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External auditor attributes and financial reporting quality of quoted manufacturing companies in Nigeria

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Abstract

The study examined external auditor attributes and financial reporting quality of quoted manufacturing companies in Nigeria. Specifically, the study focused on audit fees, and auditors' industry specialization as a dependent variable and financial reporting quality as independent variable. Ex-post facto research design was adopted. The population included all 44 quoted manufacturing companies in Nigeria out of which 10 were selected as sample size of the study. The study covered the period from 2014 to 2023 and utilized secondary data extracted from the annual accounts of the companies for the period of the study. The study employed the use of descriptive statistics, correlation and panel regression analysis techniques to analyze the data with the aid of STATA version 16. From the regression results, it was revealed that audit fees and auditor industry specialization have statistically positive significant effects on financial reporting quality of quoted manufacturing companies in Nigeria. The study concluded that external auditor attributes have strong explanatory power in determining the quality of financial reporting of quoted manufacturing companies in Nigeria. The study recommended that given the complex nature of the manufacturing companies they should insist on hiring industry specialist auditors. Even, the "Code" stipulates that in order to ensure quality audit outcomes, the engagement partner and audit team should possess the knowledge, relevant skills and experience. The findings from this study have implications for policy makers and auditors. The findings implied that auditors' fee and auditor industry specialization matter with regard to the quality of financial reporting. Therefore, the regulator's concern over the auditor fee and auditor industry specialization is a major problem in the listed manufacturing firms in Nigeria.

Keywords: Audit fees; auditors' industry specialization; external auditor attribute; financial reporting quality

1. Introduction

The financial reporting quality (FRQ) is considered the fundamental pillar for the financial market through efficient information. When the real performance of a company is not disclosed and when the reported earnings are not real, the individual employees, firms, stakeholders, and the economy will face massive losses (Jerry &Saidu, 2018). Financial reporting quality is the cornerstone of capital markets globally since it determines how efficiently resources are allocated. Gardi et al. (2023) emphasizes the pivotal role of financial reporting quality in instilling confidence among stakeholders in financial reports and bolstering their optimism.

The entire financial information community is at danger of significant losses when a company's genuine performance is neither acknowledged in annual reports nor reflected in reported earnings. Similar to this, Schipper and Vincent (2003) provided evidence to support their argument that stakeholders are very concerned about the accuracy of financial reporting revealed in annual reports since this information significantly influences their decision-making, particularly information connected to investing and contracting. One of the determinants of external auditor quality that affects financial reporting quality is fees which represent the amount that remunerates the financial auditor's activity. Egbunike and Asuzu (2020) states that audit fees should be calculated in an objective way and the auditor's independence should not be influenced by them. Among the pertinent aspects of auditing is the independence of the audit firms. Without independence, the probability of biased findings will obviously be higher (Khan, 2015). Again, audit firm industry specialization is becoming more important in the literature. Willenborg (2002) indicates that audit firms benefit from specialization in two ways. First, benefits resulting due to enhanced audit effectiveness. Second, enhanced audit efficiency leading to benefits. In addition, industry specialist auditors are incentivized to protect the reputation they have developed as an industry specialist.

To protect their reputations, auditors will provide audits of higher quality by not acquiescing to client pressures or demands. Consequently, an industry specialist auditor possesses greater competence in applying industry-specific earnings recognition standards and has acquired a reputation for providing an audit of superior quality, it is expected that an industry specialist auditor will be better equipped to identify and rein in aggressive earnings manipulation (Hussaini et.al, 2018). External auditors are expected to maintain a high level of integrity, independence, and objectivity in fulfilling their corporate responsibilities. Factors such as audit fees, audit specialization, audit independence, and audit firm size play crucial roles in determining audit quality. The fees paid to external auditors should be reasonable, objective, and appropriate, avoiding any influence on auditor independence (Usman & Ugoh, 2023). Rajgopal et al. (2021) indicated that a substantial audit fee suggests increased audit effort, consequently implying higher Financial Reporting Quality (FRQ). Audit firm specialization pertains to specialized auditors possessing more accurate knowledge about non-error frequencies compared to non-industry specialists. Auditor industry specialization can enhance the effectiveness of auditors due to their superior industry-specific knowledge (Usman & Ugoh, 2023).

