AUDIT REPUTATION AND INDEPENDENCE INFLUENCE ON THE MARKET VALUE OF FIRMS IN NIGERIA

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ABSTRACT

This study examined the effect of audit reputation and independence on the market value of listed companies in Nigeria. Audit reputation was explained by Audit Firm Size (AFS), and audit independence was explained by Audit Opinion (AOP) while market value was proxied by market Price per Share (MPS). Expost facto design was adopted for this study. The requisite data were obtained from the audited financial statements of 47 listed non-financial companies for a period of 12 years (2004-2015) giving rise to 564 company-year observations. Multiple linear regression analysis, particularly, the Ordinary Least Squares (OLS) method was used to analyze the data. The results indicated that audit quality; specifically, AFS and AOP has significant positive effect on market value of non-financial companies listed in Nigeria We therefore conclude that, audit quality significantly relates with market value and substantially affects the market value of listed non-financial companies in Nigeria positively. Hence, we recommend that the regulatory bodies should endeavour to do their supervisory task well by ensuring that audit reports/opinions reflect the true state of the financial statements especially where it is audited by the Big-4 auditors so as to justify their reputation. Again, auditors should be independent when issuing an opinion as the type of opinion issued seems to have an impact on a sensitive aspect of a corporation such as its value in the market.

Key Words: Audit Independence, Audit reputation, Market value, Audit quality.

1. Introduction

One major role of the auditing profession is to ensure that they give reasonable assurance to various users of financial statements as it relates to their reliability and credibility. But this seems futile as several cases of corporate financial scandals in Nigeria like Cadbury Nigeria Plc, African Petroleum, Lever Brothers Nigeria Plc and Nampak (Odia, 2007; Okolie & Agboma, 2008; Adeyemi & Fagbemi, 2010; Okolie & Izedonmi, 2014) have posed a great challenge on the credibility of audit reports since these cases resulted from audited financial statements where the auditors failed to detect and report financial misstatements and manipulations. Hence, investors and other corporate financial reporting stakeholders seem to be so disappointed and this is capable of affecting their economic decisions negatively.

What could be the reason(s) for such perceived audit failure that has impacted negatively on the value of client's stock? The view of some studies is that, such perceived audit quality failure can be traced to the auditors' lack of independence (Nasution, 2013). Another possible cause of perceived reduction in audit quality can be traced to a threat of replacement that might instill fear of losing the reputation that the audit firm has built over the years in form of size and market gain. However the question remains: how has audit reputation in form of size and audit independence in form of the type of audit opinion issued affected the market value of companies listed in Nigeria? In addition, considerable number of researches (Lin, Liu & Wang, 2007; Hsien & Hua, 2011; Marjolein, 2011; Morteza, 2014) has been conducted to analyze audit quality. In spite of this growing literature on audit quality internationally, it is observed that most studies have centered on the determinants of audit quality with few studies focusing on audit quality as it affects or impacts on corporate performance, valuation and market reaction.

Hence, this current study is an empirical investigation on the impact of audit reputation and independence on the market value of firms listed in Nigeria and consequently, advises policy makers appropriately on what to invest attention. This research area will also enhance the stock of extant literature on audit quality in Nigeria.

2. Concept of Audit Quality

Audit quality can be termed as a complex and multi-faceted concept as it has been challenging to conceptualize it in the past. In spite of the numerous attempts to conceptualize 'audit quality' it has remained difficult to achieve a definition that has gained universal recognition and acceptance (Beattie, Fearnley & Hines, 2010; Okolie, 2014). Again, the perception of audit quality may also depend on individuals as the various stakeholders such as shareholders, creditors, and other users of the financial statements may have different interpretations to audit quality. However, the model definition of audit quality by De Angelo (1981) that audit quality is the market –assessed joint probability that a given auditor will both detect material misstatements in the client's financial statements and report the material misstatements has been cited by most audit researchers. From this definition of audit quality, we can deduce that audit quality has to do with the ability of the auditor to detect material misstatements and report the errors. This then means that De Angelo's view of audit quality is in two perspectives. The first dimension is the detection of financial misstatements omissions and errors in financial statements; this is said to measure the technical capability of auditors. The second dimension is centered on reporting a discovered fissure. This also measures auditor's independence. The auditor must be independent as it is an important attribute that can reduce the existence of information asymmetry. In track with this view, Ali, Reza and Mahdi (2009) posit that the auditor's professional opinion will be of little or no value to financial statement users if they have the feeling that the auditor is not absolutely independent of management.

