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# AUDIT QUALITY AND FIRM VALUE OF LISTED OIL AND GAS COMPANIES IN NIGERIA

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## Abstract

*Quality audit ensures reliability of financial statement and as such enhances firm valuation and investors' confidence. The aims of this study is to find the empirical evidence of the effect of Audit Quality on firm value of oil and gas industries in Nigeria, the study covers 12 years from 2009 to 2020. Unbalanced data were collected from secondary source using annual reports and account of the listed oil and gas firm. The population of the study consist of all twelve (12) listed oil and gas companies quoted on Nigeria stock exchange market as at December 2020. A whole population was used as the sample of the study. The study observed that Audit quality has positive and significant effect on firm value. This implies that audit quality significantly influences firm value and this could be attributed to several factors such as such as investors' confidence and auditor's specialization on audits to constrain earnings management. The study recommends that Regulatory oversight and effective operational guidelines for auditors to be standardized to maintain investor's confidence and ensuring efficient capital market in constraining information asymmetry.*

**Key Words:** Audit Quality, Firm Value, Audit Quality Index, Listed Oil and Gas Companies, Nigeria

## Introduction

The efficacy of financial reports depends on the quality of information being disclosed which also influences investment decision and future valuation of shareholders' wealth. Therefore, the reliability of financial reports disclosed by managers for investment decision and future valuation largely depends on the attestation and assurance given by an independent auditor and the objective of the auditor is to restrain the information asymmetry between the agents and their principal. This view is also in line with the efficient contract theory where it argued that corporate governance structure, when effectively applied in the manner most appropriate for the particular objective of each firm, result in transparent environment for contracting parties and managers. Auditing involves the independent review of organizational conformance and performance to provide reasonable assurance to stakeholders, on the effectiveness of risk management and control. Where an audit is said to be effective or of high quality it is expected that the audit will be able to constrain managements' ability in earnings manipulation.

As pointed out by De-Angelo (1981), Audit quality can be regarded as probability that through the review of conformance, a breach will be discovered and reported. Therefore, Audit quality implies the ability to discover a nonconformity and report it. This will ultimately reduce the tendency of management to mislead stakeholders. In support to this statement, et al (1998) disclosed that, allowing outsiders to verify a financial statements reduce information asymmetry.

Likewise, observed that audit of a company's accounts is a monitoring and control tool that constrain information asymmetry. So also, affirmed that higher quality audits moderate the agency costs by reducing earning manipulation. Afterward, studies had observed the association between audit quality and firm value. The studies indicate that investors react to the quality of audit performed on a client financial statement as evidenced by Krishnan (2003); Lee & Lee (2013); Ardiana (2014); Okolie & Izedonmie (2014); Alfraih (2016); Ai-dhamari & Chandren (2017). In order to advance on these studies with dearth of literatures observing this connotation in Nigeria, it is important to observe the role of audit quality in restricting opportunistic earnings manipulation and enhancing firm valuation in Nigeria. Existing studies had given attention on the effect of audit quality on firm value in developed and developing countries. Most of the studies measure audit quality proxies independently (Ardiana, 2014;

Martinez & Moraes, 2014; Wijaya 2020; Erasmus & Akani, 2021); Ishaku, Musa & Garba (2020); Erasmus & Akani (2021);

However, Audit quality proxies can be measured in aggregate, each of the proxies portrays a distinct signal on the firm value. To ascertain a convincing result on firm value, holistic approach is required to observe the comprehensive effect. It is against this background the study applied the index of audit quality proxy (Audit size, Audit fee, Audit Tenure, Audit timeliness, Joint Audit and Audit committee effectiveness) to observe the comprehensive effect on firm value. Subsequently, the study focuses on the oil and gas industry because it remains the core sector of the Nigerian economy and had been linked with allegations of fraudulent financial practices (Tyokoso & Gabriel, 2015). Moreover, in recent times several loopholes and mismanagement in the oil and gas sector where being reported.

For example, SEC reports on the investigation of Oando Plc. said findings from the forensic audit conducted by Deloitte group of Audit firm revealed a serious infraction such as false disclosures, market abuses, misstatements in financial statements, internal control failures, and corporate governance lapses (Deloitte, 2019).

