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# EFFECT OF EXTERNAL AUDITORS' QUALITY ON CREDIBILITY OF FINANCIAL REPORTING IN NIGERIAN DEPOSIT MONEY BANKS

**By**

**Ibikunle Jide**
Department of Accountancy, Faculty of Management Sciences,
Enugu State University of Science and Technology (ESUT),
Enugu State, Nigeria.
Email: ibikunlejide09@gmail.com

**Kevin Okoh Ugwu, Ph.D.**
Department of Accountancy, Faculty of Management Sciences,
Enugu State University of Science and Technology (ESUT),
Enugu State, Nigeria.
Email: kevin.okoh@esut.edu.ng

## Abstract

*This study investigates the effect of external auditors' quality on the credibility of financial reporting of listed deposit money banks in Nigeria. The study uses the agency theory as a theoretical framework to underpin the research and examines the effect of external auditors' quality on the credibility of financial reporting of listed money deposit banks in Nigeria. Data were limited to 16 Deposit Money Banks in Nigeria for ten (10) years during the period of 2012 to 2021. The study adopts an ex-post facto research design. Findings of the study indicate that auditor firm size, tenure, and specialization have a significant effect on the credibility of financial reporting of listed deposit money banks in Nigeria, except for audit independence, which proves not to have a significant effect on the credibility of financial reporting of banks. Amongst the statistically significant variables, only audit firm size and audit independence have a negative effect on the credibility of financial reporting quality, while auditor tenure and auditor specialization had a positive influence on the credibility of financial reporting quality of banks. Therefore, the banks should engage both big four auditors and non-big four auditors for joint audit rather than rely heavily on the big four alone, as they prove to negatively affect the credibility of financial reporting due to possible complacency. Audit fees should be increased to guarantee the independence of the auditors because when their fee is below the sector average, they are forced to engage in non-audit services, thereby compromising standards. The study also suggests that auditor tenure should be elongated as longstanding auditors become more familiar and tend to understand the banks better, which will eventually lead to increased financial reporting quality.*

***Keywords:*** *Auditors, Quality, Credibility, Independence, Financial Reporting.*



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## 1. Introduction

The need for financial reporting free of misstatement have occupied much of the discussions in literature of accounting and finance (Farouk, 2018). This is because of financial scandals and collapse of giant multinational firms around the world such as Enron, WorldCom, Parmalat and Cadbury in Nigeria, among others. These have drawn the attention of regulators, policy makers, researchers, and other stakeholders in propelling the need for good corporate governance practice in developed and developing economy. These corporate failures have led to international efforts towards adopting governance practice to mitigate opportunistic tendencies of managers that have weakened investors and potential investors' confidence in companies' accounting information (Oba, 2014). Corporations have also been found wanting on their pervasiveness towards manipulative accounting practice and have brought doubt to the credibility of financial reporting of firms in Nigeria. Examples of these corporations in recent times are defunct Oceanic Bank Plc, Skye Bank, Afribank Plc and Intercontinental Bank Plc to mention just a few. The perpetration of this act is to attract unsuspecting investors, or to obtain undeserved accounting-based rewards through the presentation of an exaggerated, misleading, or deceptive state of bank financial affairs (Farouk, 2018). Therefore, it has become imperative to examine factors that could help increase the level of financial reporting quality through reduced manipulations of financial reporting, particularly in the banking sector which serves as one of the pivots of the Nigerian Economy. Apparently, external monitoring mechanisms turned out to be the most significant tool to regaining the lost confidence by the stakeholders (Abdoli & Royaee, 2012).

According to Fodio et al. (2013) one of the crucial roles of corporate governance is to basically lessen the divergence of interests between shareholders and managers. Such divergence of interests could border laterally on the management of earnings using accounting accruals and this is a major determinant of the quality of financial reporting. Qiang (2010) posited that earnings quality is a major element in the corporate governance process, as accounting gives the information needed for most governance mechanisms to function efficiently. On the other hand, many of the accounting principles such as historical cost, conservatism, prudence, etc cannot be ultimately understood unless they are seen with a corporate governance lens. Hence, there is a serious fellowship between governance and financial reporting quality of which reported earnings quality is a major component.

External auditing serves as an essential requirement in the business environment, functioning as an external monitoring mechanism. It has been mandated and regulated in numerous industrialized countries (Piot, 2001) due to its crucial role in instilling confidence and transparency in financial reporting. However, recent financial scandals have raised concerns about the effectiveness of external auditors in curbing financial reporting manipulation. This has been further exacerbated by a surge in audit failures within the capital market, leading to heightened worries regarding audit quality (Velury, 2005).

The relationship between audit quality and the credibility of financial reporting is rooted in a widespread belief that some managers may engage in abusive accounting practices for personal gain, rather than acting in the best interest of shareholders and stakeholders. External auditing has, therefore, become a vital instrument for shareholders to ensure the transparency and credibility of financial reports. External auditors are entrusted with the responsibility of verifying that financial statements adhere to Generally Acceptable Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). Their verification process adds credibility to a company's financial statements, thereby expected to restrict any opportunistic manipulation or misstatement, ultimately enhancing the credibility of financial reports.