However, this study views audit quality as the capability of the auditor to detect material misstatements and report same in a way that will affect stakeholders' level of assurance and confidence in the credibility and reliability of the financial statements. This ability of the auditor to spot material misstatements and report the identified errors and omissions is dependent on the audit firm reputation and independence.

3. Concept of Market Value

Market value has various meanings. Some definitions include that of Evans and Evans (2007) which views market value as the price that is paid by a motivated buyer after a property has been exposed to a market place where equally capable buyers exist with each having full information about the property and the market place and not operating under any form of influence. According to Campbell (2012) market value is first, the price which a security is traded and could possibly be purchased or sold and again, it is seen as what investors consider being what a firm is worth; this is computed by multiplying the current market price of a firm's shares by the number of shares outstanding. Scott (2003) sees market value securities as the price at which they are currently trading.

Various variables for market value of firms have been used by researchers across the globe (Okolie, 2014; Henri & Ane, 2013). However, this study adopts Market Price per Share as a measure of market value.

4. Audit Quality and Firm Value

Firm value is the entire value of the company's stock (Lawani, Umanhonlen & Okolie, 2015). In the view of Muhibudeen (2015), a business can be valued in different ways depending on the situation; which may include the; economic value, accounting value and market value. Our concern is the market value that denotes the value of a firm in the stock exchange market. This form of firm value is based on trade and the beliefs of investors that the accounting figures in the financial statements contain relevant and credible information as they are duly audited. Consistently, Mukhtaruddin, Relasan, Bambang, Irham and Abukosim (2014) assert that, high stock price makes the value of the firm high. Even though, high value indicates wealth yet, share prices should not be too high or too low but should rather be optimal.

Hogan (1997) argues that audit quality is capable of affecting IPOs (initial public offers) pricing when they view the value of the firm's share price from audit quality perspective. This is in accordance with the view of Ghosh (2007) that audit quality influences firm value. Wibowo and Rossieta (2010) emphasize that high audit quality is professed to be a major factor that contributes to market efficiency of any economy. Similarly, Taqi (2013) argues that while audit failures cause a waning in firm value, a high audit quality rather impacts positively on firm value. Jusoh and Ahmad (2014) are also of the assertion that audit quality is capable of influencing the value of firms positively. Therefore, where audit quality becomes questionable and threatened, the value of firms audited by such a firm decreases as well and this result in, such companies withdrawing the services of such audit firm. This was the situation with once a time renowned accounting firm "Arthur Andersen" (Ali, Reza & Mahdi, 2009). In spite of these assertions about the importance of audit quality on the market value of firms, this study had to lay emphasis on the effect of each of the audit quality surrogates as used in the study on the market value of firms.

i. Audit Firm Size and Market Value

Audit firm size is explained as whether a firm's financial statement is audited by a large or small audit company. Where a firm is audited by a large audit firm referred to as the Big-4 auditors, there is this confidence that the financial statements are presenting a true and fair view (De-Angelo 1981) consequently, investors based their decisions on the report by Big-4 auditors that are perceived to possess quality. It was based on this that Taqi (2013) argues that a high audit quality by Big-4 auditors affects the value of the firm positively. Prior to Taqi (2013) assertion; Aber, Hysen, Skender and Arben (2012) are of the view that, Big-4 auditors have positive effect on the stock prices of firms audited by them.

