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# AUDIT QUALITY DISCLOSURES OF PUBLIC NON FINANCIAL FIRMS IN NIGERIA: A FOCUS ON PREDICTIVE FACTORS

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**ABSTRACT:**

*The study empirically evaluates various factors predicting audit quality disclosures of selected non-financial firms listed on the Nigerian exchange group. Specifically, the study intends to ascertain the relationship between professional skepticism, audit fee and audit quality disclosure of selected non-financial firms listed on the Nigerian Exchange group. Adopting the ex-post-facto research design, a population of 116 non-financial firms listed on the Nigerian Exchange group as at March 1, 2021 were framed for the sample selection for the years 2012 to 2021. Thus, the content analysis approach was deployed for the extract of data from the annual reports of the sampled firms even as the Pearson correlation and Panel Least Square Regression statistical tools were used to test the hypotheses formulated in the study. The findings of the study show that professional skepticism and audit fee have a significant but negative relationship with audit quality disclosures. Based on these findings, the study concludes that less emphasis will be place on high audit fee as an incentive to producing high audit quality disclosure especially when it is not commensurate with the work. Accordingly, this study recommends that Auditors should prioritized efforts in developing and applying professional skepticism sufficiently and appropriately. Also, Auditors should charge and fix audit fee that commensurate with the audit assignment even Regulators should ensure that the effective monitoring of audit fees of auditors are consistently in place to ensure that it is not too high or low relative to the audit engagement.*

## 1. INTRODUCTION

The term audit was derived from the Latin verb 'audire' which means to 'hear'. The origin of audit dates from ancient times when the landowners allowed tenant farmers to work on their land whilst the landowners themselves did not become involved in the business of farming. The landlords relied upon

an overseer who 'listened' to the accounts of stewardship given by the tenants. In medieval Britain, an independent Auditor was employed by the feudal Barons to ensure that the returns from tenant farmers accurately reflected the revenues received from the estates. The Auditors read out their findings, hence the word 'auditor' (Adeniyi, 2012). The emphasis was very much on the detection of fraud and other irregularities. Thus, although the emphasis has changed and the role of the Auditor has become much more sophisticated, the concept of auditing is by no means a modern one. The issue of quality audit report has been one of the major concerns of Investors, Shareholders and Stakeholders as well as key considerations for auditors across the globe (Gray et al., 2011). Audit as a profession was argued to have suffered a lot because it is believed to be the pancreas that cure all ills. For example, executing high quality audit task implies reduced audit risk and minimal chances of issuing biased audit opinion (Francis, 2004). Meanwhile, reality has it that audit process has limitation of what is included in the auditing exercise. Asuch, the audit users' expectations differ from the reality of what Auditors can accomplished (Du & Roohani, 2007; Gold et al., 2012), leading to what is commonly known as the expectation gap. Nevertheless, audit practitioners and scholars have devoted commendable attention at improving public confidence by devising means of enhancing the quality of audit report produced (Hoag et al., 2017).

One of the major pitfalls of achieving audit quality disclosures is that audit scholars find it difficult to explain what a quality audit report should entail. This has often resulted in audit quality reports largely being proxied on the basis of authors' interest (Abdullah, 2006; Afify, 2008; Al-Tahat, 2015; Ika & Ghazali, 2012). Accordingly, an audit report which is assumed to be of high quality might just be another normal report in another context. And since there is no commonly accepted scholarly definition of what audit quality entails, it is therefore a difficult task fot scholars to conclude on what the optimal level of audit quality really is (Francis, 2004). Audit recommendations should therefore, be lawful, fair, objective and feasible. Several predictive factorss, both internal and external, can affect audit quality, including auditor professional knowledge and skills; skepticism; standards compliance; working conditions; audit duration and quality control (Google, 2021). External audit is the independent examination and expression of an opinion on the financial statements of an entity and risk therein by external professionals (Bediako-Ahoto, 2011). According to Soh and Martinov-Bennie (2011) the processes of external audit forms a smaller part of the audit process and therefore investors and other stakeholders often depend on the work of other organizational constituents when making decision regarding a particular organization (Chatterjee, Tooley, Fatseasa & Brown, 2011). Audit activities form part of the key functions that enhance the reliability and validity of financial and non-financial information (Gorata & Percy, 2018). Becker (1998) noted that auditing reduces the

