

# External Audit Characteristics and Value Relevance of Listed Firms in Nigeria

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## ABSTRACT

This study examined the effect of external audit characteristics and value relevance of listed firms in Nigeria. The study focused on the effect of external audit objectivity, external audit efficiency, external audit timeliness, and external audit competence on the value relevance proxied by the earnings response coefficient of listed firms in Nigeria. The study adopted the ex-post facto research design, and sixteen listed companies on the Nigerian Exchange Group were selected, for a period of ten years (2013–2022). The data for the study were analysed using the panel regression technique. The results show that external audit objectivity and external audit timeliness significantly affect the earnings response coefficient of listed firms in Nigeria. It was also discovered that external audit efficiency and external audit competence, on the other hand, do not significantly affect earnings response coefficients in listed firms in Nigeria. Based on the findings, it is therefore recommended that audit firms and regulatory agencies should ensure that external audit objectivity is sustained, as this is critical to enhancing the value relevance of firms' financial reports.

**KEYWORDS:** *External audit objectivity, external audit efficiency, external audit timeliness, external audit competence; earnings response coefficient*

## 1. INTRODUCTION

Value relevance is identified as the ability of information shown in financial statements to capture and summarise a company's worth and predict future earnings. Value relevance can also be assessed using statistical correlations between financial statement information and stock market valuations (Gjerde, Knivsflå & Sættem, 2005). This shows that Earning Response Coefficient (ERC) is fundamental to the analysis of value relevance of firms' financial data that helps the investors to assess the market reactions on the basis of firms' financial performance. Scott (2003) also added that earnings response coefficient measures the magnitude of a security's abnormal gains in response to the unexpected profit components. The earnings response coefficient, therefore, measures the unexpected return of the market in response to the unexpected parts of the reported earnings of the organization that has issued the securities (Beredugo, 2021). By implication, the low earnings response coefficient shows that profit is less informative to investors to make economic decisions.

Earnings information is marked with high-quality response of investors to the profit announcement. The ERC is the way (or the magnitude) in which the market agents react to this new information by re-estimating the current stock price (Pimentel, 2016). The metadata studies on value relevance utilising event studies explore capital market reactions to financial information, with a primary focus on earnings as the primary output of financial reporting.

Be that at it may, major components of that could boast investors' confidence on companies financial statement are auditors characteristics which have been undermine in major clans. Recent occurrences reveal that the spate of audit failures in the world has questioned the value relevance of firms' financial reports. The cause of the problem has been linked to the quality of the audit done, the audit time lag, and the opinion expressed by the auditor, which has been linked with the characteristics of the external audit (Abdillah, Mardijuwono & Habiburrochman, 2019).

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Furthermore, the majority of auditing research conducted globally has concentrated on the traits of external auditors rather than the characteristics of the external audit itself. This could be attributed to deficiencies in the qualities of external auditors, which always result in a loss of investors' confidence in corporate reports. The focus has traditionally been on external auditors' attributes such as auditors' fee, auditors' tenure, and auditors' firm size, which in most circumstances do not correlate to an effective quality audit (Amahalu & Ezechukwu, 2017).

Adeyemi, Akhalumeh, Agweda & Ogunkuade, (2017) carried out similar research to investigate the factors affecting audit quality in Nigeria. They focused on variables such as the auditors' independence, auditors' fees, and auditors' tenure. These are the characteristics of the auditor, which in most cases do not translate to an effective or quality audit.

There are distinct characteristics of external audits that influence the value relevance of financial statements apart from the external auditors' characteristics, although there are limited researches in that regard. The characteristics of an external audit affect the value relevance of firms' financial statements, which would in turn reduce the level of capital flow, thereby deteriorating the state of the business environment (Securities and Exchange Commission (SEC, 2000). These are issues that the corporate world is faced with in regards to the quality and timeliness of an external audit done on a firm.

The primary objective of value relevance research is to investigate whether the financial statements released by firms provide high-quality and valuable accounting information that enables users and investors to make informed decisions (Alfaraih & Alanezi, 2011). The reliance of potential investors on financial reports in making investment decisions depends on the perceived value and relevance of such reports, as attested to by the external audit process. The previous studies carried out opined that factors such as financial disclosure (Shamki & Abdul Rahman, 2013), earnings management (Habib, 2004), free cash flow (FuadRahman & Mohd-Saleh, 2008), IFRS adoption (Isaboke & Chen, 2019), and corporate governance (Jamaluddin, Mastuki & Elmiza, 2009) are responsible for the prediction of the value relevance of financial reports.

