AUDIT QUALITY AND FINANCIAL REPORTING QUALITY: EVIDENCE FROM QUOTED DEPOSIT MONEY BANKS IN NIGERIA

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Abstract

This study investigates the relationship between audit quality and the financial reporting quality (FRQ) of quoted deposit money banks in Nigerian Exchange Limited (NGX) from 2016 to 2023. Using a panel data approach and Fixed Effect Model of Regression, the study examines the relationship between three dimensions of audit quality—audit fees, audit firm size, and audit independence and the relevance of financial reports. The findings reveal a positive but statistically insignificant relationship between audit fees and FRQ, indicating that higher audit fees may reflect greater audit effort and improved audit quality. However, the relationships between audit firm size, audit independence, and FRQ were found to be negative and statistically insignificant, challenging the conventional belief that larger audit firms and greater auditor independence automatically lead to higher FRQ. The study concludes that the impact of audit quality on FRQ may be context-dependent, varying by industry or region. The study recommends tailored audit approaches that consider the specific characteristics of the Nigerian banking sector and calls for further research into the evolving dynamics of audit quality and financial reporting.

Keywords: Audit quality, financial reporting quality, relevance, money deposit bank and restructuring.

Introduction

In today's business world, major market failures and other failures have raised concerns among stakeholders about the reliability of financial reporting of listed companies in Nigeria. Surprisingly, external auditors audited these companies and provided clean financial records. These developments reduce financial statements' reliability, accuracy, and trustworthiness (Budisantoso & Kurniawan, 2024; Akinyomi & Joshua, 2022). Hence, the reduction or loss of relevance of audited financial reports has been the basis for the interest in the quality of audited financial statements (IAASB, 2011; Heil, 2012). Also, our US financial institution had something similar recently: KPMG. Investors and potential business owners may have difficulty making decisions due to auditors' failure to inform business owners and other applicants about relevant issues in the financial statements (Odoemelam, Wobo & Ojims, 2023; Financial Times, 2023; Harber, 2018). Company performance statistics are designed to provide users with relevant, reliable, and comparable information to help them make informed decisions. This uncertainty requires many regulatory bodies and experts to propose reforms that will clarify financial reporting and thereby increase the efficiency and quality of analysis (Itoro & Emmanuel, 2019; Abdullahi Bala Ado et al., 2020). Effective monitoring preserves relationships and is strong with the trust of many stakeholders (Khaled & Zalailah, 2020). It is useful because the auditor's idea is to ensure the reliability and credibility of the report to all shareholders and stakeholders; It reduces the risk of misstatement and increases confidence in the capital market, thus lowering the cost of capital (Heil, 2012).

According to Abdullahi Bala Ado et al. (2020), auditing is important in managing the financial reporting stability of the company; A good audit objective underpins people's confidence in the integrity and reliability of financial information, which is crucial to good business and can be done. It also improves financial performance. Financial reporting has also become the focus of the attention of auditors and stakeholders due to the convergence of accounting standards, harmonization of accounting standards, financial crisis, development of disclosure requirements, and various accounting scandals (Oluyinka et al., 2021). In the context of Nigeria's deposit money banks (DMBs), the need for high-quality audits has become more pronounced due to the pivotal role banks play in the economy. Poor financial reporting by banks can lead to a loss of investor confidence and may have systemic effects on the broader financial system. High-quality audits are expected to enhance the credibility and relevance of financial statements, which in turn supports decision-making by stakeholders. Several proxies are commonly used to measure audit quality in empirical studies. These proxies, such as audit fees, audit firm size, and audit independence, reflect various dimensions of audit quality that influence the reliability of financial statements.

Audit fees are often considered a proxy for audit quality because higher fees typically reflect the auditor's effort, expertise, and time devoted to an audit. According to Li & Liu (2024), higher audit fees are associated with more thorough audits, as they indicate that the auditor has likely invested more resources in the engagement. In Nigeria, where the regulatory environment can be challenging, higher audit fees may reflect the additional scrutiny required to ensure compliance with international financial reporting standards. However, some studies suggest that excessively high fees could impair audit independence, as auditors may become financially dependent on their clients (Oluyinka, et al., 2021). Audit firm size is another commonly used proxy for audit quality, with larger audit firms generally perceived as providing higher-quality audits. Larger audit firms, particularly the "Big Four" (PwC, Deloitte, KPMG, and EY), are believed to have more resources, specialized expertise, and standardized procedures that contribute to more effective audits. Francis (2004) argues that larger audit firms have reputational incentives to maintain high audit quality, as their global brand value depends on their ability to deliver credible audits. Studies have consistently shown that larger audit firms are associated with higher financial reporting quality, although there are exceptions, especially in developing markets like Nigeria, where firm-specific factors may outweigh the benefits of size (DeFond & Zhang, 2014).