Whittington (1993) highlights that many high-profile corporate failures are a result of combined failures in financial reporting and auditing. When monitoring mechanisms fail to identify or prevent improper financial disclosures, it leads to reporting failures. Consequently, there is an inherent connection between the credibility of financial reporting and audit quality.

The quality of audit services hinges on various factors, including the auditors' experience, industry knowledge (industry specialization), size, and independence, among others. Such expertise and experience enable auditors to identify and address complex issues specific to different industries.

**Statement of the Problem**

Practically speaking, the Nigerian banking Industry over the years has faced a lot of issues which have badly affected their performance. These issues have led to consolidation policy of 2005 brought by the Central Bank of Nigeria. This consolidation policy was to strengthen the bank and protect the depositors' fund. After the consolidation policies many banks were found to engage in insider trading, and this led to huge amount of non-performing loan. The situation involving Intercontinental and Oceanic banks serves as a relevant example, and as a consequence, the CEOs of these banks were dismissed. To prevent additional crises in the banking sector, the Central Bank of Nigeria established the Asset Management Company of Nigeria (AMCON) with a ten-year operational duration. AMCON's primary task was to assume control of the banks' toxic assets, infuse additional funds into struggling banks, assume management control, and restructure these financial institutions. AMCON effectively fulfilled its mandate by taking over certain banks and providing additional financial support. Afribank, Bank PHB, Spring Bank and Skye Bank were the first set of banks to be taken over. AMCON injected N679 billion into the Bridge Banks namely, now named Main Street Bank, Keystone Bank and Enterprise Bank, to meet the minimum capital base of ₦25 billion and the minimum capital adequacy ratio of 15 per cent. The high non-performing loan in these banks created liquidity problem and thus affected the performance of the banks. The CBN released a corporate governance code for banks in 2006 to strengthen and address the governance issues within the banking sector. Despite these interventions, more banks were still found wanting. The problem is that there still continuous skepticisms in the mind of investors, shareholders, and other stakeholders on the continuous survival of the banks and the banks' ability to make returns to the investors. Therefore, there is no gainsaying that external auditors should have a significant role in ensuring the credibility of the financial reporting but however, a research need to be conducted to establish to what extent the quality of auditors could influence the credibility of financial reporting.

Methodologically, researchers have adopted different methodologies as well as different tools of data analysis. The nature of conclusions arising from these studies is mixed and inconclusive which may be due to differences in methodology. Most of the studies in Nigeria failed to conduct robustness tests either on normality tests, heteroscedasticity tests, lagrange multiplier test, fixed effect, and random effect model where necessary which is due to the weakness inherent in the tool of data analysis used. The failure to conduct these tests may render their findings and recommendations unreliable. Therefore, this study will take into considerations all the robustness tests to correct the weaknesses in previous studies and also use the most appropriate tool to address the weakness in the tool of data analysis adopted by these studies. Therefore, the study adopted Stata as the tool of data analysis as it is more informative (have more variability, less collinearity, more degrees of freedom), as estimates are more efficient under them. Also, they allow the study of individual dynamics (e.g. separating cohort effects). While this technique and tool give information on the time-ordering of events, they also allow for the control of individual unobserved heterogeneity

**Objectives of the Study**

The main objective of the study is to examine the effect of auditor quality on credibility financial reporting of listed money deposit banks in Nigeria. Other specific objectives are to:

i. assesses the effect of auditor size on the credibility of financial reporting of money deposit banks in Nigeria.
ii. Investigate the effect of auditor independence on credibility of financial reporting of money deposit banks in Nigeria.
iii. determine the effect of auditor specialization on credibility of financial reporting of money deposit banks in Nigeria.

**Research Questions**

i. To what extent does auditor size have significant effect on the credibility of financial reporting of money deposit banks in Nigeria?
ii. To what extent does auditor independence have effect on the credibility of financial reporting of money deposit banks in Nigeria?
iii. To what extent does auditor specialization significantly influence the credibility of financial reporting of money deposit banks in Nigeria?

**Statement of Hypotheses**

The following hypotheses have been formulated in null form.

$H_{01}$: Auditor size has no significant effect on the credibility of financial reporting of money deposit banks in Nigeria.

$H_{02}$: Auditor independence has no significant effect on the credibility of financial reporting of money deposit banks in Nigeria.

$H_{03}$: Auditor specialization has no significant effect on the credibility of financial reporting of money deposit banks in Nigeria.

**Scope of the study**

The study examined the effects of auditor quality on the credibility of financial reporting quality of deposit money banks listed in the Nigerian Exchange Group (NGX) as at December 31, 2021. The justification for choosing Deposit Money Banks, to the best of our knowledge, is premised on the fact that the sector remained the pivot of the Nigerian economy and as such requires stringent monitoring and consistent research that will identify areas of weakness and strength to be improved upon. The study covers a period of ten (10) years, starting from 2012 to 2021. The justification for choosing this period is that it coincided with the period of revised version of the codes of corporate governance by the Central Bank of Nigeria and the period in which IFRS was adopted. Only sixteen listed Deposit Money Banks in Nigeria, as at December 31, 2021 were used. The variables considered include auditor size, auditor tenure, and auditor independence and auditor specialization