Most of the studies in this area are foreign-based such as, Afesha (2015), given the disparities in the nature of economies, the level of sophistication in the monitoring mechanisms and litigation risks faced by external auditors, studies from Nigeria may produce different results. This gives a considerable justification for the current study. Also, their findings are mixed and inconsistent which makes the area amiable to further research. It is important to study audit fees and auditor industry specialization to measure empirically the extent to which it associates with financial reporting quality in the Nigerian manufacturing sector. This study therefore fills the gaps in literature by empirically examining the effect of external auditor characteristics on financial reporting quality of quoted manufacturing companies in Nigeria. The study however, focused on the major audit firm's characteristics, that is, audit fees and auditor industry specialization. These characteristics are considered as determinants of audit quality which has linkage with the financial reporting quality. The main objective of the study is to examine external auditor attribute and financial reporting quality of quoted manufacturing companies in Nigeria. Specifically, the study intends to investigate the effect of audit fees on financial reporting quality of quoted manufacturing companies in Nigeria, to examine the effect of auditors' industry specialization on financial reporting quality of quoted manufacturing companies in Nigeria.

2. Literature Review

2.1 External Auditor Attributes

The external auditor's overall responsibility is to deliver reasonable assurance to the shareholders of the company in general, that the financial statements are free from material misstatement. In addition, they must assess whether the financial statements are true, fair, and compliant with international accounting standards. It must be acknowledged that external auditors are chosen by shareholders to help protect their capital. Choosing the right auditor helps ensure a thorough and transparent audit of the business (Rashid, 2017). External auditor attributes refer to the academic, professional, and industry qualifications and competences of external auditors (Cuong & Dung, 2019). The external audit function influences a firm's financial performance by facilitating effective risk management. External auditors are responsible for identifying and addressing fraud, misstatements, and errors in financial reporting. Besides, they help firms to improve their performance by offering recommendations based on the objective assessment of the available information data (Bunea, Marian, & Turlea, 2015).

2.2 Audit Fees

Al-Khaddash, Nawas and Ramadan (2013) defined audit fees as all charges that the companies pay to the external auditors against the audit services and non-audit services, e.g. management advisory and consultant service. The Securities and Exchange Commission (SEC) defined audit fee as the fees paid for annual audits and reviews of financial statements for the most recent fiscal year. Chersan (2012) also defined audit fee as the sums payable/paid to the auditor~~,~~ for the audit services offered to the auditee.

Meanwhile, according to the rules of ethics of public accountant's the fee amount may vary depending on the risk assessment, the complexity of services provided, level of expertise required to perform such services, the related cost structure of the CPA firm and other professional considerations. In this regard, Code of Ethics for Professional Accountants (IFAC, 2010) provides that when entering into negotiations regarding professional services, a professional accountant in public practice may quote whatever fee is deemed appropriate (Section 240).

2.1.3 Auditor Industry Specialization

Owhoso et al., (2002) suggested that industry specialists can more effectively detect seeded errors in staff work papers during the audit review process. Low (2004) posited that auditors' industry specialization improves their audit risk assessments. Hamersley (2006) found that matched specialists (i.e., specialists working in their industry) develop more complete problem representations about the seeded misstatement when they receive partial- or full-cue patterns than when they receive no-cue patterns, whereas mismatched specialists are not able to develop more complete problem representations even when they receive full-cue patterns. These behavioural auditing studies suggest that auditor industry specialization can enhance the effectiveness of auditors' work as a result of their greater industry-specific knowledge.

2.1.4 Financial Reporting Quality

Financial reporting is the preparation of published report for users of financial statements. Financial reporting is the process of documenting and communicating financial activities and performance over specific time periods, typically on a quarterly or yearly basis (Karim, 2020). Financial reporting uses financial statements to disclose financial data that indicates the financial health of a company over a specific period of time. The information is vital for management to make decisions about the company's future and provides information to capital providers like creditors and investors about the profitability and financial stability of the company. Financial statements provide essential financial information that helps investors, creditors and analysts evaluate a company's financial performance (Mihret &Admassu, 2011).