The type of auditor that audit a firm financial statements sends signals to the market as most investors and prospective investors believe that these Big-4 auditors have experience, prestige and reputation as such audit with much care and high quality bearing in mind that any undetected misstatement and manipulations that eventually have any adverse effect on the client's company is capable of destroying their reputation. So, investors are confident that the audit by these highly reputable auditors is more effective in curbing earnings management, manipulations and creative accounting. This in turn leads to increased value of the Big-4 auditor client's firms in the market (Lin, liu & Wang 2007). Hussainey (2009) is also of the view that investors have high future earnings anticipation where the firm in which they have investment is audited by a Big-4 auditor because of the value that an audit by such prestigious audit firm gives to its client's shares in the market thereby leading to huge earning returns.

Other researchers like Ahsan Haiyan and Donghua (2014) Marjolein (2011), and Mohammed (2012) are of the opinion that these quality audit firms does not really perform quality audit but that it is a perception because they are well known and have gained reputation hence audit by them does not provide any additional benefit to the client's value in the market. In essence, where investors (market) believe in quality by the big-4 audit firm we can infer that the share value of firms audited by them will certainly be positively affected and vise-versa when audited by a non-big-4 audit firm. This can be supported by a common saying that says “show me your friend and I will tell you who you are” hence, where a big-audit firm that is reliable and possesses reputation and credibility is the auditor, there is every possibility that the financial statement will be credible and reliable thereby, attracting more value to the client's firm.

ii. Audit Opinion Type and Market Value

Firth (1978) purports that audit opinion has a signaling effect on the market value of firms as such, states that the type of audit opinion impacts greatly on the share prices of firms. Abern Hysen, Skender and Arben (2012) opinion is not far from Firth (1978) as they also assert that audit opinion have impact on stock prices; the nature of opinion determines the effect, if the opinion is qualified it is capable of sending bad signals about the company to the market but share prices eventually rises where an auditor states an unqualified opinion that, the firm's financial reports and statements are presenting a true and fair view. The unqualified audit opinion also makes the market to see such company with a form of 'standing well' thereby, causing a rise in the demand for the shares of that company (Robu & Robu, 2013).

Some authors are of the view that audit opinion has no effect on the prices of shares in the stock market and that the type of audit opinion about the financial statements of a firm is only a write up to the firm's management thus, makes no meaning to investors in the market but that investors have other things to look out for in a firm in determining its value (Moradi, Salehi, Rigi, & Moeinizade, 2011). To Tahinakis, Mylonakis and Daskalopoulou (2010), audit opinion is not only meaningful to investors but opines that the Audit report in itself have limited informational content that is proficient enough to influence investors' decision on what shares to buy. This investors' decision on what shares to buy is capable of affecting the share prices of firms and this effect on share prices is hence not dependent on the type of audit opinion as audit report in itself is not informative enough, therefore Al-Thuneibat, Khamees and Al-fayoumi (2008) opined that audit opinion cannot send signals to the market much more of affecting share prices of companies with either a clean or an unclean audit opinion.

From the above, we can deduce that firm market value is greatly dependent on audit quality. Therefore, it is of a necessity that audit quality be improved to enhance the credibility of financial information contained in the financial statements, and consequently, send signals to the market regarding the value of a particular or specific firm.

5. Theoretical clarification

The paper builds on signaling theory. Signaling theory was formulated by Michael Spence in 1973 (Connelly, Certo, Ireland & Reutzel, 2011). Signaling theory explains how managers may communicate additional information about their company and their own behavior to the market. This theory submits that, companies that have good performance use their audited financial information to send signals to the market. A high audit quality is capable of sending signals about the credibility of the financial statements in the market. Again, this theory postulates that the market price of the company's share is influenced by the perception of the market on the audit quality in the company. Similarly, Xin, Andre, Elaine and Hong (2008), opined that audit quality signals a company's value in the market.