information asymmetry through the examination of financial statement integrity by a third party-the auditor. However, Becker points out that there are other mechanisms such as strong corporate governance and other internal factors that can be used to constrain management behavior. Since auditors are seen as the main factor in reducing the information asymmetry inherent in corporate financial reporting, the issue of audit quality has gained prominence in auditing literature (Alireza & Ahmed, 2013). DeAngelo (1981) defines audit quality as probability that an auditor will both discover and report a breach in the client's accounting system. The former is a measure of auditor's competence and the latter is a measure of independence. Explicit in this definition is that the audit quality is sacrificed when any of these two conditions are not met (Alireza & Ahmed, 2013).

Theoretically, as observed by Francis (2004) and Hoag et al (2017), measures to improve audit quality disclosures is yielding significant positive results. Hence, the question is if these theoretical findings are real, why then did high profile companies defunct? The reality in this sense reveals that the accounting profession is witnessing credibility issues (Krishnan, 2005). Users of financial statements do not have direct access to the source of financial information, which increases concern over the reliability of such statements. There is hence the need for an independent party, for instance, the Auditor, with the main purpose of an audit of financial statements being to provide users with reasonable assurance that statements are free from material misstatements (Nwoye, Ekesiobi, Obiorah & Abiahu, 2016).. The greater the assurance, the higher the quality of the report. By providing assurance that financial statements fairly represent the economic condition of the firm, audit reports enhance the quality of information (Eilifsen & Willekens, 2008; Gaeremynck & Willekens, 2003). By verifying the financial information presented by firms, auditors make it possible for users to deem financial information to be of good quality. Moreover, Maines and Wahlen (2006) observed that unqualified audit reports are vital for perceiving financial reports to be fair and reliable. Therefore, other types of reports are less desired by users. In a nutshell, lack of opinion other than an unqualified one raises questions over the financial information presented. PWC (2017) opines that Auditors issue modified reports (ones which are not unqualified) if they disagree with management about financial statements, or if they have not been able to accumulate sufficient appropriate evidence (Shakhatreh & Alkhataybeh, 2020).

The quality of the Auditor, according to Stone (2019), is believed to have no direct effect on audit quality, but does has an indirect effect on audit quality with mediation of professional skepticism. Regulatory bodies have suggested that auditors' enhanced professional skepticism will contribute significantly to improving the quality of audits and that firms should prioritize efforts in this area.

Then question then is whether the auditing standards themselves could better address the application of professional skepticism? Indeed, the need for professional skepticism cannot be overemphasized, thus, adopting and applying a skeptical mindset is ultimately a personal and professional responsibility to be embraced by every auditor (Stone, 2019).Professional skepticism is considered a core predictive factor to quality audit and is essential in all aspects of the audit-from planning and risk assessment to the critical assessment of audit evidence in forming the auditors' conclusion (Stone, 2019). Professional skepticism is closely related to fundamental ethical considerations of auditor objectivity and independence. Professional skepticism is also linked to the application of professional judgment by the auditor. (Stone, 2019). An audit performed without an attitude of professional skepticism is not likely to be a high quality audit (Bing, 2021). Auditors are often reminded to exercise professional skepticism, but there are not many practical examples to demonstrate how this can be done, especially during a pandemic and beyond.