This study will add to the existing body of knowledge on the effect of Audit Quality on firm value of listed Oil and Gas companies in Nigeria. The remaining work is structured into three sections, the first of which is a literature review. The second section is research methodology; and the last section, is results, conclusion and recommendations. In the light of the objectives of the study, the hypothesis below guides the study.

H<sub>01</sub>: Audit Quality has no significant effect on Firm Value of Quoted Oil and Gas Companies in Nigeria.

## **Literature Review**

### **Concept of Audit Quality**

There is no universal definition unanimously agreed upon. Financial Reporting Council (2006); Bonner (2008) opined that Audit quality is a complex concept. Knechel, Krishman, Pevzner, Shefchik & Velury (2013) observed the complexity of Audit quality and posited that the view of audit quality can vary depending on different perspectives. Titman and Trueman (1986); Beatty (1989); Krinsky & Rotenberg (1989); Davidson & Neu (1993), defined Audit quality as the correctness of information certified by auditors. Lee, et al (1990) defined audit quality as the possibility that an auditor will not certify an unqualified report containing material errors.

These definitions, similar to De-Angelo (1981) conforms with the aspect of competency and independence, which is considered a dualistic and indirect approach (Zehri & Shabou, 2015). While the definitions are considered comprehensive and widely accepted, their ability in capturing the overall context of audit quality appears incomplete as pointed out by Knechel, *et al* (2013) that competency and independence are not the only audit process that influences audit quality but there are also other aspect that could influence audit quality.

In an effort to provide abroad context of audit quality, Francis, (2011) and by extension, Knechel, et al (2013) used a framework to conceptualise Audit quality. Their study posited that a "good" Audit is one where the auditor abide by audit rules and regulation in conducting his duty, and taking good precaution to understand the risk attached to the Audit and appropriately amend to the peculiar environment of the client. The argument behind this concept is that previous study do not consider the risk maturity profile of the client as an input of audit process which is influenced by the peculiarity of the client environment and therefore in conceptualising audit quality, five attributes must be considered; incentives, uncertainty, uniqueness, process, and judgment. This concept is considered a direct approach (Zehri & Shabou, 2015).

### **Concept of Firm Value**

The term value has different perceptives. While in economics it is based on alternatives offerings and reference prices on a product (Ingenbleek, 2007); in accounting it is interpreted as the worth of an organization base on future expectation (performance). Several studies in accounting literature had attempted to operationalize the concept of firm value suitable to their studies. For instance, the studies of Leland & Toft (1991) posited that the worth of a firm is a function of its asset value in addition to the value of tax advantages enjoyed resulting from of finance cost minus the value of bankruptcy cost.

Modigliani (1980) explains that the worth of an organization is the summation of its liability and equity, which depends on the returns generated from them. While Jensen (1986) posited that when firms have more revenue than projects with positive net present value, debt financing restrain the managers' ability to invest in negative net present value projects. This process can be more efficient if managers are required to pay out excess funds for servicing debt, therefore adding the firm's value.

Myers (1993) observe that a company with outstanding liability may be encouraged not to undertake projects that have positive net present value where the benefits from the project will be in favour of the bondholders without increasing shareholders' wealth. This inefficiency can distort firm value, particularly where there are high levels of future investment opportunities for the firm. Pandey (2004) opined that the worth of a firm is the addition of the all its securities' value. That is, inclusive of its debt where it is a leveraged firm. It further noted that firm's equity valuation is its discounted earnings while debt is valued as the discounted interest on debt.

Firm value is therefore perceived as the present value of future expectation from a firm which is measured in terms of future return or expected future cash flow. These future expectations are regarded as the worth of the organization upon which the value of the firm is established and are determined based on public available information being processed for accurate prediction of future return. Therefore, to determine a firm value accurately, future returns of a firm must be predetermined. That is, a firm must have estimates of future returns. Gold (2003) argued that since a firm may continue growing to infinity, it is impossible to predict the net cash flows and resulting firm's value. However, it can be possible assuming a constant growth model to determine firm value.

### **Empirical Review Audit Quality and Firm Value**

This study asserts that market considers the quality of the auditor in valuation of firms. Quality audit ensures reliability of financial statement and as such enhances firm valuation. Empirical literatures had examined similar assertion.

Krishnan (2003) observed the relationship between audit quality and earnings pricing using regression and correlation. The study observed that the relationship between income and discretionary accruals is larger where an organization is audited by big 6 auditors. Cho, Han & Brown (2006) assess whether fees for consultancy services influences the value relevance of earnings in United States using regression analysis. It was observed that consultancy service fees positively affect value relevance of earnings.