According to the International Accounting Standards Board (IASB) (2010), financial reporting quality represents financial statements that provide accurate and fair information about the underlying financial position and economic performance of an entity. Financial reporting quality is defined as the financial disclosure statements that will disclose the financial status in the annual report and strengthen the investors' confidence in making credible decisions about their organizations.

Kaklar et al. (2012) expressed the view that the quality of financial reporting relates to the accuracy of financial statements in providing information about a company's daily business activities, particularly regarding anticipated cash inflows and outflows that offer insights to shareholders. Financial reporting serves the essential purpose of providing high-quality financial information about corporate and economic entities, which is relevant for making economic decisions (Sohail & Aziz, 2019).

2.2 Empirical Review

2.2.1 Auditors' fees and Financial Reporting Quality

Yayagida (2023) investigated audit fees and the financial reporting quality of listed non-financial services firms in Nigeria by using the audit committee's independence as a moderator. The study employed 30 non-financial services firms listed on the Nigerian Exchange Group over a period of 11 years from 2011 to 2021. The data was handpicked from the annual financial reports of the sampled companies. Descriptive statistics and multiple regression analysis techniques were used for data analysis. Findings revealed that audit fee does not have a direct effect on financial reporting quality of listed non-financial services firms in Nigeria. However, the effect of audit fees on financial reporting quality is statistically significant when moderated by the audit committee's independence. Based on the findings, the study recommended that more independent directors should be included in the audit committee of listed non-financial services firms in Nigeria.

Bala et.al (2018) examined the relationship between audit fees and financial reporting quality of listed firms in Nigeria. The study used 88 listed companies in Nigeria for the period from 2012 to 2016. The data were obtained from the annual reports of the listed firms through Thompson Reuters DataStream. Accruals model was used to represent financial reporting quality. Multiple regression was employed in the estimation model. The study reveals that higher audit fees are associated with lower level of discretionary accruals and thus imply higher financial reporting quality. The result also supports the resource dependence theory which proposes that higher percentage of financial experts in the board lessen the degree of accounting manipulation. Erasmus and Micah (2021) ascertain the relationship between audit quality specialty and market price per share of listed deposit money banks in Nigeria. Twelve listed deposit money banks in Nigeria were used as sample size covering from 2006-2019. Panel least squares regression was adopted with the aid of E-views. Findings show that audit specialization had negative and significant impact on Tobin's Q. Emmanuel and Emem (2020) examined the impact of audit firm attributes on the financial reporting quality of quoted manufacturing firms in Nigeria for the period of 2011 to 2015. Ex-post facto research design was adopted in the study. Data were obtained from the published annual reports and accounts, notes to the financial statements of the sixteen firms that represent the sample of the study. Multiple regression analysis was employed in analyzing the data and testing the stated hypotheses. The results of the findings showed that auditor fees have significant influence on the financial reporting quality of quoted manufacturing firms in Nigeria. However, it was discovered that audit firm size and audit delay have insignificant impact on the financial reporting quality of manufacturing firms in Nigeria.

Omoregie and Dibia (2020) explored the impact of audit firm attributes and audit quality in Nigeria. For the study objective to be accomplished, the study fundamentally embraces the survey of panel data in other to properly scrutinize the concept of audit firm attributes as it relates to audit quality in Nigeria for the period of 5-years (2014-2018). Fifteen (15) companies from the banking industries were used in total. Due to the cross-sectional nature of the study, the panel multiple regression was employed with the aid of E-view 8.0 econometric packages for the analysis of data. The result of the findings appears that the variable of Audit Independence and Audit Fees were observed to be significant and positively related with Audit Quality, Audit Firm Rotation was positively and insignificantly related with Audit Quality while Audit Delay indicated a negative and a relationship that is insignificant with Audit Quality.