6. Methodology

This study adopts an ex-post facto research design with the population covering the entire non-financial companies listed on the Nigerian Stock Exchange (NSE) that remained listed as at the year ended 31st December, 2015. This brings the study population to a total of 130 companies. The study covers a 12-year period from 2004 – 2015. This period was chosen to account for both the boom and fall periods of the Nigerian capital market. It has also reviewed the annual reports and accounts of forty-seven (47) non-financial companies listed on the Nigerian Stock Exchange making a total of 564 firm-year observations of the listed non-financial firms in Nigeria. The choice of the non-financial sector was to let go the financial sector due to the numerous reforms and other issues that seems to currently account for the value of the Nigerian financial sector hence including it in the study might not allow for accurate result.

Also, the requisite data on the firm value were extracted from the published daily share prices from the Nigerian Stock Exchange. Descriptive statistics, correlation and regression analysis were used to analyze panel data obtained for the study. Multiple regressions using the ordinary least square (OLS) method was adopted for the analysis. Hence, the following null hypotheses are formulated.

Research Hypotheses

Ho_1: Audit Firm Size (AFS) has no significant effect on the market value of Nigerian listed non-financial companies

Ho_2: Audit Opinion (AOP) has no significant effect on the market value of listed non-financial companies in Nigeria.

Variables Identification and Definitions

Table 1: Variable Definition

Variables	Definition
Dependent:	
MPS	The price per share of a company stock at the end of the year (last trading day)
Independent:	
AFS	Assume "1" if company is audited by any of the Big 4 and "0" if otherwise
AOP	we assume '1' if opinion is unqualified (clean report) and '0' if opinion is qualified (unclean report)

Source: researcher's definition

The model for the study is hereunder presented

$MPS = f(AFS, AOP)$

Using the multiple regression analysis technique, this model was reconstructed for the study as follows:

$$MPS_{it} = \beta_0 + \beta_1 AFS_{it} + \beta_2 AOP_{it} + e \ldots\ldots\ldots\ldots i$$

Where;

f = Function of; MPS = market price per share; AQ =Audit Quality; AFS = Audit Firm Size; AOP = Audit Opinion; β_o = the constant; β_1, β_2 = the regression coefficients

e = the error term

7. Data Analysis and Discussion

This section presents the result from the descriptive statistics, correlation and regression analysis in Tables 2 to 4 as follows.

Table 2. Descriptive Statistics

Variables	N	Min	Max	Mean	Std. Dev.
AFS	564	0.0	1.0	65.98	47.42
AOP	564	0.0	1.0	92.65	26.12
MPS	564	0.22	1200	98.41	76.76
N	**564**				

Source: Extract from Results Analyzed via SPSS v 21

Table 2 indicates that the mean of MPS is 98.41 with a fluctuation of about 76.76; this indicates that non-financial companies listed in Nigeria operate at a mean market value of ₦98.41 with likely variations of about ₦76.76k. The fluctuation is lower than the mean value implying that the MPS of the companies under study is high.

AFS has a mean value of 0.66 with a standard deviation of 0.47. AFS of about 66 percent indicates that, about 70 percent of the companies covered by the study are audited by the Big-4 audit firms. The standard deviation of 0.47 is an indication that there is a considerable collection of firm choices around the Big-4 and that most companies studied here are audited by Big-4 with low variation of only 0.47 of companies not audited by Big-4 auditors. AOP also presents a mean value of 0.93 and a standard deviation of 0.26; this shows that over 93 percent of companies in this study obtained a clean (unqualified) audit report with a mild variation of 25 percent suggesting a considerable clustering of AOP around the mean. We therefore assume that there is a possibility that the result will affect the market value as clean audit report is supposed to give a signal of good financial position to the market.

Correlation Result

Table 3. Correlation Analysis of the Study Variables

Variables	MPS	AFS	AOP
MPS	1.000		
AFS	0.425***	1.000	
AOP	0.118***	0.417***	1.000

Source: Based on Field data
*** = Significant at 5%

Table 3 presents the relationship between the variables of the study. The result shows a very low correlation amongst variables generally; indicating that there is no problem of high correlation among variables. The result further shows a positive correlation between the dependent variable (MPS) and independent variable (AFS and AOP). This positive correlation shows a strong relationship between the dependent variable and AFS, AOP. These strong relationships are significant at 1 percent. It is therefore pertinent to conclude that there is a strong relationship between audit quality and market value.