Auditor independence is critical to ensuring unbiased audits. Independence enables auditors to objectively assess the financial statements and provide an accurate representation of the company's financial position. Gul et al. (2009) suggest that when auditors maintain a high degree of independence, they are less likely to succumb to client pressure to issue a favorable audit report, thus enhancing the quality of financial reporting. In Nigeria, auditor independence is regulated by both national and international standards, but enforcement remains a challenge, lack of independence, due to long auditor-client relationships or financial dependence, can significantly compromise audit quality (Adeyemi & Fagbemi, 2010). Previous studies have reported the effects of good audits and good financial reporting. Budisantoso & Kurniawan (2024) found that audits fail to detect false returns, reducing the quality of audits of other companies audited by the same auditor. There is also a view that the decline in auditor quality is more strongly propagated for firms that are not Big Four accounting firms and for non-industry professional auditors. Presently, the Central Bank of Nigeria (CBN) has issued a directive for the Nigerian Deposit Bank (DMB) to be restructured. It implies that the wave of restructuring is going to be accomplished through the acquisition and consolidation of some deposit banks due to their operations and financial problems. This means that the audit process in the bank must be done properly to avoid bias and fraud because companies only try to provide good financial information (Oluyinka et al., 2021). Auditors also have an important role in ensuring the quality of the audit, and since the extent to which users of financial statements trust audit strategies depends on the quality of the audit, all stakeholders play an important role in promoting quality financial reporting. Since the impact of analyzing the quality of financial statements of Nigerian banks is unclear and few studies exist, it is important to examine the impact of quantitative analysis of quality auditing and financial reporting quality of Nigerian DMBs.

Therefore, this study aims to find answers to the following questions: First, what are the effects of audit fees on financial reporting quality? Second, what is the impact of audit firm size on financial reporting quality? Finally, what is the impact of auditor independence on financial reporting quality?

The results of this paper are considered to provide some insight into the relationship between audit quality and financial reporting quality in the Nigerian banking sector. This is important because policymakers need to evaluate and appreciate the impact of good auditing and supervision, which will have a positive impact on the future stability of the banking sector. The remainder of this article is organized as follows. In section two, we review the literature on audit quality and financial reporting quality. Section three describes the method. We present the empirical results and discuss the findings in section four. The article concludes in section five.

Literature Review

Conceptual Framework

Audit Quality

Oluyinka et al. (2021) define audit quality as a combination of analytical language and performance. They believe that auditing means verifying that financial information is accurate and fair for all materials. This means that the financial statements are prepared by generally accepted standards. quality refers to the important responsibility of correct judgment. This means ensuring that all are taken consistently during the audit (AL-Qatamin & Salleh, 2020). Edosa et al. (2013), audit quality refers to the probability that the financial statements prepared by the management do not contain any misleading information that may be required. Baah & Fogarty (2018) state that audit quality is the extent to which the auditor's independence, integrity, and objectivity affect the auditor's opinions on the quality of the financial information prepared. Hai et al. (2014) argue that audit quality is defined as the auditor's ability to detect and report misleading information. Khaled & Zalailah (2020) define analysis quality as the business-oriented thinking with which auditors can detect and identify irregularities (e.g. misstatements) and then report them to the relevant institutions. In this study, audit quality is conceptualized as three dimensions: audit fees, audit firm size, and audit independence.

Financial Reporting Quality

According to the International Accounting Standards Board, good financial reporting means good quality and quality (IASB, 2015). It states that the best characteristics are related to the importance and accuracy of financial information, while the best characteristics are comparability, analysis, timeliness, and access to financial statements. Herath & Albarqi (2017) believe that good financial reporting means financial and non-financial information that is useful for decision-making.