In providing their services, audit firms are entitled to fees paid by the client in compensation for their efforts. The level of fees paid usually relates to the efforts exerted by the auditors, depending on the client's size and risk. Therefore, such fees may be discretional, and if they are not in line with the auditor's efforts might impair independence and hence the quality of the report. The IFAC's Code of Ethics for Professional Accountants suggests that the level of fees could raise doubts over auditor independence (Abubakar & Ahmad, 2009).

### 1.1 Objectives of the Study

The broad objective of the study is to ascertain the factors predicting audit quality disclosures of selected non-financial firms listed on Nigerian exchange group. The specific objectives of the study are as follows:

i. To ascertain the relationship between professional skepticism and audit quality disclosures of selected non-financial firms listed on Nigerian exchange group.
ii. To evaluate the relationship between audit fee and audit quality disclosures of selected non-financial firms listed on Nigerian exchange group.

### 1.2 Hypotheses

In order to achieve the above objectives, the following hypotheses stated in their null forms were formulated;

1. $H_0$: There is no significant relationship between professional skepticism and audit quality disclosures.
2. $H_0$: There is no significant relationship between audit fee and audit quality disclosures.

## 2. LITERATURE REVIEW

### 2.1 Conceptual review

#### 2.1.1 Professional Skepticism and Audit Quality Disclosures

In auditing, the concept of professional skepticism is ubiquitous. Just as a Jedi in Star Wars is constantly trying to hone his understanding of the "force", an auditor is constantly crafting his or her ability to apply professional skepticism. It is professional skepticism that provides the foundation for decision-making when conducting an attestation engagement (Stone, 2019). The professional standards define professional skepticism as "an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence." Given this definition, one quickly realizes that professional skepticism can't be easily measured. Nor is it something that is cultivated overnight. It is a skill developed over time and a skill that Auditors should constantly build and refine. (Stone, 2019). It is a behavior that is essentially required to test and verify the authenticity and preciseness of audit evidence obtained. (Bing, 2021).
Carpenter et al (2002), states that there is statistically a significant positive relationship between experience and dimensions of skepticism. Furthermore, their results shows that knowledge and experience that are obtained from practice and feedback from fraud detection play an important role on increasing professional skepticism. Recently, the extent to which professional skepticism is being employed has gained a lot of criticism. Specifically, regulatory bodies argue that auditors are not skeptical enough in carrying out their duties. However, as noted in the white paper titled "Skepticism: The Practitioners' Take'', published by the Institute of Chartered Accountants in England and Wales, simply asking for more skepticism is not a practical solution to this issue, nor is it necessarily always desirable. There is an inevitable tug of war between professional skepticism and audit efficiency. The more skeptical the Auditor, the more time it takes to complete the audit. (Stone, 2019)
Audit Quality

How the auditor applies professional skepticism to an audit exercise directly impacts the quality of their service. Applying an appropriate level of professional skepticism enhances the likelihood the

Auditor will understand the industry, lines of business, business processes, and any nuances that make the company different from others, as it naturally causes the Auditor to ask questions that may otherwise go unasked. These questions not only help the Auditor appropriately apply professional standards, but also help the Auditor gain deeper understanding of your business. This will enable the auditor to provide insights and value-added services, an auditor who does not apply the right degree of skepticism may never identify. Therefore, as the white paper notes, Audit Committees, Management, and Investors should be asking "How hard do the auditors get pushed on fees, and what effect does that have on the quality of the audit?" If the Auditor is overly concerned with completing the audit within a fixed time budget, professional skepticism and, ultimately, the quality of the audit, may suffer (Stone, 2019). Six elements of professional skepticism (1) Questioning mindset; (2) Suspension of judgment; (3) Search for knowledge; (4) Interpersonal understanding; (5) Autonomy; (6) Self-esteem (Google, 2021). Without proper application of professional skepticism, the effectiveness of audit procedures is diminished. As a result, the sufficiency and appropriateness of audit evidence obtained is negatively impacted (Stone, 2019).