As a result, the current study intends to fill this conceptual gap by using distinctive external audit characteristics like audit objectivity, audit efficiency, audit timeliness, and audit competence to examine its' effect on the value relevance of financial reports of listed Nigerian firms. This will offer a new paradigm for external audit literature.

In view of this, the following specific objectives of this article include:

1. To determine the effect of external audit objectivity on the earnings response coefficient of listed firms in Nigeria
2. To ascertain the effect of external audit efficiency on the earnings response coefficient of listed firms in Nigeria.
3. To examine the effect of external audit timeliness on the earnings response coefficient of listed firms in Nigeria.
4. To determine the effect of external audit competence on the earnings response coefficient of listed firms in Nigeria.

## 2. LITERATURE REVIEW

External audit characteristics play an important role in upholding an efficient market environment because they strengthen confidence in the credibility and integrity of financial statements, which are essential for well-functioning markets (Salehi & Mansoury, 2009). Therefore, auditors are expected to ensure that the audit has intrinsic values that ensure a quality audit at all times. Thus, the role of external audit characteristics is to improve the quality of financial statements, as high-quality reporting can reduce information asymmetry problems between the firm and providers of financing. A substantial proportion of practicing auditors in Nigeria are members of the Institute of Chartered Accountants of Nigeria (ICAN) and the Association of National Accountants of Nigeria (ANAN). These professional bodies have rules guiding the conduct of their members in practice to ensure a quality audit. In the same vein, public limited companies in Nigeria are mandated by law to have their financial statements audited by an independent public accountant who is the external auditor (Okolie, 2014).

The responsibility for the preparation and presentation of financial statements of companies lies with the company directors, and the external auditor is responsible for auditing the financial statements of his clients in accordance with Generally Accepted Auditing Standards (GAAS). In Nigeria, the International Standards on Auditing (ISA) are mandatory for companies quoted on the Nigerian Exchange Group (NGX) where Nigerian Auditing Standards do not exist. The Nigerian Standards on Auditing (NSAs) are based on the International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board, published by the International Federation of Accountants (IFAC) in July 2012, and are used with the permission of IFAC. The characteristics of an external audit include a display of professionalism,

diligence, and care by the auditor in the audit process, which should lead to a true and fair view of the financial statement.

## **2.1. Determinants of external audit characteristics**

### **2.1.1. External audit objectivity**

Audit objectivity is the ability of an auditor to maintain an objective and impartial mental attitude throughout an audit. To have an objective audit, an auditor must be able to take an unbiased viewpoint in the performance of audit tests, analyses of results, and attestation in the audit report of an entity. Independence in mind reflects the auditor's state of mind, which permits the audit to be performed with an unbiased attitude. Independence in appearance is the result of others' interpretations of what independence should actually be, but if auditors are independent in fact, but users believe them to be advocates for clients, then most of the value of the audit function will be lost as stakeholders will adjudge such audits to be without objectivity. There have been divergent views on the effect of high and low audit fees on the objectivity of external audit reports, but it is agreeable that external audit fees can influence auditor independence and, by implication, audit quality

### **2.1.2. External audit efficiency**

External audit efficiency refers to the burden of the audit fee on the income of the client. Hameed (1995) found that the most significant factors that influence auditing efficiency are the auditor's experience, honesty, and knowledge of accounting and auditing standards. Uchenna & Young (2011) stated that economic reliance on the client, delivery of non-audit services to the client, and rivalry in the audit market are the main factors that weaken the perception of audit efficiency. Agmas, Mekonnen & Shibru (2020) found that the efficiency of external audit engagement is affected by the charges that the companies pay to the external auditors for the audit services. Francis & Simon (1987) stated that audit services are quality-differentiated and that in a competitive market, quality variances are replicated in charges.