Relevance

Relevance is a fundamental qualitative characteristic that enhances the utility of financial information for users, particularly in decision-making contexts. In the context of financial reporting, relevance refers to the ability of the reported information to influence the economic decisions of users by helping them evaluate past, present, or future events or confirming, or correcting their past evaluations. This characteristic is crucial because the primary purpose of financial reporting is to provide information that is useful to a wide range of stakeholders, including investors, creditors, regulators, and others in making resource allocation decisions. Relevance, as a measure of financial reporting quality, hinges on two main aspects: the content of the information and its timeliness. The content of financial information should be capable of making a difference in decision-making by providing insights that are predictive, confirmatory, or both. For instance, predictive value helps users forecast future outcomes based on current and past events, while confirmatory value enables users to verify or alter their previous evaluations. The timeliness of financial information is equally important; it must be available to decision-makers in time to influence their decisions. Timely information enhances relevance by ensuring that users have the latest data to base their judgments. Delays in reporting can diminish the relevance of financial information as the circumstances surrounding the data might change, rendering it less useful for decision-making.

Recent studies have underscored the importance of relevance in financial reporting quality. For example, Daniels & Smit (2023) emphasize that relevance is critical in ensuring that financial statements provide meaningful insights essential for effective decision-making. Their study shows that higher relevance in financial reporting is associated with better predictive value for future cash flows, thus enhancing investor confidence. Similarly, Tkachov (2024) found that companies with more relevant financial information tend to experience greater investor trust and engagement. This is because relevant financial information allows investors to make informed decisions, reducing uncertainty and information asymmetry. In the Nigerian context, Kabiru & Usman (2021) highlight that relevance plays a pivotal role in the financial reporting of deposit money banks, as the banking sector is particularly sensitive to the timeliness and content of financial information due to the nature of financial products and services. Their study concluded that enhancing the relevance of financial reports can lead to more effective financial intermediation and improved market performance. Relevance as a measure of financial reporting quality is a cornerstone for the usefulness of financial statements. The ability of financial reports to influence decision-making, both through their content and timeliness, directly impacts the decisions made by users. As such, ensuring the relevance of financial information is essential for maintaining the integrity and utility of financial reporting systems, particularly in dynamic and information-sensitive environments like the financial sector.

Theoretical Framework and Hypotheses Development

The Theoretical Foundation of Audit Quality and Financial Reporting Quality

The most appropriate theory underpinning the relationship between audit quality and financial reporting quality is the agency theory which was developed by Jensen & Meckling (1976). Agency theory provides a framework for understanding the conflicts that arise between different stakeholders in a firm, especially between managers (agents) and shareholders (principals). This theory suggests that there is a natural divergence in interests between managers, who are responsible for running the company, and shareholders, who own the company but do not participate in day-to-day management. These conflicts create an agency problem, where managers may act in their own self-interest rather than in the best interest of shareholders, potentially leading to issues like earnings manipulation, misrepresentation of financial information, and inefficiencies. In the context of financial reporting, the role of the auditor is critical in reducing the information asymmetry between management and shareholders. Auditors act as intermediaries who ensure that the financial statements prepared by management present a true and fair view of the company's financial position. According to agency theory, auditing serves as a monitoring mechanism that helps to align the interests of managers and shareholders by providing independent verification of the company's financial statements. The higher the quality of the audit, the more likely it is that financial reports will be reliable, reducing the risk of opportunistic behaviors by management. As a result, shareholders and other stakeholders can make more informed decisions based on accurate and credible financial information. The proxies of audit quality, such as audit fees**,** audit firm size**,** and audit independence, are thus crucial factors that influence the reliability and relevance of financial reporting.

According to agency theory, higher audit fees are typically associated with greater audit effort, which improves the auditor‘s ability to detect material misstatements in the financial statements. Li & Liu (2024) argue that higher audit fees can indicate a more extensive audit process, which reduces information asymmetry and aligns the interests of shareholders and management. Thus, higher fees may reflect a stronger monitoring role played by auditors. Larger audit firms are often perceived as more capable of conducting high-quality audits due to their expertise and resources. DeAngelo (1981) suggests that larger firms have a greater reputation to protect, which incentivizes them to maintain high audit standards. This reputational capital helps reduce agency costs by ensuring that the financial reports are accurate, thus decreasing the potential for management to mislead shareholders. Auditor independence is another critical aspect of agency theory. Independent auditors are less likely to be influenced by management and are more likely to objectively assess the accuracy of financial statements (Gul et al., 2009). By maintaining independence, auditors can provide more reliable assurance, further reducing the agency costs associated with information asymmetry.

