit firm size on firm financial performance? The study will break down audit quality into auditors' independence, audit firm size, and timeline, while firm financial performance will be analyzed based on earnings per share and return on assets. The remainder of this research is organized into three sections: literature review, methodology, and conclusion.

2. Literature Review

2.1 Conceptual review

2.1.1 First Bank of Nigeria

First Bank of Nigeria, commonly known as First Bank, is the oldest and one of the largest financial institutions in Nigeria. First Bank of Nigeria was founded on March 31, 1894, in Lagos, Nigeria. It was established as the Bank of British West Africa (BBWA) to cater to the banking needs of the British colonial administration and the trading community in Nigeria. The bank commenced operations with a focus on providing banking services to British firms and colonial officials. In the early 20th century, the Bank of British West Africa expanded its operations beyond Lagos, opening branches in other Nigerian cities and neighboring West African countries. The bank's growth was mainly driven by its role in financing trade and facilitating economic activities in the region. Over the years, First Bank of Nigeria has maintained its position as one of the most financially stable and respected banks in Nigeria and the African continent. It has consistently ranked among the top banks in terms of assets, customer base, and profitability. First Bank of Nigeria remains a prominent player in the Nigerian banking industry, providing a wide range of financial products and services to its diverse customer base (First Bank of Nigeria Limited [FBN], 2023).

2.1.2 Financial Performance

According to Amahalu et al. (2019), financial performance pertains to the ability of a firm to effectively utilize its core resources to generate revenue. It serves as an overall

assessment of a company's fiscal well-being over a specific period. Analyzing the empirical performance is crucial for making informed policy adjustments in the future. Financial performance is a measure of how well a company has consistently achieved its defined objectives over time. Despite the challenges posed by the global financial crisis and the failure of certain unlicensed domestic institutions, some businesses in Nigeria have demonstrated resilience and maintained their strength. Performance information can be gleaned from financial statements. The initial step in evaluating a firm's performance should involve determining whether it has successfully met the objectives set by its stakeholders (Chinedu et al., 2020).

2.1.2.1 Return on Assets (ROA)

The Return on Assets (ROA) ratio is a key metric for assessing a company's profitability. It serves as a gauge of a company's profitability in relation to its overall asset base. It measures the revenue relative to total assets. It gauges the management team's capacity to turn a profit by making use of available resources. In other words, it demonstrates how effectively the company's resources are employed to generate revenue (Amahalu et al., 2019). This profitability ratio demonstrates the rate of returns and management effectiveness. Additionally, it shows how well a company's management uses all of its resources to produce net income. A greater ROA indicates that a corporation is utilising its resources more effectively. Return on Assets is computed as follows and is shown as a percentage: Return on Assets (ROA) = Profit after Tax/Total Assets (Eshitemi & Omwenga, 2016).

2.1.2.2 Earnings per Share (EPS)

Earnings per Share (EPS) are a financial metric that represents a company's profitability and is widely used by investors and analysts to assess a company's performance. It calculates the portion of a company's net earnings that is attributable to each outstanding share of its common stock. $EPS = (\text{Net Earnings} - \text{Preferred Dividends}) / \text{Weighted Average Number of Common Shares Outstanding}$. However, it should be used in conjunction with other financial ratios and metrics to get a comprehensive view of a company's financial health and performance (Eshitemi & Omwenga, 2016).

2.1.3 Audit Quality

According to DeAngelo (1981), audit quality is the market-estimated joint chance that a particular auditor would find substantial inaccuracies in the client's financial statements and report those inaccuracies. Furthermore, DeAngelo (1981) uses a two-dimensional approach to characterise audit quality, first identifying substantial financial statement inaccuracies and errors and then disclosing them. DeAngelo (1981) defined audit quality as being a function of the external auditor's technical capabilities (ability to identify substantial misstatements) and willingness (auditor independence) to disclose the errors.

According to Houghton et al. (2010), the accounting literature on audit quality supports the idea that auditor competence and independence are two factors that contribute to audit quality. Any study examining the effects on audit quality (within nations) must take into account participants' perceptions of the independence and expertise of the auditor. Many people believe that auditor independence is the foundation of the auditing function, and this belief has served as the driving force behind numerous audit reforms worldwide since 2001 (Houghton et al., 2013).