## 2. Review of Related Literature

### 2.1 Conceptual Review

Financial reporting plays a critical role in firm's active flow and in complex economic decision because many economic decisions are based on the information obtained from financial reporting eco-system, as such it is essential to assess, sustain and improve the financial reporting quality (Sohail & Aziz, 2019). 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. Reliable reports significantly influence stakeholders in their resource allocation decisions. However, the credibility of financial reporting is a subjective evaluation of the extent to which the financial report is free from manipulation and misstatement, accurately reflecting the financial condition and operating performance of a business entity. It involves the accuracy with which a company's reported financial statements represent its operating performance and their usefulness in forecasting future cash flows (Damagum et al., 2014). Understanding that users of financial reports have varying preferences, the perceived quality of financial reporting will differ among constituents, making direct determination of quality challenging (Botosan, 2004). As a result, many evaluations of financial reporting quality focus on characteristics that influence the credibility of financial reports, such as financial restatements, timeliness, and earnings management (Schipper and Vincent, 2003; Cohen et al., 2004; Barth et al., 2008).

Damagum et al. (2014) pointed out that earnings management is frequently used as a proxy for financial reporting credibility. It refers to a tactic employed by company management to deliberately manipulate a company's earnings to meet predetermined targets. Earnings management involves material and intentional misrepresentation of results with the aim of achieving predictable and stable financial outcomes. This practice negatively impacts the quality of reported earnings and misleads stakeholders in their resource allocation decisions. Thus, earnings management, being a form of financial reporting manipulation, has been defined by various scholars. Rahman, Mohammad, and Jamil (2013) describe earnings management as reasonable and legal management decision-making and reporting aimed at achieving stable and predictable financial results. Similarly, Schipper (1989) defines earnings management as the process of intentionally taking steps within the confines of Generally Accepted Accounting Principles to achieve a desired level of reported incomes.

Naser (1993) has defined creative accounting as the transformation of financial accounting figures from what they actually are to what preparers' (managers) desire by taking advantage of the existing rules and or ignoring some or all of them. These definitions regard earnings management as legal and reasonable decision taken by management since it does not alter any accounting principles.

Earnings in Accounting are the excess of revenue over expenses. Earnings are also referred to as Income or profit. Income is regarded as an indicator of management's effectiveness in utilizing the resources belonging to the external users. Income tends to provide the basic standard by which success is measured. Thus, income is a measure to evaluate the quality of management's policy, decision making and controlling activities. Earnings of organizations could be managed upward or downward depending on the desired end of the management.

Whichever way the earnings are managed, in as much it is within the generally acceptable accounting principles, it can be regarded as legal but unethically wrong (Farouk, 2014).

The reliability of financial reporting is influenced by various factors, and one crucial aspect is the Quality of Audit. Stakeholders who rely on credible financial reporting must consider the reliability of the audit quality when making economic decisions related to a firm. Audit Quality can be defined as a system that ensures financial reporting presents an accurate and objective view of a business organization's financial status, adhering to GAAP and IFRS standards (Khalil, 2022).

Numerous studies have explored how different qualities of auditors contribute to the variations in the value of financial reporting. These qualities encompass factors such as the auditor's tenure with the organization, their level of independence, the size and specialization of the audit firm, auditor-client relationships, audit timeliness, and even the auditor's opinion, all of which play a significant role in determining the value of firms (Farouk & Shehu, 2014).

External auditors' quality has been recognized as another critical factor that enhances an organization's financial reporting. Watts and Zimmerman (1986) explain that auditing serves as a valuable form of monitoring used by firms to reduce agency costs. The value of auditing lies in its ability to reduce misreporting of financial information and thereby enhance the reputation of the firm.

**Auditor Size:** Audit firm size signifies various types of qualities. It is assumed that size of audit firms suggests reputation, international affiliation, and integrity which are reflected in the audit report on the accounts of their clients. DeAngelo (1981) argues that Big4 auditors provide better quality audits than non-Big4 auditors, which is supported by extensive subsequent empirical research. Teoh and Wong (1993) find higher Earnings Response Coefficients (ERCs) for clients audited by Big4 firms compared to those audited by non-Big4 firms. Similarly, Francis and Yu (2009) and Choi et al. (2010) have shown that audit office size is a primary determinant of audit quality. Therefore, with regards to auditor size, this study suggests large firms to be the Big4 auditors while non-Big4 auditors are regarded as "small" firms.

**Auditor Independence** refers to a state of objectivity and lack of bias, as defined by the United States Securities and Exchange Commission (SEC) in 2000. It can be described as the unbiased mental attitude of an auditor while making decisions throughout the audit and financial reporting process. When an auditor lacks independence, there is a higher chance of being perceived as lacking objectivity (Okolie, 2014). In such cases, the auditor might be less likely to report any identified breaches (DeAngelo, 1981).

Hope and Langli (2007) view auditor independence as the ability of the auditor to maintain objectivity and resist client pressure. This pressure could be in the form of financial inducements or other means that might influence the auditor to comply with management's desires instead of exercising their professional judgment. This perspective aligns with the code of ethics set forth by the International Federation of Accountants (IFAC, 2000) and The Institute of Chartered Accountants of Nigeria (ICAN, 2009), which define independence as not being controlled by external influences, including financial benefits. The codes further emphasize the importance of the auditor's objectivity in the discharge of their duties.

