**AN EVALUATION OF INFLUENCE OF AUDIT QUALITY VARIABLES ON EARNINGS RESPONSE COEFFICIENT OF QUOTED DEPOSIT MONEY BANKS IN NIGERIA**

**Wasiu Bello1, Morufu O. Oladejo2**

**Department of Management and Accounting Faculty of Management Sciences Ladoke Akintola University of Technology, Ogbomoso, Oyo State, Nigeria.**

**Abstract**

Quality audit provides tool for uncovering errors and sending signals about the credibility of corporate financial statements. Reports of systemic failure and conflicting findings of academic researches on the financial health of Nigerian Deposit Money Banks (DMB) raised some queries on its Audit Quality(AQ). This study examined the influence of Audit Quality Variables (AQV) on Earning Response Co-efficient (ERC) of listed Deposit Money Banks in Nigeria. This study made use of secondary data obtained from annual reports and account of selected banks from 2010 to 2017. Purposive sampling technique was adopted to select six (6) banks out of twenty-one banks. Representative variables for AQ are Audit firm size (AUDS), Auditors Independence (AUDIN), and Non-Audit Services (NAS) while ERC was proxied using Unexpected Earnings (UE). Ordinary Least Square Regression was used to measure the influence of Audit Quality on Earnings Response Coefficient of DMBs in Nigeria at 0.05 level of significance. AUDS, AUDIN and NAS had a positive significant influence on ERC with t = 1.30, p = 0.003; t =1.21, p = 0.004; and t = 1.95, p = 0.001 respectively. With the R2 and Adjusted R2 (0.647 and 0.6600 respectively) confirmed the significant of the model. It therefore recommended that DMBs in Nigeria should endeavor to employ the services of one of the big audit firms in order to improve Audit Quality.

**Keywords**: Audit Quality, Earning Response, Deposit Money Bank

**INTRODUCTION**

Studies have shown that ensuring the reliability of financial information published by firms requires that the statements are certified by an auditor thus lending credence to financial statements and instill users confidence. For example, Dandago and Rufai (2014) believed audit quality is often related to the competence and independence of auditors as being able to detect material misstatements and being prepared to issue appropriate audit reports to reflect their finding. Dantas and Otavio, (2015) believed that the performance of independent auditors has a direct relationship with the purpose of ensuring the credibility of the financial reporting process and the reliability of financial reporting is an essential condition for the functioning of the banking system. Therefore as put by Suyono (2012) without audit service by an independent party, the reliability of financial statements could not be assured.

The earnings response coefficient (ERC) has been described to be estimate of the change in a company’s stock price due to the information provided in a company’s earnings announcement. ERC is the effect of a dollar of unexpected earnings on stock returns and, in principle, can be measured as the slope coefficient in the regression of abnormal stock returns on unexpected earnings (e.g. Cho and Jung,1991). The ERC is therefore the estimated relationship between equity returns and the unexpected portion of a firm’s earnings. Shangguan (2007) defines ERC as the measure of the extent to which stock prices react to earnings surprises. Therefore, the audit of a company’s accounts according to Okolie (2014) signals the beginning of a process for earnings announcement.

Signaling theory suggests that companies with good performance use financial information disclosures to send signals to the market Craven and Marston (1999), A high quality audit sends a signal to the market that the financial statements are more credible than those audited by lower quality auditor (Krishnan and Yang 1999; Menon and Williams 1994).In order to maintain high audit and earnings quality and to curb the spate of vicious corporate collapses that pervade the globe in the past decade, audit quality standards and codes of best practice have been developed in different countries. These codes constitute the bulk of the regulatory frameworks that are meant to guarantee integrity of auditors’ reports in relation to corporate earnings and financial statements.