2.2.2 Auditors Specialization and Financial Reporting Quality

Qawqzeh et al. (2020) investigated the influence of the industry specialization on the financial reporting quality, as well as the mediating effect of the external audit quality on this relationship in the Jordanian firms. The study utilized Panel Data of 180 companies listed in ASE from 2009-2017. The results revealed that industry specialization has significantly and positively impacted FRQ. Fossung and La Fortune (2019) investigate the contribution of external audit specialty in improving the quality of accounting and financial information produced by unlisted companies like Cameroon. A survey of samples of 52 employees of companies in Cameroon was used, by adopting both linear regression and ANOVA were used for the analysis. The results indicate that the auditors' field of specialization did not reduce manipulation of accounting and financial information. Al-Dalabih (2018) examined the role of external auditor specialization in protecting the financial information listed in the financial statements in the Jordanian industrial companies. Questionnaire was administered to a sample of 70 auditors who work for Jordanian industrial companies. A total of 68 questionnaires were received that are valid for statistical analysis using SPSS statistical software. The results of the study revealed that external auditor through specialization are keen to ensure the credibility of the financial statements of the company. Tyokoso, et al (2016) examined the effect of auditor specialization on earnings management of listed oil marketing companies in Nigeria. Secondary data were extracted from nine companies listed on the Nigerian Exchange Group (NGX) from 2009 to 2014 and analyzed using panels multiple regression technique. The result of the Hausman specification test suggests that the fixed effect regression model is most appropriate for the dataset. The result of the fixed effect regression model showed that auditor industry specialization positively impacts earnings management of the firms at 5% level of significance.

2.3 Theoretical Framework

2.3.1 Agency Theory

The agency cost theory was developed by Meckling and Jensen (1976). The theory postulates that owners are the principals, while managers are the agents. The owners of a company will always want to maximize their wealth, and management will work to meet those demands. They are rewarded with significant incentives in order to meet the interests of shareholders. The owners' belief is shaped with the understanding that tax avoidance strategies will increase or maximize their wealth and subsequently will support management drive for this practice. These situations can lead to a conflict of interest on the part of the government and the corporation. The proponents believed that the principal should lavishly reward and compensate the agent, as well as offer incentives, in order to prevent or reduce agency costs (Meckling & Jensen, 1976). Financial reports of companies are means for management to provide the users of those reports the right information of the company. Because of the conflict in interest between managers and shareholders, it is necessary that financial reports are independently audited by an external auditor.

3.1 Methodology

This study adopted the ex-post facto research design to examine the relationship between the dependent and the independent variables. The population of the study consists of forty-four (44) quoted manufacturing firms operating on the Nigeria Exchange Group (NXG) as at 31st December 2023. The sample size of the study is ten (10) manufacturing firms drawn from the defined population. The study covered the period 2014 to 2023, which gives a total observation of 100. In addition, in arriving at the sample size, the following criteria were also considered: Companies are in operation during the study period, that is, 2014 through 2023; Companies are not merged or taken over by another firm during the period of the study. The study covered the period 2014 to 2023. The sample size is however limited to lack of generalization, low statistical power. The study employs the secondary sources method of data collection to achieve its objectives. The secondary data are derived from the Annual Financial Reports of the companies collected from the Nigerian Exchange Group (NXG), while other quantitative data would be sourced from relevant journals and textbooks. Panel analysis technique was adopted for the study.

3.1.1 Model Specification

The following equation forms the model of the study; this equation is represented as follows;

FRQ=f (AF, AIS)

Explicitly, the regression model is econometrically represented as:

$FRQ = \beta 0_{it} + \beta_1 AF_{it} + \beta_2 AIS_{it} + e_{it}$

Where:

FRQ =Financial Reporting Quality

β_0 =Constant

AF= Audit Fees

AIS= Auditor Industry Specialization

e = Error Terms

β_1-β_2= are the parameters estimate or coefficients in equation

i_t= cross-sectional time series.