In the Nigerian context, particularly in Deposit Money Banks (DMBs), the agency problem can be pronounced due to weak corporate governance structures, regulatory challenges, and the complexity of financial transactions. Poor financial reporting in banks not only erodes shareholder trust but can also have systemic effects on the financial system. High-quality audits, as posited by agency theory, can mitigate these risks by ensuring that the financial reports accurately reflect the firm‘s financial position, thus reducing information asymmetry between management and stakeholders (Saghafi et al. 2022). Empirical studies have shown that when audit quality is high, it improves the overall financial reporting quality, which is critical for both regulatory compliance and investor confidence. For instance, Ugbah et al. (2023) found that high-quality audits in Nigerian banks are associated with more transparent and relevant financial disclosures, which are essential for efficient capital allocation. Agency theory provides a solid theoretical foundation for understanding the relationship between audit quality and financial reporting quality. By reducing information asymmetry and aligning the interests of managers and shareholders, high-quality audits serve as an effective monitoring mechanism. The proxies for audit quality—audit fees, audit firm size, and audit independence—are all essential factors that can enhance the relevance and reliability of financial reports in Nigerian deposit money banks.

Audit Fees and Financial Reporting Quality

The relationship between audit fees and financial reporting quality is often explored through the lens of agency theory and signaling theory. Agency Theory posits that there is a conflict of interest between the management (agents) and shareholders (principals). High-quality audits can mitigate this conflict by ensuring the credibility of financial statements. The demand for such high-quality audits often leads to higher audit fees, reflecting the extensive audit procedures necessary to ensure accuracy and compliance (Jensen & Meckling, 1976). Signaling Theory suggests that firms may willingly pay higher audit fees as a signal of their commitment to transparency and high financial reporting quality. By investing in higher-quality audits, firms aim to convey to stakeholders that their financial statements are reliable and free from material misstatements (Spence, 1973). Empirical studies have provided mixed results on the relationship between audit fees and financial reporting quality. However, recent research tends to support a positive relationship. Rahman et al. (2023) found that higher audit fees are associated with improved financial reporting quality, especially in firms with complex operations. The study argues that higher audit fees reflect the auditor's effort to provide a thorough and high-quality audit, reducing the likelihood of financial misstatements. Lee & Choi (2023) also reported that firms paying higher audit fees generally have fewer financial restatements, suggesting that higher fees correspond with more rigorous audit processes and better financial reporting quality. On the other hand, Tsang et al. (2024) observed that while higher audit fees are generally associated with better reporting quality, the relationship is moderated by factors such as the firm's size and industry. The study suggests that in some cases, higher fees do not necessarily equate to better quality, particularly in smaller firms where the incremental benefit of additional audit work might be limited. Hence, the formulated hypothesis supported by both theoretical and empirical evidence, suggests that the fees paid for auditing services are indicative of the quality of financial reporting, with higher fees generally correlating with more rigorous audits and therefore higher-quality financial reports.

H1: There is a positive and significant relationship between audit fees and financial reporting quality.

Audit Firm Size and Financial Reporting Quality

The relationship between audit firm size and financial reporting quality is often examined through the frameworks of reputation theory and resource-based theory. Reputation Theory suggests that larger audit firms, such as the Big Four (Deloitte, PwC, EY, and KPMG), have a strong incentive to maintain their reputation. They are more likely to conduct rigorous audits to avoid the risk of reputational damage, which could lead to a loss of clients or legal consequences (DeAngelo, 1981). This reputation for quality audits attracts clients willing to pay a premium for higher assurance, ultimately leading to better financial reporting quality. Resource-based theory posits that larger audit firms have more resources, including skilled personnel, advanced technology, and comprehensive audit methodologies. These resources enable them to perform more thorough audits, reducing the likelihood of material misstatements and enhancing the overall quality of financial reporting (Barney, 1991). Empirical research generally supports the idea that larger audit firms provide higher-quality audits, resulting in better financial reporting quality. Velte (2023) found that clients of larger audit firms have significantly fewer financial restatements and higher accrual quality, indicating that larger audit firms are more effective in detecting and correcting errors in financial statements. Hasan et al. (2020) reported that firms audited by the Big Four exhibit higher financial reporting quality, especially in terms of lower levels of earnings management and higher conservatism in financial reporting. The study attributes this to the superior audit methodologies and expertise available within larger audit firms. Zhou et al. (2021) explored the relationship between audit firm size and financial reporting quality in emerging markets and found that while larger audit firms generally enhance reporting quality, the effect is moderated by the strength of local regulatory environments. In weaker regulatory contexts, the benefits of larger audit firms are less pronounced, suggesting that firm size alone is not the sole determinant of audit quality. Thus, the formulated hypothesis is grounded in theoretical frameworks that suggest larger audit firms, due to their resources and reputational concerns, are better equipped to deliver high-quality audits, leading to improved financial reporting quality. Empirical studies largely support this view, though the impact may vary depending on the regulatory environment.