2.1.3.1 Audit Independence and Financial Performance

Donatella et al. (2019) suggest that the concept of independence encompasses both impartiality and the absence of bias in one's mindset. Consequently, the degree of independence exhibited by auditors is influenced by the regulations and procedures of the audit firm, along with the attitudes of the employees involved in performing audit tasks (Geiger & Kumas, 2018). Amahalu and Obi (2020) define audit independence as the auditor's

ability to maintain objectivity while carrying out their duties. Audit independence refers to the ability of the external auditor to act with integrity and impartiality during his/her auditing functions. Auditor independence may be impaired by auditor tenure. As the relationship between the auditor and client lengthens, the auditor may develop close relationship with the client and may likely act in favor of the management such like, impair objectivity and audit quality (Chinedu et al., 2020). Audit quality in recent times has become a source of worry globally as most auditors seem not to be discharging their duties independently (Ivungu et al., 2019).

2.1.3.2 Audit Tenure and Financial Performance

The term "audit tenure" refers to the full time that an auditor has a customer. As the parties' personal relationships and familiarity build, it may become harder for the auditor to remain objective, which could lead to a lack of focus on the part of the investigator. This could happen when there are longer stretches between the auditors and their clients. In addition to endangering independence, if the audit appointment becomes routine over time, the auditor will have less time to look for weaknesses in internal controls and risk sources (Capkun et al., 2016).

2.1.3.3. Audit Firm Size and Financial Performance

Audit firms are service-driven professional and expertise-intensive organizations set up to uphold high-quality reporting among entities. Results from extant researches suggests that the size of audit firms have been used as proxy for audit quality given that larger audit firms are known with a reputation of upholding and guaranteeing impartial and high-quality audit services (Chinedu et al., 2020).

2.2 Theoretical Framework

2.2.1 Agency Theory

The interaction between the primary (shareholders) and the agents (business manager) was the focus of Jensen and Meckling's (1976) agency theory. The term "agency relationship" refers to a legal arrangement whereby one or more parties (referred to as the principal(s)) appoint another party (referred to as the agent(s)) to carry out specific tasks on their behalf. In order to make decisions on behalf of the principal (the business owner), this entails giving the agent some of their authority. If the agent refuses to follow the principal's instructions when making decisions, the principal may decide to limit deviations from his interest by giving the agent the right incentive and incurring costs for monitoring the agent's activities (Aliyu et al., 2015).

Understanding the role of an auditor in the creation of high-quality reports for the business requires an understanding of the principal-agent relationship as portrayed in agency theory. This is due to the fact that principals rely on their agents to work in their best interests, but information asymmetries between principals and agents lead to principals and agents acting with conflicting goals. In order to build up their agents' trust, principals may not have enough procedures or mechanisms in place. One such tool is the audit. The agency theory is a practical economic theory of accountability that sheds light on how audit quality has evolved generally.

2.3. Empirical Literature

Studies on audit quality, size, independence, tenure, and other topics are widely available. For instance, Egbunike and Abiahu (2017) conducted a research study to explore the impact of various audit firm characteristics on the financial performance of money deposit banks in Nigeria. Specifically, the study aimed to investigate how audit quality, audit fee, and audit report lag influenced the return on assets, earnings per share, and net profit margin of Nigerian banks. The researchers utilized an ex post facto and correlational research design for their study. The study encompassed all money deposit banks that were operational

as of the end of the 2015 financial year. The findings of the research indicate that audit quality significantly affects the return on assets of Nigerian banks. Moreover, both audit fee and audit report lag were found to have significant effects on the return on assets, earnings per share, and net profit margin of Nigerian banks.