Regression Analysis

Result of regression analysis is presented in Table 4. as follows:

	β	t-test	P-Value
Constant	0.196	1.742	0.082
AFS	0.426	11.470	0.000
AOP	0.122	3.281	0.001

$R=0.442^a$, $R^2=0.196$, $AR^2=0.193$, $F(2,562)=70.845, p=0.000$

a Predictors: (Constant), AOP, AFS

Source: Results of Analysis via SPSS v 21

Table 4 presents the summary result that shows a relationship between AQ and MPS. This result shows a relationship between them. The table shows that there is a moderate positive relationship of 44.20 percent between AQ and MPS. An R^2 of 0.20 also shows that 20 percent of the variations in MPS can be explained by the variability in AFS and AOP while about 80 percent is accounted by factors outside this study. The result of the regression indicates that other factors than AQ contribute to most of the variations in the market value of firms, here represented by MPS. These other factors may be the size of the organization itself, its capital structure, liquidity, profitability, government interference (law), SEC and CBN guidelines amongst others may have an effect on the market value of firms in Nigeria.

The result also indicates that if AQ is not a factor to consider in the value of firm, MPS will significantly increase by ₦19.60k occasioned by factors outside this study. The result also indicates that if a company is audited by a Big 4 audit firms, it will significantly cause an increasing effect on the MPS by 42.6 percent. We therefore, infer that since the Big- 4 audit companies are well known and have gained reputation for audit quality; an audit by them will impact on the market value (MPS) of companies audited by them. Likewise, an increase in AOP will significantly increase MPS by 12.2 percent. This means that more of unqualified audit opinion will consequently increase market price per shares.

Test of Hypotheses

Using the t-values and p-values produced by SPSS output the formulated hypotheses were tested in this section and are presented as follows:

Ho_1: Audit Firm Size (AFS) has no significant effect on the market value of Nigerian listed non-financial companies

Table 4 presents the result for testing this hypothesis. It shows that t-cal. for AFS is 11.470 with P-value of (p=0.000). The t-cal. is greater than t-critical and the p-value is less than 0.05. This means that AFS has a significant effect on the MV of Nigerian listed non-financial companies. We therefore reject the null hypothesis.

Ho_2: Audit Opinion (AOP) has no significant effect on the market value of listed non-financial companies in Nigeria.

Table 4 again presents the result of the test of this hypothesis. Here, we found the value of t calculated for AOP to be 3.281 with a P-value of 0.001 meaning; the t-calculated is greater than t-critical and the p-value is less than 0.05 ($1.96 < 3.281$ and $0.001 < 0.05$). Therefore, the null hypothesis is hereby rejected which implies that AOP has a significant effect on MV of non-financial firms listed in Nigeria.

The result of the test of hypotheses for this study presents a one-way result where all the null hypotheses are rejected. By implication, we can say that AQ proxied by AFS and AOP have a significant impact on MV of the listed non-financial companies in Nigeria.

Discussion of Findings

On the strength of the regression result and analysis thereupon, it can be inferred that all the independent variables significantly affect the market value of listed non-financial companies in Nigeria with the impacts in one direction.