### **2.1.3. Audit timeliness**

Audit timeliness is the number of days between when a company's financial year ends and the day on which its audited financial statement is made public on the Nigerian Exchange Group. It depends on factors related to both the auditor and the audited company, such as the time needed to prepare the financial statements, the board of directors decision to publish the financial statements, regulatory requirements for a minimum period between the Annual General Meeting date and the reporting date, as well as other

factors related to the availability of a date or place for the Annual General Meeting. A long audit may constitute a threat to the time-value relevance of the report, and in some cases, a relatively short audit is likely to be done in haste and might be characterised by errors. Professional accounting bodies like AICPA (1978 and 1992), ICAA and CPA Australia (2001), and the Coordinating Group on Audit and Accountant Issues (2003) also expressed concerns that the length of the audit may impair audit quality. Palmrose (2008) sees audit quality as a level of assurance, and an experimental study by Knapp (2011) tends to establish a connection between audit timeliness and competence.

### **2.1.4. External audit competence**

The association between audit company size and auditor competence has long been of interest to researchers and policymakers in auditing. Iatridis (2012) posits that audit company size could be a proxy for auditor competence because larger audit companies have more experience, have the required skills, and are less likely to compromise their independence than smaller audit companies. Subsequent empirical studies by Enofe, Mgbame, Aderin & Ehi-Oshio (2013) have largely validated the theoretical prediction that larger audit companies provide higher-quality audits than do smaller audit companies. Dang, Brown & McCullough (2004) find out that audit company size is positively associated with audit quality as measured by discretionary accruals and modified opinions. Choi et al. (2010) state that audit quality is often tied to audit company scale. A large body of research examines the relationship between audit company size and audit quality.

## **2.2. The Debates on Auditors Quality Measures**

Scholars have put forward varying measures of audit quality, none of which is conclusive. Giroux & Jones (2011) identified five theoretical constructs to evaluate audit quality: auditor type, audit experience (industry and specialisation), audit fee, demographics, and local government type. De Angelo (1981) associates audit quality with the size of audit firms, but prior studies by Dunakhir (2016) maintain that size alone should not be a prime determinant of future success. Salehi & Mansoury (2010) suggest auditor size, auditor tenure, specialty in the auditor industry, auditor authenticity risk, client legal claims, and auditor independence as measures of audit quality. Firth (1980) took a random sample of Chartered Accountants in practice firms and industry, major stockbrokers and investment managers of unit trusts, insurance companies and merchant banks, and loan officers of major banks and financial institutions, and



found a positive effect of mandatory audit partner rotation on audit quality in areas with weak legislation. Al-Ajmi (2009) found a positive effect of mandatory audit firm rotation on audit quality in areas with weak legislation.

### 2.3. External audit characteristics and value relevance of financial reports

The significance of value in financial statements is the ability of information to capture and sum up a firm's value and provide future earnings proficiency (Gjerde et al, 2011). Share price reactions around the release of earnings announcements indicate that the released earnings figures contain new information for market participants, leading them to change their expectations about firms' future cash flows. When market efficiency and no other information are responsible for price changes, earnings announcements can be considered as a useful tool for investment decision-making. This helps to illustrate the responses of market participants to reported earnings.

In order to answer questions about the nature of information in reported earnings and its correlation with firm valuation, the literature on the earnings response coefficient suggests evaluating its significance. Therefore, if an enterprise experiences unexpected earnings, investors will modify their expectations of its future cash flows assuming that the earnings innovation is permanent, and therefore a price change equals the revenue surprise plus its value in perpetuity. In other words, the earnings response coefficient is the marginal stock price response to a one-unit change in earnings innovation; therefore, the price change is the one Naira earnings innovation plus the discounted present value of the one Naira in perpetuity. According to Kothari (2001), the earnings response coefficient is projected at values ranging from 8 to 21, but empirical evidence suggests values that are lower than this range.

Knapp (2011) corroborated that an external audit characteristic produces qualitative financial reports, which in turn prevent financial crises (Knapp, 2011). In another development, Palmrose (2008) viewed external audit characteristics from the perspective of providing assurance that the financial statements would contain no material misstatements. By extrapolation, the reliability of financial statements is reflected in audit quality as a result of the characteristics of the external audit. Similarly, Shockley (1981) documented that perceptions of audit characteristics are vital as they determine the quality of audit reports.

In addition, external audit characteristics, when considered in line with the objectivity, efficiency,

competence, and timeliness of the audit, affect the confidence level of users of the audited financial statements as well as the value relevance of such reports (Amahalu & Ezechukwu, 2017). Bethitina (2015) illustrated a reduced stock market response to earnings reports when qualified opinions are issued and found that, if the external audit characteristics are questionable, audit reports provide a lower level of assurance to users of financial statements. In other words, quality audit reports, as a consequence of credible external audit characteristics, lead to the production of financial reports that are of value and relevance.