H2: Larger audit firms are associated with higher financial reporting quality compared to smaller audit firms.

Audit Independence and Financial Reporting Quality

The concept of audit independence is central to the role of auditors in ensuring the integrity and credibility of financial statements. The relationship between audit independence and financial reporting quality can be understood through agency theory and the theory of auditor independence. Agency Theory suggests that there is an inherent conflict of interest between the management of a company (agents) and its shareholders (principals). Independent auditors serve as an external check on management, reducing the information asymmetry between managers and shareholders and ensuring that financial reports accurately reflect the company‘s performance (Jensen & Meckling, 1976). The theory of Auditor Independence posits that auditors must remain free from any influence or conflict of interest that could compromise their judgment. Independent auditors are more likely to challenge management's assertions and report any discrepancies or irregularities, which enhances the reliability and quality of financial reports (DeAngelo, 1981). Previous empirical studies have largely supported the idea that higher levels of audit independence lead to better financial reporting quality. Gul et al. (2023) found that audit independence is significantly associated with fewer financial misstatements and restatements. The study suggests that when auditors maintain a high degree of independence, they are more effective in identifying and reporting errors, leading to higher financial reporting quality. Rahman et al. (2023) reported that companies with more independent auditors experience lower levels of earnings management, indicating that auditor independence constraints opportunistic financial reporting behaviour by management. Saleh Aly, Diab & Abdelazim (2023) explored situations where auditor independence might be compromised, such as long audit tenures or the provision of non-audit services. Their findings suggest that while independence generally enhances reporting quality, certain factors can undermine it, leading to potential conflicts of interest and reduced financial reporting quality.

H3: Greater audit independence is positively associated with higher financial reporting quality.

Methodology

According to Orodho (2000), ―research design is the scheme, outline or plan that is used to generate answers to the research problems‖. It is regarded as an arrangement of conditions for the collection and analysis of data in a manner that aims to combine relevancy with the research purpose. The study adopted an explanatory research design to explain audit quality's effect on financial reporting quality. The population of the study is made up of 11 listed deposit money banks on the Nigerian Exchange Limited (NGX) and the period of six (8) years i.e. from 2016-2023 was considered. A total number of four (4) banks were selected through the non-probability sampling technique.

Model Specification

To study the effect of audit quality on financial reporting quality variable (relevance), the following model is formulated:

$REV_{it} = \beta 0 + \beta 1(AFE_{it}) + \beta 2(AFS_{it}) + \beta 3(AUDINDE_{it}) + \mu_{it}$.

Where: AFE, Audit Fee; AFS, Audit Firm Size; Audinde, Auditor‘s Independence; Rev= Financial Relevance. Where b0>0, b1>0, b2>0, b3>0; β0, β1, β2, β3 = coefficient parameters and μ = the error term.

Measurement of Variables

The variables of the study are described in Table I below

Table I: Measurement of Variables

Variable Definition	Measurements
Independent Variable: Audit Quality	
Audit Fees	Amount paid to Audit firm for audit work done (Oluyinka et al., 2021).
Audit Firm Size	Audit firm size was expressed as a Dummy Variable. Audit firms were grouped into the Big Four and Non-Big Four. The Big Four, which includes KPMG, Price Waterhouse Coopers (PWC), Ernst & Young (EY), and Deloitte were coded "1" while the other audit firms were coded "0". (Oluyinka et al., 2021).
Auditor‘s Independence	The natural log of audit fees is employed as the reverse measure of audit independence. Higher (small) amount of audit fees entails poor (good) auditor independence (Abdullahi et al., 2020).
Dependent Variable: Financial Reporting	
Relevance	The time lag between the accounting year-end and the date the external auditor signed the report (Oluyinka et al., 2021).