3.1.1 Variable Measurement

Table 1: Variable definition and measurement

S/N	Variables	Measurement	Source
1	AIS	Measured by dichotomous variable 1 for the companies audited by industry specialist auditors and 0 for non-specialist auditors.	Zhou and Elder (2001): Krishnan & Yang 2003).
2	AF	Measured as a natural logarithm of the amount of audit fees paid to the auditor by the company	Effiok, and Eton (2013)
3	FRQ	Proxied by discretionary accruals	Dechow, Sloan and Sweeny (1995)

Researcher's computation, 2024.

4.1 Data Analysis

Table 2: Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
FRQ	100	.07333	.06867	.0089	.3700
AF	100	3.4085	1.4060	1.0791	6.9491
AIS	100	.5482	.4985	0	1

Source: Output from STATA, 2024

The result of the descriptive statistics in Table 2 indicates that the measure of financial reporting quality (FRQ), which is the inverse of absolute discretionary accruals of manufacturing firms has an average value of .0733 with standard deviation of .0686, and minimum and maximum values of .0089 and .3700 respectively. The extent of absolute value of discretionary accruals in the sample firms has a mean of 7.33% with standard deviation of 6.86%. The values of minimum and maximum which are far from each other indicated a high deviation between companies. The firms tend to record a reasonably high financial reporting quality in some years than in others. The descriptive statistics also indicated that the sample firms have an average of log audit fees (AF) of 3.4085 with standard deviation of 1.4060 respectively. This means that the average amount of audit fees paid by the firms within the period of the study is 3.40 million naira. The figure of the standard deviation shows that there is a high level of variance in the audit fees paid by companies. The minimum and the maximum as shown by the table is 1.079181 and 6.9491. This implies that the least amount spent on audit fees is 1.08 million naira and the largest is 6.9million naira. The descriptive statistics in Table 2 shows that on average, the auditor industry specialist auditors (AIS) during the period of the study 54.82%, from the mean value of .5482 with standard deviation of.4985. This shows that on average 54.84% of the firms used auditors that were specialists in auditing manufacturing companies. The value of the standard deviation which depicts 49.85% means most of the firms used industry specialist auditors in their audit engagements. The auditor industry specialization shows a minimum of 0 and maximum of 1 respectively.

3.1.2 Correlation Matrix

Table 3. Correlation Matrix

Variables	FRQ	AF	AIS
FRQ	1.0000		
AF	0.1882	1.0000	
AIS	0.1855	0.3336	1.0000

Source: Output from STATA, 2024

Table 3 shows the correlation between the dependent variable, FRQ and the independent variables, AF and AIS. The table reveals a positive correlation between the dependent variable of financial reporting quality and the explanatory variables of audit fees, auditor industry specialization with coefficients of 0.1882 and 0.1855 respectively. This implied that the two explanatory variables move in the same direction with financial reporting quality because they depict a positive value in the correlation matrix.

3.1.3 Panel regression Result

Table 4: Panel Regression Model

Variable	Coef.	T	P>/t/
AF	0.2614	3.05	0.003
AIS	0.2465	2.51	0.012
R-Squared	0.442		
Hausman Test	17.89		0.000

Source: output from STATA, 2024

The R-square value shows the level at which the explanatory variables explain the dependent variable. The regression results in Table 4. reveals that the R-square is 0.4427. This means that the external auditor attributes in the study explained the financial reporting quality (FRQ) to the tune of 44.27%. This serves as substantial evidence to conclude that the external auditor attributes selected for the study are suitable for the study on the effect of external auditor characteristics on financial reporting quality of manufacturing firms in Nigeria.

4.1. Testing of Hypotheses

H_{01}: Audit fees have no significant effect on financial reporting quality of listed manufacturing firms in Nigeria

The result in table 4 shows that audit fees have a t-value of 3.05, a coefficient of .02614 and a p-value of 0.003 which is significant at 5%. This means that audit fees have a significant positive relationship with financial reporting quality of listed manufacturing companies in Nigeria. Based on this, the study rejects the null hypothesis one (H_{01}) which states that, audit fees have no significant effect on financial reporting quality of listed manufacturing firms in Nigeria.