**1.2 Statement of the Problem**

 Researchers have shown that fluctuation is attributed to earnings in emerging markets and market volatility and that there is a relative paucity of research on influence of Audit Quality Variables on ERC determinants in emerging markets. Evidence from the available literature of accounting and value relevance suggest that the drivers of audit quality with influence on ERC are little known and the literature on the subject is not well developed. Existing literature shows that the size of audit fee is the most critical factor capable of eroding audit quality and auditor independence (Semiu and Johnson 2012). According to DeAngelo (1981) some of the attributes of audit that could affect the audit quality positively and increase the chances of discovering and reporting material intentional errors and misstatements in the financial statements include the size and experience of the auditor, auditor remuneration and the joint audit services. It is further shown that in Nigeria researches on these factors in the banking sector are few thus making it imperative for the current study to provide empirical evidence on the effect of the determinant factors on audit quality of quoted Deposits Money Banks (DMBs) in Nigeria.

Studies on how audit quality influence earning management of (DMBs) in Nigeria cannot be adequate considering the sensitivity of the financial sub sector to the developing economy like Nigeria. The paper aims to evaluate the influence of Audit Quality Variables on Earnings Response Coefficient of Nigerian Deposits Money Banks (DMBs).

**1.3 Research Hypotheses**

H03: Earning Response Coefficient is not significantly influenced by audit quality

Variables

**2. Literature Review and Conceptual Explanation**

Riley (2001) observed that audit quality is multidimensional and inherently unobservable, and that there is no single auditor characteristic that can be used as a proxy for it. In the absence of direct measures for quality, audit consumers must assess the quality by using surrogates, or the overall reputation of an auditor. According to Stanley and Perelayefa, (2016), audit quality simply underscores the extent to which the output of the process serves the decision useful function of the accounting information system. Also Dantas and Medeiros (2014), believe that audit quality is not infor­mation disclosed at the time it is performed. Titman and Troman (1986) define audit quality, accuracy and integrity of information audit quality is accuracy and integrity of information that placed after auditing the investors .Palmrose (1988) define audit quality in terms of the amount of accredited auditors. Since the purpose of the audit, make sure about the financial statements, therefore, audited financial statement audit quality means being free of the distortions is important.

Existing literature shows that the size of audit fee is the most critical factor capable of eroding audit quality and auditor independence (Semiu and Johnson 2012). More broadly, context factors that influence AQ include sound corporate governance (especially if it creates a climate of transparency and ethical behaviour within the entity); Law and regulation (if it creates a framework within which the audit can be effectively conducted); regulatory oversight (if it establishes an effective regime for monitoring the quality of auditors’ work and effective dialogue between auditors and regulators); the quality of the applicable financial reporting framework (use of a financial reporting framework that does not promote robust and transparent disclosures may adversely affect AQ as well as related external perceptions). Titman and Trueman (1986; cited in Behn and Choi, 2008) suggest that high audit quality would improve the reliability of financial statement information and allows investors to make more precise estimate of the firm‘s value.

As indicated by Aliyu, Musa and Zachariah, (2015), astounding audit is the one that is equipped for revealing material blunders and misstatements in the financial statements. Yields of the audit are significant impacts on AQ that are considered by partners in their evaluations of AQ. Such impacts as placed by Okolie, (2014) incorporate the auditor's report (saw as decidedly affecting AQ on the off chance that it plainly passes on the result of the audit), auditor interchanges to those accused of administration (on issues, for example, subjective parts of the element's financial revealing practices and insufficiencies in inward control that can emphatically impact AQ). The consequence of the investigation of Okolie, and Izedonmi,(2014)shows that Audit Quality applies critical impact on the MPS of cited organizations in Nigeria.

According to Sulaiman, (2011) Inputs Factors Which May Influence Audit Quality Characteristics of audit firm: Size Audit fees Non-audit services Audit tenure Characteristics of auditors ( Professional attributes and Professional values) while Outcomes Related to Audit Quality Financial Reporting Quality are Quality of earnings ; Accurate financial information ; Restatements of Financial Statements ; Accurate audit opinion. Wooten (2003) found that detecting material misstatements is influenced by how well the audit team performs the audit, which in turn is influenced by the quality control system and management resources of the audit firm.