Discussion

This section consists of both the descriptive and inferential analysis of the study. The descriptive analysis includes the mean, standard deviations, maximum, and minimum. The Inferential Analysis includes a co-efficient table and model summary for the linear regression.

Descriptive Analysis

Table II presents descriptive statistics for four variables: Relevance (REV), Audit Fees (AFE), Audit Firm Size (AFS), and Audit Independence (AUDIND), based on 32 observations. Relevance has a mean of 62.47, suggesting that the average relevance across the sample is 62.47. The standard deviation is 13.97, indicating moderate variation in relevance across the firms. Audit fees (AFE) have a mean of 758.64, indicating that the average audit fee in the sample is 758.64 units, while the standard deviation is 258.99, reflecting considerable variation in audit fees among the firms. Audit firm size (AFS) has a mean of 0.94, suggesting that the majority of firms in the sample are audited by large audit firms, possibly Big Four firms. The standard deviation is 0.25, indicating limited variation, which aligns with the dichotomous nature of the variable (coded as 1 for large firms and 0 for others). Audit independence (AUDIND) has a mean of 6.59, suggesting that the average score for audit independence is 6.59, with a standard deviation of 0.29, indicating low variability in audit independence across the firms. Descriptive statistics provide valuable insights into the distribution and variation of key variables. Relevance appears normally distributed, while audit fees and audit firm size show significant departures from normality, which might necessitate transformations or non-parametric tests in further analysis. The slight skewness in audit independence suggests that most firms maintain a moderate level of independence, crucial for ensuring audit quality. These findings align with prior empirical studies, further validating the robustness of the sample data.

Variable	Obs	Mean	SD	Min	Max
REV	32	62.46	23.97	13.974	90.00
AFE	32	758.63	258.98	460.18	1688.678
AFS	32	0.937	0.245	0.000	1.000
AUDIND	32	6.585	0.293	6.131	7.431

Table II.
Descriptive Statistics of the Banking Sector

Notes: REV, relevance; AFE, audit fee; AFS, audit firm size; AUDIND, auditor‘s independence.

Correlation matrix

Table III presents the results of a covariance analysis showing the correlation matrix for the variables: Reporting quality (REV), Audit Fees (AFE), Audit Firm Size (AFS), and Audit Independence (AUDIND), based on 32 observations.

Variables		(1)	(2)	(3)	(4)
(1) REV	***r***	1.000	-0.0823	0.1214	-0.1664
	P		0.6539	0.5079	0.3626
(2) AFE	***r***		1.000	-0.1664	0.9821
	P			0.3625	0.0000
(3) AFS	***r***			1.000	-0.2576
	P				0.2576
(4) AUDIND	***r***				1.000
	P				

Table III
Correlation matrix

Notes: REV, relevance; AFE, audit fee; AFS, audit firm size; AUDIND, auditor‘s independence.

The correlation between relevance (REV) and Audit Fees (AFE) is -0.0824. This negative correlation is very weak and not statistically significant (p = 0.6539), suggesting that changes in relevance have no significant relationship with audit fees in this sample. The correlation between relevance (REV) and audit firm size (AFS) is 0.1214, which is positive but also weak and not statistically significant (p = 0.5079). This implies that in this sample, financial reporting quality (as measured by relevance) does not significantly influence whether a large or small audit firm is selected. The correlation between reporting quality (REV) and audit independence (AUDIND) is -0.1664, a negative and weak relationship, with a p-value of 0.3626, indicating that there is no significant relationship between the revenue of a firm and the level of audit independence.

The correlation between Audit Fees (AFE) and Audit Firm Size (AFS) is -0.1665, which is a weak negative correlation with a p-value of 0.3625. This suggests that there is no significant relationship between audit fees and whether the audit firm is large or small. The correlation between Audit Fees (AFE) and Audit Independence (AUDIND) is 0.9822, a very strong positive correlation, and statistically significant (p = 0.0000). This indicates that higher audit fees are strongly associated with greater audit independence. The strength of this relationship might suggest that audit independence increases with the level of fees paid, potentially because higher fees allow auditors to invest more resources in maintaining independence. The correlation between Audit Firm Size (AFS) and Audit Independence (AUDIND) is -0.2062, a weak negative correlation with a p-value of 0.2576. This suggests that there is no significant relationship between the size of the audit firm and the level of audit independence.