H_{02}: Auditor industry specialization has no significant effect on financial reporting quality of listed manufacturing firms in Nigeria

The regression results on table 4 also shows that auditor industry specialization has a significant positive effect on financial reporting quality manufacturing firms in Nigeria, from the coefficient of .02465 with t-value of 3.51 and a p-value of 0.012 which is statistically significant at 5% level of significance. Based on this, the study rejects the null hypothesis two (H_{02}) which states that, auditor industry specialization has no significant effect on the financial reporting quality of listed manufacturing companies in Nigeria.

4.1.1 Discussion of Findings

In this study audit fee is measured using a natural log of audit fees paid by firms for the period of the study. The study found that audit fees have a positive significant statistical effect on financial reporting quality of quoted manufacturing companies suggesting that the fees paid to external auditors helps to ensure the credibility of financial reporting. This means that audit fees exert significant influence on financial reporting quality of companies in the area covered by the study. This is supported with the findings of Bala et.al (2018) that higher audit fees are associated to lower level of discretionary accruals and thus imply higher financial reporting quality and against the findings of Yayagida (2023) that audit fee does not have a direct effect on financial reporting quality of listed non-financial services firms in Nigeria. The study revealed a positive significant effect of auditor industry specialization on financial reporting quality of quoted manufacturing companies in Nigeria. This means that a unit increase in industry specialist auditors will lead to an increase in the financial reporting quality in the area covered by the study. The study is in line with Qawqzeh et al. (2020) that industry specialization has significantly a positive impact on FRQ and also against the findings of Erasmus and Micah (2021) that audit specialization had negative and significant impact on Tobin's Q. Additionally, the study concurs with the agency theory by Meckling and Jensen (1976) that the owners of a company will always want to maximize their wealth, and management will work to meet those demands.

5.1 Conclusion and Recommendations

5.1.1 Conclusion

This study examined the effect of external auditor characteristics on financial reporting quality of quoted manufacturing companies in Nigeria. Specifically, the study assessed the combined effect of audit fees and auditor industry specialization on financial reporting quality. From the regression results, it was revealed that audit fees and auditor industry specialization have statistically positive significant effect on financial reporting quality of quoted manufacturing companies in Nigeria. The study concluded that external auditor attributes have strong explanatory power in determining the quality of financial reporting of quoted manufacturing companies in Nigeria.

5.1.2 Recommendations

Firstly, the study recommends that firms should pay fees commensurate with the type and magnitude of the audit assignment. Although, audit regulations recommend that audit partners determine fees that would cover for all expenses that may be incurred in conducting the audit while reserving a considerable amount as profit. Secondly, it is recommended that given the complex nature of the manufacturing companies they should insist on hiring industry specialist auditors. Even, the "Code" stipulates that in order to ensure quality audit outcomes, the engagement partner and audit team should possess the knowledge, relevant skills and experience.

Lastly, SEC should ensure listed manufacturing firms to acceptable ethical standards in discharging their duties and responsibilities, so as to enhance the credibility of their financial reports and safeguard their entities from going-concern threats.

5.1.3 Limitations of the Study

The study is limited by employing the use of secondary data which was extracted from the Nigeria Exchange Group (NXG) and company's financial report. These data were used as obtained and the researcher had no means of independently verifying the validity of the data which is assumed to be accurate for the purpose of the study. The sample size of the study is small.

5.1.4 Suggestion for Future Studies

Further research should involve more samples and additional variables. Other methods of data analysis can be used in the study to get more relevant findings. Other studies can be extended to other areas where this study does not cover such as financial firms, service companies among others. Other studies can look at 2024 since the data collection for the study was 2023.

5.1.5 Policy Implication of Findings

The findings from this study have implications to the policy makers and auditors. The findings implied that auditors fee and auditor industry specialization matter with regard to the quality of financial reporting. Therefore, the regulator's concern over the auditor fee and auditor industry specialization is a major problem in the listed manufacturing firms in Nigeria. The findings also show that if the auditors are well paid, it is likely that a high-quality financial reporting could be achieved. Moreover, the findings suggest maintenance of auditor industry specialization in order to achieve a higher quality financial reporting.

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