In Nigerian listed manufacturing enterprises from 2006 to 2016, Chinedu et al. (2020) looked at the impact of audit quality on financial performance. Out of the 80 listed manufacturing companies in Nigeria, 24 companies were chosen using the stratified purposive sampling technique. The companies' public yearly financial statements were used to collect secondary data. The data analysis used the Ordinary Least Squares method of regression. According to the study, among other things, the independence of the auditor and the size of the firm have a favourable and significant impact on the financial performance of listed manufacturing firms.

For 10 years, from 2009 to 2018, Soyemi et al. (2021) evaluated the impact of audit quality on the financial performance of 40 listed non-financial enterprises in Nigeria. To estimate the model used in this study, ordinary least squares (OLS) was used. These companies' annual reports and audited financial statements were chosen using a stratified selection technique, and secondary data of a panel character were collected from them. Following that, the outcome showed a strong and favourable impact of audit tenure and audit firm size on operating cash-flow. Additionally, there were negligible and favourable correlations between audit fees, audit committee expertise, and operating cash-flow.

In 2022, Ozegbe and Jeroh conducted a study that investigated the connection between audit quality and the financial performance of publicly listed companies in Nigeria. The study employed the Panel Least Square technique, along with descriptive analysis and relevant diagnostic tests, as analytical tools to analyze the data collected. The research focused on data from quoted companies in Nigeria, spanning a period of 10 years from 2011 to 2020. Audit quality was measured using indicators such as statutory audit services, audit tenure, auditor's independence, and audit-firm size, while firm performance was assessed using Return On Assets (ROA). The firm year data used in the study were extracted from the respective annual reports and sourced from the MACHAMERATIOS database. From the results, audit independence exerts significant negative influence on ROA; audit tenure and audit firm size had positive relationship with ROA, although, this relationship was not significant.

Eshitemi and Omwenga (2016) conducted a study to assess the impact of audit quality on the financial performance of publicly listed Parastatals in the Nairobi Securities Exchange. The main focus of the research was to investigate the relationship between various factors related to audit quality, such as auditor independence, audit firm size, attributes of the audit team, and auditor experience, and how they influenced the financial performance of the listed Parastatals. The researchers collected data from both primary and secondary sources, covering a period of five years from 2009 to 2013. To analyze the data, the researchers utilized multiple regression analysis. The study's findings revealed that there was a positive and significant effect of audit quality on the financial performance of the listed Parastatals. Specifically, the degree of auditor independence was found to have a direct relationship with the firms' substantial net profit margin, meaning that a higher level of auditor independence was associated with greater profitability for the firms. Additionally, the size of the audit firm showed a positive and significant impact on the Return on Equity (ROE) and Return on Assets (ROA) of the listed Parastatals.

3. Research Methodology

3.1. Research Design

This study is anchored on agency theory. The agency theory is a practical economic theory of accountability that sheds light on how audit quality has evolved generally. A data model was developed to investigate the effect of audit quality on firm financial performance in Nigeria, using First Bank of Nigeria as case study being the oldest bank in Nigeria, the choice of selection of the institution premised on purposive sample approach, being time series research work, the study covered forty two years (42).

3.2. Data and Analytical Procedure

The study made use of secondary source of data contained in the annual financial reports of First bank of Nigeria under investigation spanning from 1980 to 2021.

3.3. Model Specification

This study expresses return on asset as a function of auditor’s independence, audit-firm size and audit tenure. Accordingly, equation from the regression analysis is predicted as follow:

$$FFP = f(AUQTY)$$

$$(EPS, ROA, ROSF) = f(AUDIND, AUF, AUDTEN) \text{ ----Decomposed}$$

$$EPS = f(AUDIND, AUF, AUDTEN) \text{ -----Model1}$$

$$ROA = f(AUDIND, AUF, AUDTEN) \text{ -----Model 2}$$

$$ROSF = f(AUDIND, AUF, AUDTEN) \text{ -----Model3}$$

$$EPS = \beta_0 + \beta_1 AUDIND + \beta_2 AUF + \beta_3 AUDTEN + \epsilon_{it} \dots\dots (1)$$

$$ROA = \beta_0 + \beta_1 AUDIND + \beta_2 AUF + \beta_3 AUDTEN + \epsilon_{it} \dots\dots (2)$$

Where: EPS= Earnings per Share; ROA = Return on Asset; AUDIND =Auditor’s Independence; AUF = Audit-Firm Size; AUDTEN = Audit Tenure; β_0 = Intercept or Constant coefficients (the constant term); β_1 - β_3 = Regression Coefficients; ϵ_{it} = Schocastic, disturbance error term (noisy variable).