The major threat to auditor independence is the audit fees received by the auditor for audit and non-audit services. Prior studies contend that high fees paid by a company to its external auditor increase the economic bond between the auditor and the client and thus the fees may impair the auditor's independence (e.g. Frankel, Johnson and Nelson 2002; Li & Lin, 2005). Thus, the concept of auditor independence in the context of this study refers to a state of not being controlled by the management of an entity using any means financial or otherwise.

**Auditor Specialization:** Auditor industry specialization is a major topic in auditing literature. Although studies on auditor specialization are extensive, definition and designation of industry specialized auditor are not clearly agreed upon by researchers. Auditor industry specialization is the auditor's knowledge and experience about a client or an industry. As mentioned, Vivian (2015) auditor industry specialization consist of developing constructive ideas in order to help clients to create added value in addition to provision of approaches and or new actions for some of the subjects that the client is faced with in the relevant industry. To be known as an industry specialist, auditors should know and understand special industrial issues, know the key organizations in that industry, be active in that industry, and be aware of the effectiveness of special industrial issues on different sectors of the industry.

Regarding the designation, most researchers define auditor industry specialists to include the largest supplier in each industry, as well as the second and third largest suppliers in the industry in which readily observable differences existed between the second and the third or between the third and the remaining suppliers. This definition basically takes the within-industry market share approach in which an auditor is considered to be industry specialists if it possesses a significant part of the market shares in that industry.

The importance of industry specialized auditors is attributable to the research findings that auditor industry expertise is associated with better auditor performance and higher audit quality. For better auditor performance, researchers argue that industry specialized auditors produce more accurate and efficient audit. Auditor industry specialization in the context of this study refers to the extent of specialist knowledge of an industry developed through extensive auditing experience, specialized staff training and expensive investment in information technology, by an audit firm.

## 2.2 Theoretical Framework

**Agency Theory:** This study used the agency theory as a theoretical background to develop an empirical framework for examining the effect of external auditor quality on credibility of financial reporting of listed money deposit Banks in Nigeria. Agency theory was developed by Jensen and Meckling about five decades ago.

Agency theory is founded on seven fundamental assumptions: self-interest, goal conflict, bounded rationality, information asymmetry, preeminence of efficiency, risk aversion, and information as a commodity. These assumptions overlap and build on numerous preeminent articles and theories. Agency Theory explains how to best organize relationships in which one party determines the work while another party does the work. In this relationship, the *principal* hires an *agent to* do the work, or to perform a task the principal is unable or unwilling to do. The foundation of agency theory is premised on the assumption that both the principal and the agent are driven by self-interest, leading to inevitable inherent conflicts. Consequently, when both parties prioritize self-interest, agents may pursue their own objectives, which can deviate and conflict with the principal's goals. Despite this, agents are expected to act solely in the best interest of their principals, forming the core of the present research.

Jensen and Meckling introduced a theory regarding how corporate governance is influenced by conflicts of interest among the company's stakeholders, including owners (shareholders), managers, and major debt providers. These different groups harbor distinct interests and objectives.

i. The shareholders want to increase their income and wealth. Their interest is with the returns that the company will provide in the form of dividends, and also in the value of their shares. The value of their shares depends on the long-term financial prospects for the company. Shareholders are therefore concerned about dividends, but they are even more concerned about long-term profitability and financial prospects, because these affect the value of their shares.

ii. The managers are employed to run the company on behalf of the shareholders. However, if the managers do not own shares in the company, they have no direct interest in future returns for shareholders, or in the value of the shares. Managers have an employment contract and earn a salary. Unless they own shares, or unless their remuneration is linked to profits or share values, their main interests are likely to be the size of their remuneration package and their status as company managers.

iii. The major providers of debt have an interest in sound financial management by the company's managers, so that the company will be able to pay its debts in full and on time.

Jensen and Meckling defined the agency relationship as a form of contract between a company's owners and its managers, where the owners (as principal) appoint an agent (the managers) to manage the company on their behalf. As a part of this arrangement, the owners must delegate decision-making authority to the management. The owners expect the agents to act in the best interests of the owners. Ideally, the 'contract' between the owners and the managers should ensure that the managers always act in the best interests of the owners. However, it is impossible to arrange the perfect contract because decisions by the managers (agents) affect their own personal welfare as well as the interests of the owners. This raises a fundamental question. How can managers, as agents of their company, be induced or persuaded to act in the best interests of the shareholders?

Ibikunle (2013) in his study noted that a foundational target of external monitoring mechanisms structures is to reduce this agency problem. As such, a companionship exists between external monitoring mechanisms and financial reporting. Managers in practice may not disclose absolute and detailed information to shareholders. This inherent gap between information available with managers and what is divulged is called information asymmetric which is the nub of the agency theory. In essence, a basic agency theory proposes that due to information imbalances and self-interest, principals have no grounds to fully trust their agents. Consequently, principals will endeavor to address these apprehensions by implementing mechanisms that align the interests of agents with their own and minimize the potential for information imbalances and opportunistic conduct (The Institute of Chartered Accountants in England and Wales, 2005). According to agency theory, audit is a monitoring mechanism that provides reasonable assurance that financial statements prepared by managers are free of material misstatement and therefore protects the interest of stakeholders. Furthermore, in cases where interests of management conflicts with the interests of stockholders and the fact that management compensation often is based on reported earnings and to maximize their wealth, managers have incentives to manage reported earnings and they often have the ability to do (Dang, 2004). The agency problem between stockholders and managers gives rise to the engagement of an auditor who provides independent assurance to corporate stakeholders. Thus, auditing (agent) plays a significant role in enforcing and protecting stakeholders' right (financial reporting credibility) by detecting misstatements and expropriation by managements. For auditors to successfully discharge this responsibility, they need to be independent that is the state of being objective and just. Therefore, the higher the audit quality, the more they detect management's manipulations in the financial statements.