### 2.1.2. Audit Fees and Audit Quality Disclosures

In providing their services, audit firms are entitled to fees paid by the client in compensation for their efforts. The level of fees paid usually relates to the efforts exerted by the auditors, depending on the client's size and risk. Therefore, such fees may be discretional, and if they are not in line with the auditor's efforts might impair independence and hence the quality of the report. The IFAC's Code of Ethics for Professional Accountants suggests that the level of fees could raise doubts over auditor independence (Abu &Ahmad, 2009). One established notion in the literature is the importance of independence in determining financial statement quality. Many questions have been raised over the ability of auditors to furnish high quality work objectively and independently if they charge their clients high fees. Dhaliwal et al (2008) indicate that if the audit fee is high relative to the size of the client, the auditor's independence is more likely to be impaired, and financial statements less likely to be reliable.

Higher fees, according to Karsemeijer (2012), increase the chances of auditor-client economic bonding, which may cause auditors to put their professional independence in jeopardy, thus undermining audit quality (Choi et al., 2006; Audousset–Coulier et al., as cited in Oladipupo & Monye-Emina, 2016; Xie et al., 2010). Lower fees might increase the client's loyalty to the auditor, since they are charging less than the market rate, so the auditor might tolerate management misstatements or aggressive accounting practices (Ettredge et al., 2007, Hay et al. (2006), in their

meta-analysis of 147 published studies, found that the size of the client is the predominant determining factor of audit fees in all the papers. The majority of studies used total assets as a measure of client size. They reported that size explained over 70% of the change in audit fees. Simply put, auditing larger firms require more effort and time compared to smaller firms. Hence, it is expected that the larger the client, the higher the audit fees. Simunic (1980) and Palmrose (1986) argue that the major factor in determining audit fees is the effort exerted by the auditor during the audit process. Planning for the audit, meetings with the client, conducting fieldwork and preparing audit documentation and audit reports definitely takes more time if the auditee is a large firm with more divisions, more extensive operations, and a sophisticated financial reporting system (Shakhatreh & Alkhataybeh, 2020).

Furthermore, bigger firms have more analysts (Christensen et al, 2012), which puts the auditor in more jeopardy of a worsened reputation if something goes wrong. Consequently, auditors will demand higher fees in such cases. Therefore, the positive relation between auditee size and audit fees is somewhat intuitive. However, Gerrard et al. (1994) argue that due to economies of scale, the increase in audit fees will start to decline; that is, the audit fee/auditee size relationship is not linear. In the same vein, Pong and Whittington (1994) indicate that economies of scale lower audit fees as firm size increases. Hence, it is expected that the audit fee/size ratio will decrease when client size increases, as proven by Gonthier-Besacier & Schatt (2007). Measurement of audit fees in this research is based on the notion that auditor independence is affected not by the mere level of the fees paid by the client, but by the expected normal fee rates based on the efforts exerted by the auditor; that is, the level of fees adjusted by the size of the client (Shakhatreh & Alkhataybeh, 2020).

### 2.2 Theoretical Review

#### 2.2.1 Skepticism Theory

This theory was put forward by the French philosopher Rene Descartes (1596 to 1650 A.D). He argues that if humans always doubt (the truth) of something then at the same time, they will find something that is not in doubt. This attitude is also used to doubt the truth of all believes, by which a definite truth will be found. Auditors demonstrate professional skepticism by being skeptical or exhibiting dubious behavior. Additional audits and direct inquiries are in form of auditors behavior in following up on the auditor's doubt about the clients. The theory relates to one of the specific research objectives, professional skepticism as it relates to audit quality disclosure.