Although several studies have sought to measure “ac­tual” audit quality, what has prevailed in the literature, since DeAngelo’s study (1981), are the metrics that try to capture “perceived” audit quality, such as: (i) the auditor’s size, particularly big-*N*, as in DeAngelo (1981), Dang (2004), Gu, Lee and Rosett (2005), Behn, Choi and Kang (2008), Kanagaretnam, Krishnan and Lobo (2009, 2010), and Zagonov (2011); (ii) auditor specialization, as in Behn et al. (2008), Chambers and Payne (2008), Romanus, Maher and Fleming (2008) and Kanagaretnam, Krishnan et al. (2009, 2010); (iii) coeffi­cient of the response of the stock price to the accounting results, as in Teoh and Wong (1993) and Ghosh and Moon (2005); and (iv) errors in the projections of managers or analysts, as in Dang (2004) and Behn et al. (2008).

**2.1.4Earnings Response Coefficients (ERC) and its Measurements**

Collins and Kothari,(1989) described ERC as an estimate of the change in a company’s stock price due to the information provided in a company’s earnings announcement. Zakaria, (2012) observed that cross sectional variation in ERC has been the subject of extensive and rigorous research at least in developed economies. ERC is the impact of a dollar of surprising earnings on stock returns and, on a fundamental level, can be estimated as the incline coefficient in the regression of unusual stock returns on startling earnings (Okolie,, 2014;Pimentel, 2009; Chambers, Freeman and Koch 2005; Cho and Jung, 1991). The ERC is hence the assessed connection between equity returns and the startling bit of a company's earnings (Zakaria, 2012). Further, Shangguan (2007) characterizes ERC as the proportion of the degree to which stock prices respond to earnings shocks.

In line with previous studies, Hansen (2007) expressed ERC in the following mathematical model:

UEt = a0t + β1t (ern – u) it + eit (1)

Where: UEit = the unexpected earning;

a0t = benchmark rate;

 β1t = earning response coefficient;

(ern – u) it = (actual earnings less expected earnings) = unexpected earnings.

eit = random movement.

The unexpected earnings are treated as a ratio of expected earnings in the study of Okolie, 2014 ;

 According to Teoh and Wong (1993), UEs are measured as the actual earnings disclosed minus a measure of investors’ prior expectation of earnings scaled by the stock price.

 UE is estimated as:

UEi,t = [EPSi,t – EPSi,t-1] / MPSi,t. (2)

Where: MPS is the market price per share as at the end of the year (Chritie, 1987).

 These prior studies indicate that price is the appropriate scaling factor from the theoretical derivation of the ERC based on the dividend and earnings capitalization formulae as submitted by Okolie, 2014.

**2.2 The Agency Theory**

Audit fills a crucial need in advancing certainty and strengthening trust in financial information. Organization theory is a valuable economic theory of responsibility that clarifies the improvement of the audit. Agency theory sets that specialists have more information than principals and that this information asymmetry unfavorably influences the principals' capacity to screen whether their interests are in effect appropriately served by the operators (Gerrit and Mohammad, 2007). Organization theory depends on this connection between speculators (principals) and managers (Agents).

An organization is seen as a trap of agreements. A few gatherings (providers, bankers, clients, workers and so forth.) make some sort of commitment to the organization at a given cost. The undertaking of the administration is to arrange these gatherings and contracts and attempt to upgrade them: low cost for obtained supplies, high cost for sold products, low financing costs for credits, high offer costs and low wages for representatives. In these connections, the executives are the specialist, which attempts to pick up commitments from principals who are bankers, investors, representatives.