Francis & Ke (2006) examined whether initial fees for consultancy services disclosure affects capital market assessment of subsequent quarterly earnings surprise in France using regression. The study observed that market response negatively to the discovery of consultancy service fees.

Lee & lee (2013) assessed audit quality and value relevance of earnings and value of equity in Taiwan using regression and two-way tests. The findings from the study indicated that when these variables are audited by big four auditors, variations in stock returns are noticed and are more value relevant as against those not audited by big four auditors. Ardiana (2014) assessed external audit attributes on firm's value in Indonesia. It observed that audit tenure negatively influences value of firms and reports certified by big audit firms with unqualified reports have more value.

Martinez & Moraes (2014) investigated fees paid for audit and non-audit services in relation to market and book value of firms in Brazil. The study indicates that Tobin's Q and audit fees are significantly related while non-audit service fees is negatively related to Tobin's Q. In the same vein,

Alfraih (2016) examined audit quality and value relevance of financial reporting in Kuwait. It was observed that value relevance is significantly influenced by audit quality. Al-dhamari & Chandren (2017) evaluated the possibility of women audit partner influencing client's value relevance in Malaysia. The study observed that client's value is more relevance and reliable when signed by women partners from big 4 audit firms.

Wijaya (2020) examined audit quality and firm value of listed manufacturing companies in Indonesian. It was observed that audit quality positively influences firm value of manufacturing companies in Indonesian. More so, Sattar, Javeed, & Latief, (2020) examined product market competition, Audit quality and Financial Performance. The study indicates that Audit Quality enhances reliance on reported firms' performance. Meanwhile in Nigeria, Okolie & Izedonmi (2014) investigated audit quality and pricing of firms in Nigeria. It was observed that quality of Audits influences market value of firms quoted in Nigeria NGX. So also, Farouk & Hassan (2014) assess audit quality and financial performance firms in Nigeria using regression analysis. The study indicated that quality Audits plays a vital role in determining financial performance. Ado, Rashid, Mustapha, & Ademola (2020) conducted a study on audit quality and financial performance of some companies in Nigeria. The findings observed that auditors fee positively but insignificantly influences return on Assets.

Abba & Sada (2020) investigated audit quality and firm value of commercial banks in Nigeria. The study observed that Auditors with industry specialization significantly influences value of the commercial banks. However, The Auditor size does not influence the value. Erasmus & Akani (2021) also investigated audit quality and market value of commercial banks in Nigeria. It indicates that auditors' fees and size negatively but and insignificantly influences their market price. Whereas, audit tenure significantly influences market price.

Lastly, Ishaku, Musa & Garba (2020) carried out a study on audit quality and firm value of insurance companies in Nigeria. The study indicates that the Audit firm size and tenure negatively influences firm value. However, audit fees and company size positively influences firm value.

From the review of these literatures, it can be observed that the major findings of these studies is that investors react to the quality of audit performed on a client financial statement as evidenced by Krishnan (2003); Lee & Lee (2013); Ardiana (2014); Okolie & Izedonmie (2014); Alfraih (2016); Al-dhamari & Chandren (2017); Abba & Sada (2020). The studies suggest that the market also reacts to audit independent, which enhances audit quality by observing the amount spent on consultancy services executed by the independent Auditor as evidenced in the study of Francis & Ke (2006); Martinez & Moraes (2014).

Having in mind that literatures had noted that audit quality influences firm valuation, the resulting firm value relied upon the audited earnings disclosed by the firm. In order to advance on these studies with dearth of literatures observing this connotation in Nigeria, this study assesses the role of audit quality in influencing firm valuation in Nigeria.

### **Theoretical Framework**

The theory that underpinned is study is agency theory. Agency theory, an economic concept of agent, principal relationship, developed during 1960s and 1970s. The model is on the premise that due to information asymmetries and selfish interest of agents. Business owners do not trust their agents and will therefore ensure effective mechanisms are present that will align the interests of agents with the business and control the level of information asymmetries and opportunistic behaviour. This shows the relationship that exist between the external auditor and shareholders of the organization.