### 2.3 Empirical Review

This section reviews previous research, the techniques, sources and method of data collection, population, sample size and sampling techniques were examined. An attempt is made to critique the literature in order to establish gaps to be filled.

#### 2.3.1 Auditor Size and Financial Reporting Credibility

Khalil (2022) investigates the effect of audit firm size on the quality of financial reporting of banking Industry in Pakistan from year 2011–2018. Multivariate Regression was used, and the result indicates that there is no significant difference between financial reporting quality of banks audited by Big-4 Affiliates and NonBig-4 Affiliates. Khusboo (2021) determined the effect of auditor size on earnings management and substitutability of earnings management strategies using a sample of all Bombay Stock Exchange-listed companies for 10 financial years from 2010 to 2019. The findings suggest significance of Big 4 auditors in constraining all forms of earnings management. Erasmus and Micah (2021) ascertain the relationship between audit quality indicators 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 indicate that audit firm size had positive and significant impact on Tobin's Q. Mohammad and Ahmed (2017) examined the effect of large audit firms on financial reporting quality from sample of firms of Bursa Malaysia. The findings revealed that large audit firms do not have any significant effect on financial reporting quality. Idris, Abu Siam and Ahmad (2018) explore new evidence on the nature of the relationship between the external auditor size and earnings management in one of the emerging economies, Jordan. For this purpose, a panel data consisting of 64 industrial firms listed on Amman Stock Exchange (ASE) is used, covering the period between 2009 and 2014. Results show that a positive interaction effect of external auditor size and audit committee effectiveness on earnings management is found, which is supportive of the substitute relationship between the external auditor size and effective audit committee in reducing earnings management.

Qawqzeh et al. (2020) investigated the influence of the external auditor's size 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 the auditor size has an insignificant impact on FRQ. Jerry and Saidu (2020) examined the impact of audit firm size on financial reporting quality of listed insurance companies in Nigeria. Data were collected from the annual reports and accounts of thirteen sampled insurance companies out of thirty-three listed insurance companies on Nigerian Exchange Group (NGX) for the period of eight years (2008 to 2015). Findings revealed that audit firm size has a positive and significant impact on financial reporting quality. Sumiadji et al. (2019) test the effect of audit quality on earnings quality. Data consisted of 116 annual data of manufacturing companies listed in the Indonesia Stock Exchange within 2011-2014. Their results showed that earnings quality is formed by the attributes of persistence and predictability. Research results showed that auditor size has effect on earning quality. Tyokoso et al. (2016) examined the effect of audit firm size attributes 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 panel multiple regression technique. The result of Hausman specification test suggests that the fixed effect regression model is most appropriate for the dataset. The result showed that audit firm size reduces the credibility of financial reporting of the firms at 1% level of significance.

### 2.3.2 Auditor Independence and Financial Reporting Credibility

Erasmus and Micah (2021) ascertain the relationship between audit fee (independence) 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 shows that audit fees have negative and insignificant impact on Tobin’s Q.

Khusboo and Singh (2021) determined the effect of audit independence on earnings management and substitutability of earnings management strategies using a sample of all Bombay Stock Exchange-listed companies for 10 financial years from 2010 to 2019. The findings revealed that auditor independence is found to be aiding quality of earnings through accruals, thus impairing earnings management practice of managers. Qawqzeh et al. (2020) investigated the influence of the external auditor's independence 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 auditor tenure has significantly a negative impact on FRQ. Hasan, Kassim and Hamid (2020) examined the moderating effect of audit independence and audit committee on financial reporting quality in Malaysian companies. The results show that financial accounting expert independence indicates significant results with real EM. The findings also show that audit independence and audit committee have a significant role in restricting the real EM. Audit independence is found to significantly moderate the relationship between audit committee with financial reporting quality.

Ikpantan and Daferighe (2019) conducted a study to evaluate the impact of audit independence on the financial reports of Deposit Money Banks (DMBs) in Nigeria. The researchers used purposive sampling to select ten (10) deposit money banks, and the study covered a 14-year period, resulting in 140 observations. Data were extracted from the published annual reports and accounts of the banks. They utilized Pearson Product-Moment Correlation and Linear multiple regressions for data analysis. The findings revealed a weak yet significant relationship between audit fees, representing auditor independence, and the amount of discretionary accruals in Nigerian deposit money banks.