Discussion of Findings on Audit Firm Size (AFS) and Market Value

AFS (Audit Firm Size) shows that if all the other variables are held constant and there is an addition of one more unit to AFS, it will cause a significant positive effect of about 43 percent on market value. That is, an audit by the Big-4 auditors results in higher impact on the MV of firms audited by them. This finding tends to follow the assertion by De Angelo (1981) that big audit firms have less incentive to behave opportunistically and since they are more wealthy and possess more valuable reputation which they are assumed to guard; hence, they ensure audit quality. Having said that, stakeholders appear to believe that, large audit firms perform better and therefore assuring higher audit quality. Thus, this presumed audit quality by the Big-4 auditors as per our findings has an influence on the price of shares in the market. Some researchers such as Imhoff (1988) are however of the opinion that the large auditor firms do not really possess audit quality but perceived quality due to their reputation. Whether it is a real or perceived audit quality, our finding shows that an audit by the Big-4 audit firms sends signals to the market and further positively influence the market price per share of non-financial companies listed in Nigeria. This finding is consistent with the findings of Okolie (2014), Ardiana (2014) and Jusoh and Ahmad (2014) but differs from the findings of Shah-hosseini (2014), Marjolein (2011), Mohammed (2012) and Ahsan, Haiyan and Donghua (2014) who find that AFS has an adverse effect on market value. This difference in findings may be as a result of the differences in location and market of study as the studies in Nigeria agrees with this current findings.

Discussion of Findings on Audit Opinion (AOP) and Market Value

AOP (Audit Opinion) is also one of the independent variables used in the study. The regression result on AOP that if other variables are held constant and AOP is increased by a unit, it will positively affect the market value by 12.2 percent. This means that, audit opinion has a positive effect on MV. This finding implies that stakeholders rely on audit opinion as being independent and objective thus increasing the credibility of the financial statements audited. Consequently, the MPS is significantly affected by the nature of opinion issued. Here, the result suggests that the more the unqualified audit opinion, the higher the positive effect on the MPS. This finding is consistent with the findings from Firth (1978); Rudekhani and Jabbari (2013); Robu and Robu (2013) but differs from the findings in the study of Al-thuneibat, Khamees and Al-Fayoumi (2008) and Shah-hosseini (2014).

On the whole, it can be deduced that audit quality surrogated by AFS and AOP in a combined effort towards improving the market value of companies under study accounted for about 20 percent of the variation in MPS.

5.1 Summary, Conclusion and Recommendations

Deriving from the result analysis, audit quality proxied by AFS and AOP is found to have a positive effect on market value proxied by MPS. The study also found that there is a positive relationship between audit quality and market value and the strength of this relationship is a moderate one of 44.2 percent. The study also found that the r^2 is 0.196 meaning that AQ accounts for about 20 percent of the variations in MV of non-financial companies listed in Nigeria. The test of hypotheses also shows that AQ has a significant positive effect on market value of listed non-financial companies in Nigeria. The test of significance also reveals that all the results obtained are significant at 1 percent. We hereby conclude that, audit quality significantly relates with market value and substantially affects the market value of listed non-financial companies in Nigeria positively. This conclusion is substantive where audit quality is proxied by Audit Firm Size and Audit Opinion Type.

The result and findings of this study present implications for regulators such as SEC, FRC and professional accounting bodies like ICAN and ANAN. First, the regulatory bodies should endeavour to do their supervisory task well by ensuring that audit reports/opinions reflect the true state of the financial statements especially where it is audited by the Big-4 auditors so as to justify their reputation

Furthermore, to be able to insist on audit quality that will continually impact on the value of the companies' shares in the market, these regulatory and professional bodies should have sanctions and disciplinary penalties like temporal suspension and total withdrawal of operating license from auditors/audit firms that tend to mar audit quality by giving wrong audit opinion in Nigeria generally. Auditors should be independent when issuing an opinion as the type of opinion issued seems to have an impact on a sensitive aspect of a corporation such as its value in the market. Organizations should also ensure that the financial statements prepared by them present a true and fair position of the firms as at date of presentation. This is necessary as any errors, misstatements and omissions discovered and reported in the audit report is capable of affecting the value of the firm negatively.

On this note, we advocate that good supervisory work by Financial Reporting Council (FRC) be put in place to check on auditors and costly sanctions be spelt out on auditors/audit firms who give an opinion that seems not to reflect errors, misstatements and omissions as they have discovered or fail to discover since such an action is capable of marring the audit profession in Nigeria.

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