**3.0 METHODOLOGY**

The study area covers all existing Quoted Deposit Money banks in Nigeria. This study focused on the identified Quoted banks through the floor of Nigeria Stock Exchange. Fifteen (15) Deposit Money banks in Nigeria as at 2017 were quoted on the Nigeria stock exchange, out of which six (6) were purposively selected for the purpose of the study over a 8-year period from 2010-2017. These 6 banks are Access, Diamond, Fidelity, FBN, Eco bank and Zenith bank. Lagos state was chosen based on the fact that all the banks established their head office in Lagos and the city is known to be at the forefront of economic and commercial activities. Data were extracted from annual reports and accounts of the selected banks.

The data were analysed using STATA12 statistical analysis software and the extent of influence of audit quality on earnings response Coefficient was determined using Ordinary least square Regression.

**3.1 Model for the extent of influence of Audit Quality Variables (AQV) and ERC**

This study adapts and modifies the model used by Teoh and Wong, (1993) used in Okolie, (2014) to measure influence of AQV on ERC. Linear regression analyses were used to test the relationship between the dependent variable (ERC) and the identified independent AQ measurement variables.

ERCi,t = a0 + β1AudsSi,t + β2Audini,t + β3NASi,t + ei,t (3)

Where

ERC = Earning Response Coefficient,

ERC = UE (Unexpected Earnings) = (EPSit – EPSi,t-1) x100MPSit

AudsSi = Auditor Firm Size

Audini = Auditor independence

NASi = Non Audit Services

 **4.0 RESULTS AND DISCUSSION**

**Table 1: Influence of Audit Quality Variables on Earning Response Coefficient (ERC)**

***Variables*: *ERC, AUDSIZ, AUDIN, NAS***

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Variable** | **Coefficient**  | **Standard Error** | **T-Test Values** | **Probability** |
| C | 41.94477 | 21.20071 | 1.53 | 0.002 |
| **AUDSIZ** | 7.281347 | 4.434892 | 1.30 | 0.003 |
| **AUDIN** | .0611032 | .626846 | 1.21 | 0.004 |
| **NAS** | 9.334131 | 9.203782 | 1.95 | 0.001 |

*R-square= 0.6600, Adjusted R-square=0.6470, F-statistics=*1.27*, Prob(F-stat)=0.0004*

**Source:** *Author’s Computation (2018)*

**4.1 Extent of Audit Quality Influence on Earning Response Coefficient (ERC)**

With a view to ascertain the extent of effect of audit quality on earning response coefficient, this study conducted regression analysis. Ordinary lease square regression was used to examine the extent to which Audit Quality Variables influence Earning Response Coefficient (ERC). The result presented in table 1 reported the estimates of explanatory variables including audit size, audit independence and non-audit services respectively. The result in table reported specific coefficient estimates of 7.281347, .6311032, and 9.334131 for audit size, audit independence and non-audit services respectively. Based on the results presented the reported coefficient estimates revealed that all the explanatory variables exert positive influence on earning response coefficients. The analyses indicated that audit quality is positively and significantly related to earning response coefficients at 0.003, 0.004and 0.001percent respectively.

Furthermore, The results presented in table, given the coefficient of determination (R2) of 0.6600 (approximately 66%) and also supported by high value of Adjusted (R2) significant at 0.6470 (approximately 65%), the result indicates that Independent variables incorporated into this model have been able to revealed that Audit quality positively influence Earning Response Coefficient (ERC). The F-Value (1.27) and P-Value (0.0004) also confirmed the significance of the model. Due to this result the null hypothesis earlier stated that Earning Response Coefficient is not significantly influenced by audit quality Variables is rejected while the alternative hypothesis is endorsed.

**5.0 CONCLUSION AND RECOMMENDATION**

Study revealed that Audit quality variables positively influence earning response coefficient of the sampled deposit money banks in Nigeria. It therefore recommended that Deposit Money Banks in Nigeria should endeavor to employ the services of one of the big audit firms in order to improve audit quality, allows for greater earnings quality and lower earnings management

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