### **Research Methodology**

This study applied descriptive research design which focuses more on “what” of the research rather than “why” of the research subject. The study relied on financial statements of the Oil and Gas companies. The positivist paradigm is used to anchor the study. The study population consists of all the thirteen (13) Oil and Gas companies listed on NGX. Data were collected through secondary sources from published financial statements of all the companies covering a period of twelve years 2008 to 2020.

Firm value, which is the dependent variable, was measured as the ratio of the firm's market value and book value of equity (market value/book value) this has been widely used in literature and comparable studies (Makela, 2012; Martinez & Moraes, 2014). Audit Quality, being the independent variable, measured using the surrogate approach of measuring Audit Quality. The study uses an audit quality index, which typically examine combinations of Audit Quality attributes. This is consistent to the studies of Gul (1991); Warming-Rasmussen & Jensen (1998); Chang & Monroe (2001) and Duff (2004); Siala & Jarboui (2018).

**Measure of Audit Quality Index (AQI)**

**Table 1:**

Audit Attributes	Measurement	Source	Scoring
Audit firm size	Big four auditor and Non big four auditor	Asthana & Boone, 2012 and Kimeli, 2016	Big four=1 Non big four=0
Audit fee	Measuring high and low audit fee against industry average	Afza and Nazir, 2014; Hua, Hla and Isa, 2016	High audit fee=1 Low audit fee=0
Audit tenure	Auditors not to be retained above 10 years	Alsmairat, Yusoff&MdSalleh, 2018; Wijaya, 2020	Below 10 years=1 Above 10 years=0
Audit timeliness	Average of 125 days for audit report signing.	Whitworth & Lambert (2014).	Below 125 days=1 Above 125 days=0
Joint Audit	Joint auditor and Single auditor	Lobo, Paugam , Zhang, And Casta (2017)	Joint Auditor=1 Single Auditor=0
Audit committee effectiveness	compliance with the requirement of CAMA for equal members of directors and shareholders' representative up to a maximum number of 6.	Awolabi and Dada (2011)	Even number ≤6 = 1 Odd number > 2 = 0
Audit Quality Index	Weighted average of total score of Audit attributes for i year		

Authors (2020)

Firm size and board independence were used as control variables. Firm size as Natural log of total assets while board independent is measure as the ratio of independence directors on total directors.

**Model Specification**

A GLS (Random effect) regression was applied to assess the relationships between the dependent variable (firm value), and the independent variables (Audit quality index) and the control variables (Firm size and Board Independence).

The econometric form of the equation is given as:

$$MBV_{it} = \beta_0 + \beta_1 AQI_{it} + \beta_2 SIZE_{it} + \beta_3 BI_{it} + E_{it} \dots\dots\dots$$

Where;

MBV= market value of firm to book value of firm

AQI=Audit Quality Index

SIZE= Log of company's total asset

BI=Board Independence

$\beta_0$  = the intercept (the expected value of dependent variable when independent variables = 0)  
 $\beta_1, \dots, \beta_7$  = the coefficient of independent variables (the expected change in dependent variable corresponding to a change of one unit in independent variables)  
 $E$  = residual error term  
 $i$  = individual firm  
 $t$  = period

### Results and Discussions

In this section, descriptive statistics, correlation metrics then regression result is presented, analyzed and discussed.

### Descriptive Statistics

The descriptive statistics is on Table 1, which shows the measures of central tendency.

**Table 2: Descriptive Statistics of the Variables**

Variables	OBS	Mean	Std. Dev.	Min	Max
<b>MBV</b>	122	6.4434	15.0622	-0.11	118.32
<b>AQI</b>	123	0.4797	0.1767	0	0.8333
<b>SIZE</b>	122	7.5835	0.7608	5.25	9.03
<b>BI</b>	122	59.3814	18.1586	0	90

**Source:** Descriptive Statistics Result using STATA 14.0

In Table 2, the mean MBV for the sampled listed oil and gas companies in Nigeria is 6.4434, indicating that the average market to book value ratio of the companies is about 6 times with a minimum ratio of -0.11 and maximum ratio of about 118.32. This indicates a high variation of market to book value ratio as depicted by the value of standard deviation (15.0623) which is higher than the mean value.

Audit quality index with a mean value of 0.4797. That is, on average the companies have about 48% audit quality. A minimum value of 0 and a maximum value of 0.8333 was recorded. Indicating a low variation in audit quality among the companies as indicated by the value of standard deviation of 0.1767 which is lower than the mean value.