### 2.2.2 The Theory of Inspired Confidence

This theory was developed in the late 1920s by the Dutch professor Theodore Limperg (Hayes et al., 1999:36) (Bing, 2021). Limperg's theory addresses both the demand for and the supply of audit services. According to Limperg, the demand for audit services is the direct consequence of the participation of outside stakeholders in the company. These stakeholders demand accountability from the management, in return for their contribution to the company. Since information provided by management might be biased, a possible divergence between the interest of management and outside stakeholders, an audit of this information is required. With regard to the level of audit assurance that auditor should provide, (the supply side), Limperg adopts a normative approach. The auditor's job should be executed in such a way that the expectations of a rational outsider are not thwarted. So, given the possibilities of audit technology, the auditor should do everything to meet reasonable public expectations. The relationship of accountability is realized with financial statements; however, as outside parties cannot monitor any material misstatement or bias in financial reports, the demand for an independent reliable audit arises. The supply of audit services should satisfy the public confidence that arises from audit and fulfill community expectations, as the general function of audit is derived from the need for independent examination and an expert opinion based on findings; due to the confidence society places in an independent auditors' opinion. It can be assumed that if society lost confidence in audit opinion, the social usefulness of audit would cease; as audit delivers benefits to the users of financial statements. The auditor should maintain appropriate business practices to maintain his independence from the firm being audited, in order to satisfy his obligation to examine business practices and provide a credible opinion on the financial statements. The theory is relevant to the study both in the demand for and the supply of audit services. The study would meet the stakeholders demand for accountability from management and the expectation from the community as well as satisfy the public confidence that arises from the audit by unravelling the determinants of audit quality disclosures which is in consonance with the theory of inspired confidence.

## 3. MATERIAL AND METHOD

The study adopted the ex post facto research design. It is a category of research design in which the investigation starts after the fact has occurred without interferences from the researcher. It is a method in which groups with qualities that already exist are compared on some dependent variables (Alleydog, 2023). Content analysis was used to extract relevant data pertaining to the variables of the study. The population of the study is made up of one hundred and sixteen (116) listed non-financial companies on the Nigerian Exchange group. The study used listed firms because information related to these entities can be easily accessed online. This non- financial firms falls under the following sectors

namely; Industrial goods, consumer goods, consumer services, health care sector, ICT, services, construction/real estate, conglomerates, natural resources, Agriculture and oil and gas sectors. The sample size for the study is selected from the consumer goods, industrial goods and oil and gas sectors. The choice of these sectors is informed by the fact that they both involve the production of goods and assuch, would facilitate ease of comparison and relative uniformity. Nine companies from these sectors had issues with incomplete annual reports for the ten year under review (2012-2021), and some others were delisted by the Nigerian exchange group. Hence, thirty-five (35) firms in these sectors purposively formed the sample size. Purposive sampling enables researchers to squeeze a lot of information out of the data that are accessible and collated. The Pearson Correlation analysis was used to test the three hypotheses.

**Table 1:** Variables Measurement

| | **Variables** | **Measurements** | **Sources** | **Remark/Decision rule** |
|---|---|---|---|---|
| Dependent Variable | Audit Quality Disclosures (AQD) | Proportion of non-audit fee to audit fee plus 1 | (Rajgopal *et al*, 2015) | < **1**=High audit quality,>2=Poor audit quality. |
| Independent Variables | Professional Skepticism | Measured as natural logarithms of auditor (Auditing firms) years of experience. | (Stone, 2019), Carpenter *et al* (2002), | |
| | Audit fee | Measured as natural logarithms of audit fees in the sample listed non-financial firms | (Ndubuisi & Ezechukwu, 2017). | |

**Source:** Researchers' Compilation (2022)

### 3.1 Decision Rule

if the probability of the p-value is less than the significant levels which is 0.05, the null hypothesis is rejected, while the alternate is accepted. On the other hand, if the probability of the p-value is higher than 0.05 the null hypothesis is accepted and the alternate is rejected.