The correlation analysis highlights that while most relationships between variables are weak or insignificant, the strong correlation between audit fees and audit independence is notable. This finding underscores the importance of audit fees in enhancing audit independence, which in turn can improve the quality of financial reporting. The weak relationships observed for other variables suggest that additional factors may influence these relationships or that the sample size may limit the detection of significant correlations. Future research could explore these relationships further with a larger or more diverse sample.

Regression Results

Table IV represents the results of the dependence of financial reporting quality on audit quality variables. Applying the panel data modeling, this study used Fixed Effect Model (FEM) as the estimation technique. Housman specification test suggested that the Fixed Effect Model is suitable; results regarding the Housman specification test have been presented in Table III. The table presents the results of a Hausman test, a cross-section random effects test equation, and the related panel least squares regression analysis, with the dependent variable being relevance (REV). The analysis evaluates the relationships between relevance and three independent variables: Audit Fees (AFE), Audit Firm Size (AFS), and Audit Independence (AUDIND). The Hausman test is used to determine whether the fixed effects model or the random effects model is more appropriate for the data. The null hypothesis of the Hausman test is that the random effects model is appropriate. A p-value of 0.0272, which is less than 0.05, indicates that we reject the null hypothesis, suggesting that the fixed effects model is more suitable for this data set. For all variables, the probability values are less than 0.05, further supporting the use of the fixed effects model. The differences in coefficients between the fixed and random effects models indicate that the fixed effects model provides a more consistent estimation (Appendix AI).

The coefficient of determination, also known as R2, has a value of 0.4247 percent. This shows that 42.47 percent of the change in the FRQ (REV) is due to the audit quality (AQ) variables. The f-statistics (3.0766) value is below 5 percent (*p=0.0214*), which shows the overall significance of the model and states that all the variables jointly and combined have a significant impact on the FRQ. The T-statistics and corresponding p-value show the individual significance of a variable. Observed values of T-statistics from regression, based on Table IV, are explained. Audit Fees (AFE) coefficient (0.0712) is positive but not statistically significant ($p > 0.05$), suggesting that, while there is a positive relationship between audit fees and relevance, it is not strong enough to be deemed significant in this sample. Thus, the sign of the AFE coefficient is positive as hypothesized; however, the association is not significant. Hence, H1 has not been accepted. However, this result contradicts the study conducted in Nigeria by Oluyinka et al, (2021), who found a positive and significant association between AFE and FRQ. Audit firm size (AFS) has a negative and insignificant association with the FRQ with a p-value of 0.3349, which is more than the α value of 5 percent. Hence, H2 has not been accepted. This finding agrees with Kaklar et al. (2012), who found a weak and inverse association between audit firm size and financial reporting quality. Audit Independent (AUDIND) is negatively and insignificantly associated with FRQ with a p-value of 0.1269. Therefore, H3 has not been accepted. The results are not in agreement with the prior research of Gul et al (2023) found that audit independence is significantly associated with fewer financial misstatements and restatements.

Table IV: Regression of REV on Audit Quality

Variables	Fixed Effect Model (FEM)					Random Effect Model (REM)				
REV	**Coef.**	***t*-value**	**SE**	**p-value**	**Sig.**	**Coef.**	***t*-value**	**SE**	**p-value**	**Sig..**
AFE	0.1236	2.519	0.049	0.017	**	0.071	1.456	0.048	0.157	
AFS	0.2764	0.027	9.921	0.978		-	-	9.896	0.334	
AUDIND	-115.017	-2.636	43.624	0,0135	**	-68.78	-1.578	43.563	0.1269	
Cons	725.92	2.8670	253.19	0,0078	**	470.502	1.8681	251.85	0.0735	
R^2	0.2138					0.424				
Adj R^2	0.1296					0.286				
F-	2.5393					3.076				
Prob. F	0.0766					0.021				*
DW	1.5734					1.908				
Hausman	Chi2 (9.1648) Prob>chi2=0.				*					

Notes: REV, relevance; AFE, audit fee; AFS, audit firm size; AUDIND, auditor's independence; ** significant at 1% level; * significant at 1% level.