Table 3.1 Operationalization of Variables

S/N	Type of variable	Variable	Measurement	Apriori Expectation
1	Dependent	ROA	Profit after Tax/Total Assets.	
2	Dependent	EPS	(Net Earnings - Preferred Dividends) / Weighted Average Number of Common Shares Outstanding.	
	Dependent	ROSF	(Net Income / Shareholders' Equity) × 100	
1	Independent	Auditor’s Independence	This is the ratio of audit fee to the company's revenue	+Ve
2	Independent	Audit-Firm Size	A dummy variable, that is coded “1” if the firm is audited by a Big4 and “0” otherwise. However award 2 for Joint Audit	+Ve
3	Independent	Audit Tenure	Award number for years spent by audit firm to audit a client’s company.	-Ve

Authors’ Compilation (2023)

4. Data Analysis

This study adopted Augmented Dickey-Fuller Unit Root Test to determine stationarity and order of integration of the variables.

4.1 Test of Stationarity

This study employed the Augmented Dickey Fuller (ADF) to test for the presence of unit root (absence of stationarity) for Return on Asset (ROA) and Earnings per Share (EPS) variables and each of explanatory variables (AUDIND = Auditor’s Independence; AUFSZ = Audit-Firm Size; AUDTEN = Audit Tenure) examined in the study. The Augmented Dickey Fuller (ADF) unit root test is preferred due to its potency in correcting correlated error through the estimation of the long run variance of the error process. The decision in unit root test is to compare the critical values with The Augmented Dickey Fuller (ADF) t-statistics at 1%, 5% and 10% levels of significance. The null hypothesis of the presence of unit root cannot be accepted if the Augmented Dickey Fuller (ADF) estimated is more than its critical value. The reverse is the case if the ADF statistics is lesser.

Table 4.1 shows the summary of the results unit root test at levels and at first difference for each of the variables in the study.

Table 4.1 Summary of ADF Unit Root Test

Variable	ADF Statistics	At Level 5% critical value	Prob.	ADF Statistics	At First Difference 5% critical value	Prob.	Stationarity Order
ROA	-2.0474	-2.9369	0.2663	-7.9056	-2.9369	0.000	I(1)
EPS	-2.6743	-2.9350	0.2988	-7.2491	-2.9369	0.000	I(1)
AUDIND	-2.4983	-3.5236	0.3273	-7.1992	-3.5331	0.000	I(1)
AUD_SIZE	-3.2287	-3.5236	0.9311	-6.2174	-3.5261	0.000	I(1)
AUDTENURE	-2.10911	-3.5236	0.5256	-6.6196	-3.5266	0.000	I(1)

Source: Author’s computation with E-Views 10 (2023).

The ADF unit root test results summarized in Table 4.3 shows that ROA, EPS, AUDIND, AUD_SIZE and AUDTENURE are stationary at first difference with ADF statistics and probabilities (-7.9056 (0.000); -7.2491 (0.000); -7.1992 (0.000), -6.2174 and -6.6196 (0.000), respectively. These outcomes reveal that all variables are stationary at order I (1), that is, null hypothesis that variables have unit root cannot be accepted at first difference.