## 4. RESULT AND DISCUSSIONS

### 4.1 Descriptive Analysis of Data

The mean data of the selected firm as computed by E-views 12.0 software via the criteria of Mean plus SD Bound are detailed in this sub-section. The annual reports of the selected firms spanning from 2012 to 2021 provided the data used in the analysis. The average data of audit quality disclosure, professional skepticism and audit fee are presented in Table 2 below;

Table 2: Audit Quality Disclosure (AQD), Professional Skepticism (PSK), Audit Fee (AUDF) from 2012 to 2021

| Year | AQD | PSK | AUDF |
|---|---|---|---|
| 2012 | 0.97 | 1.630 | 7.121 |
| 2013 | 1.01 | 1.672 | 7.171 |
| 2014 | 1.15 | 1.675 | 7.199 |
| 2015 | 1.18 | 1.644 | 7.198 |
| 2016 | 1.04 | 1.601 | 7.210 |
| 2017 | 1.14 | 1.604 | 7.229 |
| 2018 | 1.04 | 1.606 | 7.262 |
| 2019 | 1.05 | 1.606 | 7.279 |
| 2020 | 1.32 | 1.618 | 7.084 |
| 2021 | 1.41 | 1.622 | 7.303 |

Source: Authors Computation (2022)

### 4.2 Test of Hypotheses

The result of the Pearson correlation analysis between the dependent variable (audit quality disclosure) and the independent variables (professional skepticism and audit fee) is presented in Table 3 below;

Table 3: Pearson correlation analysis

| | | ADQ | PSK | AUDF |
|---|---|---|---|---|
| ADQ | Pearson Correlation | 1 | -.159** | -.239** |
| | Sig. (2-tailed) | | .003 | .000 |
| | N | 350 | 350 | 350 |
| PSK | Pearson Correlation | -.159** | 1 | .586** |
| | Sig. (2-tailed) | .003 | | .000 |
| | N | 350 | 350 | 350 |
| | N | 350 | 350 | 350 |
| AUDF | Pearson Correlation | -.239** | .586** | 1 |
| | Sig. (2-tailed) | .000 | .000 | |
| | N | 350 | 350 | 350 |

Source: SPSS version 23

**. Correlation is significant at the 0.01 level (2-tailed)

### 4.2.1 Hypothesis One

Ho: There is no significant relationship between professional skepticism and audit quality disclosure.

Table 3 above shows a negative correlation of -0.159 between professional skepticism and audit quality disclosure at 1% significant level. The table also shows a p-value of 0.003 which is less than the significant level of 0.01. Therefore, the null hypothesis is rejected and the alternate hypothesis which states that; there is significant relationship between professional skepticism and audit quality disclosure is accepted.

### 4.2.2 Hypothesis Two

**Ho:** There is no significant relationship between audit fee and audit quality disclosure.

The above Table 4 output revealed a negative association of -0.239 between audit fee and audit quality disclosure at 1% significant level. Results from the above table also revealed a p-value of 0.00 which is less than 0.01.Therefore, the alternate hypothesis, which states that there is significant relationship between audit fee and audit quality disclosure is accepted .

## CONCLUSION AND RECOMMENDATIONS

The study ascertained the determinants of audit quality disclosures of selected non-financial firms listed on the Nigeria Exchange group. Also, the study ascertained and determined the relationships between the dependent variables (audit quality disclosures) and the independent variables professional skepticism and audit fee. The study revealed that Professional skepticism is statistically negatively and significantly related with audit quality disclosure (-0.159:0.003< 0.01) and there is statistically negative significant relationship between audit fee and audit quality disclosure (- 0.2391:0.0<0.01) in a selected non-financial firms listed on the Nigerian Exchange group.

Based on the findings of this study we carefully recommend the following;

1. Auditors should prioritized efforts in developing and applying professional skepticism sufficiently and appropriately

2.Auditors should charge and auditee should fix an audit fee that commensurate with the audit assignment in terms of the client size, efforts exerted and time spent on the audit activities, regulators should ensure they monitor the audit fees of auditors to ensure that it is not too high or low relative to the audit engagement. This will ensure that auditor's independence is not impaired and financial statements are reliable.

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