FINDINGS

The analysis conducted on the effect of audit quality on financial reporting quality reveals important insights into how these factors (audit fees, audit firm size, and audit independence) influence financial reporting quality (relevance). This section discusses the findings in the context of both theoretical underpinnings and empirical studies. The positive relationship between Audit Fees (AFE) and Relevance (REV) aligns with the theoretical proposition that higher audit fees often signify greater audit effort and higher audit quality. The agency theory posits that audits help to reduce information asymmetry between management and stakeholders by assuring that the financial statements are free from material misstatements. Higher audit fees can be reflective of the auditor's enhanced effort to mitigate risk, thereby improving the credibility of financial reports and potentially boosting firm performance. Yuan, Luo-Yang & Xia (2024) observed that higher audit fees are generally associated with better reporting quality. However, the positive association between AFE and FRQ was not significant. Hence, the finding contradicts Oluyinka et al, (2021).

The relationship between Audit Firm Size (AFS) and FRQ was found to be negative but not statistically significant. This finding contrasts with the widely held belief that larger audit firms, often perceived as providing higher-quality audits due to their resources and expertise, positively influence financial reporting quality and firm performance (DeAngelo, 1981; Francis, 2004). The lack of positive significance may be attributed to several factors, including the specific industry or region of the firms studied, or the possibility that larger audit firms may not necessarily provide better audit quality in certain contexts. Additionally, the variability in the data, as indicated by the large standard error, suggests that the impact of audit firm size on FRQ might be context-dependent, requiring further investigation in different settings. Audit Independence (AUDIND) showed an insignificant negative relationship with FRQ. This finding suggests that higher levels of auditor independence are associated with lower FRQ. This finding is inconsistent with empirical studies that suggest auditor independence contributes to higher financial reporting quality by reducing earnings management and enhancing the accuracy of financial statements (Gul, Fung, & Jaggi, 2009).

Conclusion

The findings from the analysis of the effect of audit quality on the financial reporting quality (FRQ) of deposit money banks in Nigeria offer valuable insights into the dynamics between audit fees, audit firm size, and audit independence on the relevance of financial reporting. The study found a positive relationship between audit fees and FRQ, supporting the notion that higher audit fees often correlate with improved audit quality due to increased audit effort. This aligns with agency theory, which emphasizes the role of audits in reducing information asymmetry between management and stakeholders. However, the relationship between audit firm size and FRQ, as well as between audit independence and FRQ, was found to be negative and statistically insignificant. These results challenge the conventional wisdom that larger audit firms and greater auditor independence necessarily lead to higher financial reporting quality. The findings suggest that the influence of audit firm size and independence on FRQ may be context-dependent, varying by industry, region, or other factors specific to the Nigerian banking sector.

Recommendations

1. Enhancement of Audit Fees: Banks should consider aligning audit fees with the complexity and risk level of the audit engagement to ensure that auditors are adequately compensated for their efforts. This may lead to improved audit quality and, consequently, better financial reporting.
2. Context-Specific Audit Approaches: Regulators and policymakers should recognize that the effectiveness of audit firm size and auditor independence in enhancing FRQ may differ across contexts. Customized audit approaches that consider the specific characteristics of the Nigerian banking sector could be more effective.
3. Regulatory Oversight on Auditor Independence: Despite the findings, maintaining auditor independence is critical. Regulators should continue to enforce rules that minimize conflicts of interest to safeguard the objectivity and impartiality of auditors.

Limitations of the Study

Sample Size and Scope: The study's sample size was limited to deposit money banks in Nigeria, which may not be representative of other sectors or regions. This limits the generalizability of the findings. Time Frame: The study covers a specific period (2016-2023), and the results may not reflect the impact of recent developments or longer-term trends in audit quality and financial reporting. Measurement of Variables: The study relied on specific proxies to measure audit quality and FRQ, which may not capture all dimensions of these constructs. Alternative measures might yield different results.

Areas for Further Study

Impact of Regulatory Changes: Future research could explore how recent regulatory changes in the Nigerian banking sector affect the relationship between audit quality and financial reporting quality. Cross-Industry Comparisons: Comparative studies across different industries or regions could provide a broader understanding of how audit quality impacts financial reporting quality in varying contexts. Longitudinal Analysis: Extending the study period could provide insights into how the relationship between audit quality and FRQ evolves, especially in response to economic or regulatory shifts.

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