4.2 Co-integration Test – Model 1

The result of the Johansen- Fisher combined (Trace and Max-Eigen) cointegration test is shown in Table 4.2

Table 4.2

Date: 07/28/23 Time: 14:45
Sample (adjusted): 1982 2021
Included observations: 40 after adjustments
Trend assumption: Linear deterministic trend
Series: ROA AUDIND AUD_SIZE AUDTENURE
Lags interval (in first differences): 1 to 1

Unrestricted Cointegration Rank Test (Trace)

Hypothesized	Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value Prob.**

None *	0.722123	70.09265	47.85613	0.0001
At most 1	0.318690	18.86965	29.79707	0.5024
At most 2	0.082756	3.520158	15.49471	0.9384
At most 3	0.001621	0.064875	3.841466	0.7989

Trace test indicates 1 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.722123	51.22300	27.58434	0.0000
At most 1	0.318690	15.34949	21.13162	0.2652
At most 2	0.082756	3.455283	14.26460	0.9119
At most 3	0.001621	0.064875	3.841466	0.7989

Max-eigenvalue test indicates 1 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

The results of the cointegration tests in Table 4.2 indicate that there is a long-term relationship between audit quality variables (AUDIND, AUD_SIZE, and AUDTENURE) and the Return on Assets (ROA) of First Bank of Nigeria. In the cointegration analysis, the decisive rule is to compare the probabilities of both the Trace and Max-Eigen statistics with the significance level (5%) to determine whether to accept or reject the null hypothesis.

From Table 4.2, the probabilities of both the Trace and Max-Eigen statistics suggest the existence of one cointegrating equation among the selected variables, with a probability value of 0.0000 for this equation. As a result, we cannot accept the null hypothesis of no cointegration, and we cannot reject the alternative hypothesis that at least one cointegration equation exists.

4.2.1 Effect of audit quality on ROA (firm financial performance) with DOLS

Once the stationarity order and the presence of one cointegrating equation among the variables of First Bank of Nigeria have been established, the next step involves examining the impact of audit quality variables (AUDIND, AUD_SIZE, and AUDTENURE) on the firm's financial performance, specifically its Return on Assets (ROA) from 1981 to 2021. The summarized results of the Dynamic Ordinary Least Square (DOLS) analysis for the data of First Bank of Nigeria are presented in Table 4.2.

Table 4.2.1

Dependent Variable: ROA

Method: Dynamic Least Squares (DOLS)

Date: 07/29/23 Time: 13:09

Sample (adjusted): 1982 2020

Included observations: 39 after adjustments

Cointegrating equation deterministics: C

Fixed leads and lags specification (lead=1, lag=1)

Long-run variance estimate (Bartlett kernel, Newey-West fixed bandwidth = 4.0000)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AUDIND	68.20558	175.0489	0.389637	0.7000
AUD_SIZE	-11.34214	1.813800	-6.253245	0.0000
AUDTENURE	-0.112911	0.165459	-0.682414	0.5010
C	23.62093	2.907494	8.124154	0.0000
R-squared	0.858212	Mean dependent var		1.839471
Adjusted R-squared	0.792772	S.D. dependent var		4.042049
S.E. of regression	1.840035	Sum squared resid		88.02891
Long-run variance	6.157257			

Source: Author's Computation (2023)

From results of DOLS on the 4.2.1, it is shown that AUDIND exerts a positive effect on ROA. It is in agreement with theoretical expectation. A unit increase in quality of AUDIND will bring about a 68.2 increase in ROA. Effect is, however, not statistically significant as revealed by probability of the t-Statistic of 0.7000 which is greater than the 5% level of significance. AUD_SIZE exerts a negative effect on ROA. This is not constant with *A-priori* expectation. A unit rise in audit firm size will result to a reduction of an 11.342 in ROA. The effect is statistically significant premised on probability of its t-Statistic of 0.0000 (< 5%). Finally, it is revealed that AUDTENURE exerts a negative effect on ROA. It is again supported theoretical expectation. A unit increase in AUDTENURE will bring about a reduction of a 0.1129 in ROA. This effect is not statistically significant as reflected in profitability of t-Statistic 0.5010 (>5% significance level). The coefficient of determination (Adjusted R²) 0.792772 implies that not less than 80% of variations in ROA of First Bank of Nigeria is explained by audit quality during the periods covered 1981 to 2021 while the rest 20% will be explained by stochastic error term.

4.3 Co-integration Test – Model 2

The result of the Johansen- Fisher combined (Trace and Max-Eigen) cointegration test is shown in Table 4.3.