Size of the companies indicates a mean value of 7.5835. It also indicates a minimum value of 5.25 and a maximum value of 9.03. This implies a low variation of total assets as shown by the value of standard deviation of 0.7608, which is lower than the mean value.

Board independence recorded a mean value of 59.3813. It also indicates a minimum value of 0 and a maximum value of 90. This implies a low variation in board independence as shown by the value of standard deviation of 18.1586 which is lower than the mean value.

### Correlation Analysis

Table 3 is the correlation values of the variables. The values of the correlation coefficient range from -1 to 1. The correlation coefficients on the main diagonal are 1.0, because each variable has a perfect positive linear relationship with itself.

**Table 3: Correlation Matrix of the Dependent and Explanatory Variables**

VARIABLES	MBV	AQI	SIZE	BI
MBV	1.0000			
AQI	0.0289	1.0000		
SIZE	-0.0231	0.4150	1.0000	
BI	0.0421	0.1121	0.06388	1.0000

**Source:** Correlation Matrix Results using STATA Version 14.0.

From Table 3, Audit Quality index, board independence and firm value have weak and positive correlation with coefficient values of 0.0289, 0.0421, respectively. Also, weak and negative relationship exists on firm size with the correlation coefficient value of -0.0231.

**Regression Results**

The section explains the influence of Audit Quality on firm value of the sampled listed Oil and Gas companies in Nigeria.

The result was presented on Table 4. The random effect regression result on Table 3 shows the value of the overall R<sup>2</sup> as 0.383, which is the multiple coefficients of the determinants that gives the proportion of the variations in the dependent variable and explanatory variables jointly. Therefore, it signifies that approximately 38% of total variation in firm value of the sampled listed oil and gas companies in Nigeria is caused by audit quality index, size and board independence of the companies.

Table 3 also shows the F-statistics value of 53.55 with the corresponding P-value of 0.0000. The P-value of 0.0000 implies that the relationships among the variables were not due to chance and as such, the results from the regression can be relied upon.

**Table 4: Regression Result**

Variables	GLS(RE)		
Constant	-8111.34	***	(-5.71)
AQI	1961.96	***	(1.81)
SIZE	1265813	***	(4.91)
BI	549.285	***	(5.96)
Obs			122
Hetttest			0.0000
F-Test			0.0000
R <sup>2</sup>	Within	0.2751	
	Between	0.5798	
	Overall	0.3831	
F			53.55
Sig			0.0000

**Source:** Result Output from STATA 14.0

NOTE: \*\*\*, \*\* and \* indicate 1%, 5% and 10% significant levels respectively; the z-values are presented in parenthesis while the other figures represent the coefficients.

Table 4 shows that audit quality index has positive and significant effect on firm value at 1%, 5% and 10% levels of significance, with the coefficient and z-value (ceff=1961.96, z=1.81).

Table 3 also shows that the control variables, size and board independence have significant impact on



firm value with the coefficient and z-values of (ceff=1265813, z=4.91),(ceff= 549.285, z=5.96).From this result, the study rejects the null hypothesis, which states that audit quality has no significant effect on firm value of quoted Oil and Gas companies in Nigeria.

The positive relationship between Audit quality index and firm value indicates a superior understanding of the intricacy and client major business risk by auditors of the oil and gas companies. Also, it shows that most of the auditors used by oil and gas companies are specialized/big 4 auditors which enhances their companies' reputation in the capital markets, attracting investors and increase share value/appreciation. This result is consistence by the result of Abba & S Adah (2020); Afza & Nazir (2014); Ojonimi (2017), Baffa & Yero (2017), Ugwunta, Ugwuanyi & Ngwa (2018).

### **Conclusion and Recommendations**

The study had examined the effect of Audit Quality on firm value in the Nigerian Oil and Gas Industry. The findings show that Audit Quality has positive and significant effect on firm value. This suggests that Audit quality significantly influences firm value and this could be attributed to several factors such as investors' confidence and auditor's specialization on audits to constrain earnings management.

This finding is consistent with the study of Abba & Sadah (2020); Afza & Nazir (2014); Ojonimi (2017), Baffa & Yero (2017), Ugwunta, Ugwuanyi & Ngwa (2018).

The study recommends that Regulatory oversight and effective operational guidelines for auditors to be standardized to maintain investor's confidence and ensuring efficient capital market in constraining information asymmetry.

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