Tyokoso et al. (2016) investigated the effect of audit independence attributes on earnings management in listed oil marketing companies in Nigeria. They obtained secondary data from nine companies listed on the Nigerian Exchange Group (NGX) during the period 2009 to 2014 and analyzed it using panel multiple regression technique. The results indicated that auditor independence and the interaction between audit committee financial expertise and auditor industry specialization were negatively and significantly associated with earnings management in the firms at a 5% level of significance.

Sunday (2019) examined the relationship between auditors' independence and the quality of corporate financial reporting in Nigeria. The study collected data from annual reports of listed manufacturing companies from 2013 to 2017. The findings showed a significant positive relationship between audit client size and the quality of financial reporting. Additionally, the study found a significant negative relationship between auditor status, such as being one of the big 4 audit firms, and the quality of financial reporting.

Fossung et al. (2019) investigated the contribution of external audit independence in enhancing the quality of accounting and financial information produced by unlisted companies in Cameroon. The study used a survey of 52 employees of companies in Cameroon, and both Linear regression and ANOVA were employed for analysis. The results indicated that the auditor's mandate duration and reputation significantly influence the quality of accounting and financial information.

Tontiset and Kaiwinit (2018) examined the antecedents of financial reporting reliability in Thai-listed companies. The study used a sample of listed companies on the Stock Exchange of Thailand (SET). The results demonstrated that audit firm independence has a positive and significant effect on financial reporting reliability.

Chinedu et al. (2020) examined the effect of auditor’s independence on financial performance of listed manufacturing firms in Nigeria from 2006-2016. Ordinary Least Square method of regression was employed, and the findings revealed that auditor’s independence has a positive and significant effect on financial performance of listed manufacturing firms. Paydarmansh et al. (2014) examined the effect of independent audit quality on the quality of financial disclosure in Tehran Stock Exchange. This study is ranged from 2008 to 2013 and the results demonstrated that there is no relationship between audit fee incomes of the audit firm to quality of information. Hsiao, Lin and Yang (2012) conducted an empirical analysis of the effect of audit fee (independence) on financial reporting fraud and found no significant relationship between reporting fraud and fees paid to auditors for various services.

### 2.3.3 Auditor Specialization and Financial Reporting Credibility

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 a positive impact on FRQ.

Mohammed and Ahmed (2021) examined the effect of audit firm specialization on financial reporting quality from sample of firms of Bursa Malaysia. The findings revealed that industry leadership/specialization has significant impact on financial reporting quality. 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 that audit specialization had negative and significant impact on Tobin’s Q.

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 sample of 52 employees of companies in Cameroon was used, while both linear regression and ANOVA were used for the analysis. The results indicate that the auditor’s 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 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. Paydarmansh et al. (2014) examined the effect of independent audit specialization on the quality of financial disclosure in Tehran Stock Exchange. This study period ranged from 2008 to 2013 and the results demonstrated that there is no relationship between auditor industry specializations and quality of accounting information.

Sumiadji et al. (2019) tests the effect of audit firm specialization on earnings quality. Data consisted of 116 annual data of manufacturing companies listed in the Indonesia Stock Exchange within 2011-2014. Their results showed that audit specialization does not have significant effect on earnings quality of firms. Esezobor and Esther (2020) assessed the impact of audit quality attributes on financial reporting quality in Nigeria. A sample of 10 banks and 4-year observations from the period of 2015-2018 were used. The study concludes that audit quality attributes are significant in improving the financial reporting quality of some selected commercial banks in Nigeria during the period covered by the study

## 2.4 Gap in Empirical Review

The review carried out revealed an inconsistency in measurement of the variables. Another worrisome aspect is the inconsistency in the findings from the studies reviewed. The study period examined by the studies covers time period that some are not current and findings from that research may have been overtaken by events.

Previous studies have examined some specific auditor quality variables which have influence on financial reporting quality. This study is, however, unique because variables such as audit size, auditor independence, auditor tenure, and auditor specialization are examined against the credibility of financial reporting of banks. Most studies such as Yusuf (2016), Vivian (2015) concentrated only on non-financial sector because of the peculiarity of the financial sector in measuring financial reporting quality. Furthermore, studies of this nature were mostly conducted in developed countries, however, the few conducted in Nigeria and other countries either combined both financial and non-financial sectors together using a single model which may not be applicable to banking sector. Therefore, attempt is made to bridge the gap by investigating only financial sector in Nigeria most especially the most vibrant sector (Deposit Money Banks) which drives the Nigeria’s economy.

In view of the above, it is needful to conduct a study with a vision of filling these gaps identified in the literature. This study examines the effect of external auditor quality on credibility of financial reporting of listed commercial banks in Nigeria.

## 3. Methodology

### 3.1 Research Design

The study adopted the ex-post facto research design. The design is considered appropriate because it helps to determine the effect of auditor quality on credibility of financial reporting which permits prediction.

### 3.2 Area of Study

The study is conducted in Nigeria and with reference to deposit money banks listed on Nigerian Exchange Group (NGX) on or before year 2012 and still remain listed as at December 31, 2021. The study covers 10 years.

### 3.3 Sources of Data

Secondary source of data was used to gather data in relations to the variables of the study for the purpose of analysis.