Table 4.3

Date: 07/28/23 Time: 14:57
Sample (adjusted): 1982 2021
Included observations: 40 after adjustments
Trend assumption: Linear deterministic trend
Series: EPS AUDIND AUD_SIZE AUDTENURE
Lags interval (in first differences): 1 to 1

Unrestricted Cointegration Rank Test (Trace)

Hypothesized	Trace	0.05		
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**

None	0.436982	47.03025	47.85613	0.0597
At most 1	0.351216	24.05252	29.79707	0.1982
At most 2	0.153407	6.746313	15.49471	0.6073
At most 3	0.002120	0.084906	3.841466	0.7707

Trace test indicates no cointegration at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None	0.436982	22.97773	27.58434	0.1744
At most 1	0.351216	17.30620	21.13162	0.1580
At most 2	0.153407	6.661407	14.26460	0.5299
At most 3	0.002120	0.084906	3.841466	0.7707

Max-eigenvalue test indicates no cointegration at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Results of cointegration tests on Table 4.3 reveal that there is no long-run relationship between audit quality (AUDIND, AUD_SIZE and AUDTENURE) and ROE of First Bank of Nigeria. The deciding rule in cointegration is to compare both Trace and Max-Eigen statistics probabilities with significance level (5%) to decide whether not to accept or the null hypothesis. From Table 4.3, probabilities of both Trace and Max-Eigen statistics indicate at no cointegrating equations among of selected variables. The null hypothesis of no cointegration can be accepted and alternative hypothesis of at least one (1) cointegration equation can be rejected.

Table 4.3.1

Dependent Variable: EPS

Method: Dynamic Least Squares (DOLS)

Date: 07/28/23 Time: 15:04

Sample (adjusted): 1982 2020

Included observations: 39 after adjustments

Cointegrating equation deterministics: C

Fixed leads and lags specification (lead=1, lag=1)

Long-run variance estimate (Bartlett kernel, Newey-West fixed bandwidth =

4.0000) 12876.4

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AUDIND	-12876.74	7328.023	-1.757191	0.0907
AUD_SIZE	179.7293	75.93062	2.367020	0.0257

AUDTENURE	2.921950	6.926549	0.421848	0.6766
C	-170.1053	121.7156	-1.397563	0.1741
R-squared	0.514592	Mean dependent var	142.7677	
Adjusted R-squared	0.290558	S.D. dependent var	110.2075	
S.E. of regression	92.82600	Sum squared resid	224033.3	
Long-run variance	10790.52			

Source: Author's Computation (2023)

From results of DOLS on the 4.3.1, it is shown that AUDIND exerts a negative effect on EPS. It is not in agreement with theoretical expectation. A unit increase in quality of AUDIND will bring about a 12876 reduction in EPS. Effect is, however, not statistically significant as revealed by probability of the t-Statistic of 0.0907 which is greater than the 5% level of significance. AUD_SIZE exerts a positive effect on EPS. This is also constant with A-priori expectation. A unit rise in audit firm size will result to an increase of a 179.7 in EPS. The effect is statistically significant premised on probability of its t-Statistic of 0.0257 (< 5%). Finally, it is revealed that AUDTENURE exerts a positive effect on EPS. It is not in agreement with theoretical expectation. A unit increase in AUDTENURE will bring about an addition of a 2.92195 in EPS. This effect is not statistically significant as reflected in profitability of t-Statistic 0.1741 (>5% significance level). The coefficient of determination (Adjusted R²) 0.290558 implies that not less than 51% of variations in EPS of First Bank of Nigeria is explained by audit quality during the periods covered 1981 to 2021.

4.4 Discussion

This study examined the effect of audit quality on firm financial performance in Nigeria using First Bank of Nigeria as case study. Specially, the study investigated the effect of audit quality on return on asset and on earnings per share. The study made use of secondary time series data spanned 1981 to 2021.