### 3.4 Population of the Study

The study population covers all the twenty-three (23) Deposit Money Banks as at December 31, 2021. Out of the 23 banks, the study used a sample size of sixteen (16) deposit money banks listed on the Nigerian Exchange Group (NGX) as at December 31, 2021 for the purpose of data analysis

### 3.5 Determination of Sample Size

The sample size of this study was determined by three criteria:

1. Deposit money banks that have been listed on the floor of Nigerian Exchange Group (NGX) on or before year 2012
2. Deposit money banks that are still in operation and still remain listed on the floor of Nigerian Exchange Group (NGX) as at December 31, 2021
3. The banks must have their financial reports up to date and fully available in the public domain

### 3.6 Method of Data Collection

Data were extracted from the Published Audited Annual Reports and Accounts of the selected banks for a range of ten (10) years. Selection of this period is considered imperative because the period under review has witnessed clamor and outcry for sound and credible financial reporting. In addition to this, the period coincides with the period in which all the banking sector adopted were expected to fully prepare their financial reports based on International Financial Reporting Standards (IFRS).

### 3.7 Method of Data Analysis

Generalized Least Square was used in the estimation process. The study adopted Chang, Shen and Fang (2008) model to proxy financial reporting credibility. The choice of the model is premised on its suitability and applicability in the financial sectors (Farouk, 2018). The residual from these models is used to represent financial reporting quality in the second regression.

### 3.8 Model Specification

The model for the dependent variable which represents financial reporting credibility is presented below.

$$DLLP_i / TA_{t-1} = LLP_{it}/TA_{t-1} - \{\alpha_0 \; 1/TA_{t-1} + \alpha_1 \; LCO_i/TA_{t-1} + \alpha_2 \; BBAL_i/TA_{t-1}\} \text{ ......... } \textit{Model 1}$$

**Where** DLLP = Discretionary loan loss provision**,** LLP = Loan loss provision**,** LCO = Loan Charge-off**,** BBAL = Beginning Balance of loan loss**,** $TA_{t-1}$ = Lagged Total Assetsand$\alpha_0$ = Constant.

**Parsimonious Model of the Study**

$$FRQ_{it} = \beta_{0it} + \beta_1 AS_{it} + \beta_2 AI_{it} + \beta_3 AT_{it} + \beta_4 ASP_{it} + FZ\ \mu_{it} \ldots\ldots \text{Model 2}$$

Where:

FRC = Financial reporting quality, AS = Auditor Size, AI = Auditor Independence, AT = Auditor Tenure, ASP = Audit Specialization, FZ = Firm Size, $\beta_1$ –$\beta_4$ = Coefficient of explanatory variables, $\beta_o$ = Constant, μ = Error Term and it = Firms and Time

## 4. Data Presentation and Analysis

This section covers the preliminary analysis of data using descriptive statistics and correlation analysis. This is followed by the presentation and interpretation of regression result.

### 4.1 Data Presentation

**Table 1: Descriptive Statistics**

| Variables | Min | Max | Mean | Std. Dev. | Swilk |
|---|---|---|---|---|---|
| FRQ | 0.000097 | 0.101 | 0.007 | 0.018 | 0.00000 |
| AS | 0.000 | 1.000 | 0.593 | 0.492 | 0.99977 |
| AI | 0.012 | 7.301 | 0.499 | 1.191 | 0.00000 |
| AT | 1 | 3 | 2.587 | 0.694 | 0.00002 |
| ASP | 0 | 1 | 0.181 | 0.386 | 0.06099 |
| FZ | 0.069 | 2.749 | 1.549 | 0.624 | 0.00006 |

Source: Descriptive Statistic from STATA 13

Table 4.1 shows that earnings management has mean a value of 0.007 for the money deposit banks used within the study period. This implies that most of the banks have a minimal earnings management and as such high credibility of financial reporting. Auditor size has a mean of 0.593 which is closer to one and thus implies that on average, majority of banks engaged one of the big four as their external auditors. Also, the auditor independence has an average value of about 0.50. This shows that about 50% of the auditor engaged by the banks could be deemed to be independent. The auditor tenure stood at an average of 2.58 for all the banks implying that most of the external auditors engaged by the banks have stayed beyond two years. The auditor specialization has an average of 0.181, indicating that, on the average, most of the auditors audit only about 20% of the entire banks in Nigeria implying less specialist within the sector.

**Table 2: Correlation Matrix**

| | FRQ | AS | AI | AT | FZ | ASP |
|---|---|---|---|---|---|---|
| FRQ | 1 | | | | | |
| AS | -.3638* | 1 | | | | |
| AI | .4207* | .2655* | 1 | | | |
| AT | -.1954* | .1456 | -.0886 | 1 | | |
| FZ | -.7989* | .3065* | -.6096* | .2100* | 1 | |
| ASP | -.0478 | .2240* | -.2155* | -.0413 | .3111* | 1 |

Source: Correlation Matrix from STATA 13
*. Correlation is significant at 0.01 and 0.05 level (2-tailed)

Table 2 indicates that financial reporting quality is about 36% inversely correlated with auditor size. Audit independence is 42% positively and significantly correlated with credibility of financial reporting of money deposit banks in Nigeria. The relationship between audit tenure and credibility of financial reporting is negative and significant. However, auditor specialization recorded about less than 5% negative but weak association with credibility financial reporting of banks. Furthermore, the magnitude of correlation between firm size and credibility of financial reporting is negative and significant implying inverse correlation between the two variables.

To establish absence of harmful multicollinearity, the variance inflation factor (VIF) and tolerance test revealed a consistent smaller than ten and one value respectively, which implies no threat to the validity and inferences to be drawn (Cassey & Anderson, 1999).

Heteroscedasticity test result showed a significant probability value of 0.0000 which indicate that heteroscedasticity was present. Normality test of error term result obtained from the kernel density test indicates a non-tolerable result. The outcome from this test necessitated the estimation of Generalized Least Square. Hausman specification test conducted suggested the interpretation of Random Effect.

### 4.2 Data Analysis

**Table 3: Summary of Regression Result (Random Effect)**

| Variables | Coefficient | Z-Statistics | Prob. Value | Cumulative Results |
|---|---|---|---|---|
| Constant | 17.717 | 15.65 | 0.000 | |
| AS | -0.0228 | -7.00 | 0.000 | |
| AI | -0.00002 | -0.19 | 0.852 | |
| AT | 0.00233 | 1.74 | 0.082 | |
| ASP | 0.02413 | 6.41 | 0.000 | |
| FZ | -0.00485 | -1.10 | 0.273 | |
| $R^2$ Within | | | | 0.3904 |
| $R^2$ Between | | | | 0.2389 |
| $R^2$ Overall | | | | 0.2891 |
| Wald $Chi^2$ | | | | 91.34 |
| Prob> $Chi^2$ | | | | 0.0000 |

Source: Result output from STATA 13

The cumulative $R^2$ of 0.2891 signified that only 28.91% of the total variation in financial reporting quality of listed commercial banks in Nigeria is accounted for by auditor size, auditor independence, auditor tenure, auditor specialization and total assets.

The Wald Chi$^2$ value of 91.34 which is significant at 1% level indicates that audit quality and financial reporting quality model is fit. It implies that for any change in audit quality of listed banks in Nigeria; their financial reporting quality is affected directly. The probability values of the F-statistics implies that there is a 99.9 percent probability that the relationship among the variables (dependent and independent) are not due to mere chance and as such the independent variables reliably predict the dependent variable of the study.

### 4.3 Test of Hypotheses

Auditor size has significant but negative effect on credibility of financial reporting of listed money deposit banks in Nigeria. There is sufficient evidence therefore to reject null hypothesis one of the studies.

Auditor independence has insignificant and negative effect on credibility of financial reporting of listed money deposit banks in Nigeria. In line with this, there is evidence to fail to reject null hypothesis two of the study.

Audit specialization has positive and significant effect on financial reporting quality and therefore gives enough evidence to reject the null hypothesis three of the study.

### 4.4 Discussion of Findings

From the Table 3, auditor size result signifies a significant but negative effect on credibility of financial reporting of listed deposit money banks in Nigeria. This implies that when big four auditor firm is used, it is not a guarantee for improved credibility of financial reporting or manipulation of financial reporting in banks.

Auditor independence has insignificant and negative effect on credibility of financial reporting of listed money deposit banks in Nigeria. This implies that for every increase in the level of auditors' independence, their earnings management insignificantly increases by the coefficient value.

Audit tenure has significant and positive effect on credibility financial reporting. This connotes increase in the credibility of financial reporting due to increased auditor tenure in listed money deposit banks in Nigeria. This result is expected because when external auditors stay longer in an organization, they become more familiar and tend to understand the organization better which may eventually lead to enhance the credibility of financial reporting.

Audit specialization has positive and significant effect on credibility financial reporting which implies that for every increase in the specialization of auditors, there will be a significant decrease in the level of earnings management of listed money deposit banks in Nigeria. This output is not surprising because the more specialized an auditor becomes, the more s/he gets used to the various techniques through which earnings management could be perpetrated and as such could assist the firms in covering those anomalies.

## 5. Summary

### 5.1 Summary of Findings

Auditor size, tenure and specialization have significant effect on the credibility of financial reporting of listed deposit money banks in Nigeria except for auditor independence. Amongst the significant variables, only size has negative effect on financial reporting quality while auditor tenure and auditor specialization help increase the financial reporting quality of banks.

## 5.2 Conclusion

Following the findings from the study, conclusions are reached as follows:
Banks that employ the service of the big4 audit firms do not guarantee that financial reporting would not be manipulated or reduction in earnings management because of their size and the reputation they have built over the years. Every increase in the level of auditor independence leads to a decrease in the banks' financial reporting quality. An increase in the tenure of auditors results in increase in financial reporting quality. Auditor industry specialization increases lead to a significant increase in the level of financial reporting of listed commercial banks in Nigeria.

## 5.3 Recommendations

Based on the conclusion, the study proffers the following recommendations. Management/Regulators and policy makers should ensure that:

i. To enhance the quality of earnings, the listed deposit money banks in Nigeria should not only engage the services of the big4 auditor.

ii. Audit fee should be increased to guarantee the independence of the auditors in order to carry out their audit function without undue influence.

iii. Auditor tenure should be elongated as longstanding auditors become more familiar and tend to understand the banks better which will eventually lead to increased credibility of financial reporting.

iv. Auditors who specialize within that same industry are engaged to carry the auditing of the organization to ensure financial statement free of errors and misstatement.

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