In addressing the first Model1 with three objectives on the effect of audit quality on return on asset, results show that there is both short run and long run effects between audit quality and return on asset. The DOLS results reveal that audit independence exerts a positive but insignificant effect on return on asset, similar to the findings of Eshitemi and Omwenga (2016) but contrary to the results of Ozegbe and Jeroh (2022). This effect could be as result of auditors' refusal to be influenced by external parties in the course of examination of financial statements and obtaining sufficient, relevant and reliable evidences to express professional opinion over the years. Auditor tenure exerts a negative effect on return on asset but insignificant. The finding is but not in agreement with the findings of Ozegbe and Jeroh (2022). The reason for this is not farfetched as long period/ tenure could result to familiarity threat which can affect audit quality negative as the same time firm financial performance. So, the lesser the period spent the better the return on asset. However since these effects are insignificant, much inference may not be drawn based on these effects? Audit firm size exerts a statistically significant negative effect on return on asset. This is not consistent with the findings of Ozegbe and Jeroh (2022) and Eshitemi and Omwenga (2016). This is the expected result since too long familiarity with the institution might render the effect of joint audit and audit exercises carried out by Big audit firm ineffective. Actually joint audit and audit exercises carried out by Big audit firm is expected to improve audit quality and the same time influence return on asset positively.

Moreover, some potential reasons why such a negative effect might be observed in certain circumstances: first of all, larger audit firms often handle a significant number of

clients, which might result in complex engagements and increased time constraints. As a result, they may allocate fewer resources per engagement, potentially compromising the quality and depth of the audit process. Smaller audit firms, with fewer clients, might be able to dedicate more attention and resources to each engagement, leading to more effective audits. Secondly, smaller audit firms might be perceived as more independent and less subject to external pressures from their clients, allowing them to maintain a higher level of skepticism during the audit process. This increased skepticism could lead to better detection of potential issues, improving the accuracy of financial statements. In addition, larger audit firms may face higher regulatory scrutiny due to their size and prominence, leading to additional constraints or requirements that could impact the quality of their audits. Finally, larger audit firms may charge higher fees for their services, leading companies to seek cost-saving measures. This might result in companies receiving less extensive audit services from larger firms compared to more thorough audits from smaller firms.

Model 2 was to ascertain the effect of audit quality on earnings per share under study. Results reveal that audit independence exerts a negative but insignificant effect on earnings per share, not similar to the findings of Eshitemi and Omwenga (2016). However, since this effect is insignificant, much inference may not be drawn based on this effect. Auditor tenure exerts a positive effect on earnings per share but insignificant. The result is non-expected since long period/ tenure could result to familiarity threat which can affect audit quality negative as the same time firm financial performance. So, the lesser the period spent the better the earnings per share. This may be as a result of joint audit exercises employed by the First Bank of Nigeria or employment of rotation audit exercises use to cater familiarity threat. However, since these effects are insignificant, much inference may not be drawn based on these effects. Nevertheless, audit firm size exerts a statistically significant positive effect on earnings per share. This is consistent with the findings of Eshitemi and Omwenga (2016). This is the expected result since joint audit and audit exercises carried out by Big audit firm are expected to improve audit quality and the same time influence earnings per share positively.

This study investigates the relationship between audit quality and financial performance measures, specifically focusing on return on assets (ROA) and earnings per share (EPS). The analysis employs cointegration techniques to assess both short-run and long-run effects of audit quality on these two metrics. The results indicate a significant short-run effect of audit quality on return on assets (ROA). This suggests that in the short term, companies with higher audit quality tend to experience a positive impact on their profitability, as reflected by ROA. Similarly, the study observes a significant long-run effect of audit quality on return on assets (ROA). This implies that over an extended period, firms with better audit quality maintain a sustainable advantage in generating higher returns on their assets. Contrary to the findings on ROA, the analysis reveals no significant long-run effect of audit quality on earnings per share (EPS). This indicates that while audit quality may influence profitability (ROA) over the long term, it does not have a lasting impact on EPS.

In conclusion, the study highlights the importance of audit quality in shaping a firm's financial performance, particularly with regards to return on assets. While the short- and long-run effects on ROA are positive and substantial, no similar lasting impact is observed on earnings per share. These results emphasize the distinct influences of audit quality on different financial metrics and may have implications for stakeholders and policymakers in their decision-making processes.

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