### 2.4. EMPIRICAL REVIEW

Ado, Rashid, Mustapha & Ademola (2020) examined the direct influence of audit quality on the financial performance of listed companies in Nigeria. In a similar vein, Wajiya (2020) examined the effect of audit quality on firm value in manufacturing companies listed on the Indonesian Stock Exchange from 2013 to 2017. The results showed that audit quality has a positive effect on firm value in manufacturing companies on the Indonesian Stock Exchange. Okezie & Egeolu (2019) examined the effect of audit independence on the reliability of financial reports in the banking sector. Nishtiman et al. (2019) examined the impact of audit quality on accounting conservatism in Turkey. The results showed that audit quality had a significant effect on the value and relevance of the financial reports of the banks under study.

Amahalu & Ezechukwu (2017) conducted a study on the determinants of audit quality and the quality of financial reports, with a focus on selected deposit money banks listed on the floor of the Nigeria Stock Exchange from 2010–2015. It was found that audit fees, audit tenure, and audit firm size have a positive and statistically significant relationship with the quality of financial reports of banks listed on the Nigeria Stock Exchange. The study recommends that the auditor-client relationship should not exceed 3 years to reduce objectivity and audit quality.

Adeyemi et al. (2017) and Augustine et al. (2017) conducted research to investigate the factors affecting audit quality in Nigeria. Adeyemi et al. (2017) used a combination of archival and survey research methods to gather information from respondents concerning their opinions on certain aspects of audit quality. Augustine et al. (2017) used a regression model to analyse the existence of significant relationships between audit quality and audit firm-related characteristics. Dunakhir (2016) used a quantitative method of research design to identify the most important factors affecting audit quality in Jordanian

commercial banks (JCBs). The researchers implemented a number of statistical techniques and procedures to help examine research hypotheses. The final conclusions of the authors' indicate a positive and significant correlation between audit quality and audit efficiency, the reputation of auditing offices, auditing fees, the size of audit firms, and the proficiency of auditors.

Mgbame *et al.* (2012) carried out an empirical study on the relationship between audit tenure and audit quality. They utilised the binary logistic model estimation technique in analysing the perceived relationship between the tenure of an auditor and the quality of the audit. Other explanatory variables like returns on assets (ROA), board independence, director ownership, and board size were also considered in the study. Their findings revealed a negative relationship between auditor tenure and audit quality, though the variable was not significant. The other explanatory variables considered alongside auditor tenure were found to be inversely related to audit quality, with the exception of returns on assets, which exhibited a positive effect. They recommended that there is a need for the Financial Reporting Council and other regulatory bodies, in line with best practices, to look critically into the issue of auditor tenure and the impact on audit quality in Nigeria.

Yuniarti (2011) proposed the hypothesis that audit firm size and audit fees have an effect on audit quality. Dehkordi & Makarem (2011) investigated the influence of audit firm size and auditor type on audit quality. Results showed that the size of non-governmental audit firms does not affect their audit quality, and changes within private audit firms do not lead to changes in the level of discretionary accruals. In some settings, factors such as auditor type, intense competition, audit committee, and litigation risk are of greater importance than audit firm size.

Hsieh (2011) also examined the existence of a relationship between evidence of reduced audit quality, measured by estimated discretionary accruals, and audit firm tenure with a specific client. It was discovered that estimated discretionary accruals are significantly and negatively associated with audit firm tenure with a specific client. Additional analyses suggested that lower audit quality observed in first-year clients is not caused by lower audit effort, suggesting auditor independence may be impaired. Egolum (2021) conducted a study on the effect of external audit characteristics on earnings management of listed consumer goods firms in Nigeria. The results showed that higher auditor independence had a significant likelihood of reducing managers income-soothing activities. The expertise hypothesis suggests

extended tenure improves the working relationship between the auditor and the firm. Policies should be taken to improve audit tenure system compliance in Nigeria.

Onyeaghala & Ofor (2020) studied the effect of external audit characteristics on the firm value of quoted consumer goods companies in Nigeria. The results showed that audit firm size had a negative and significant impact, while audit firm tenure, report lag, and age had a non-significant impact. Izukwe & Jeroh (2022) studied the association between auditors' attributes and the firm value of Nigerian service firms. They found that audit fees and firm worth are significantly correlated, while audit tenure and joint audits have a negligible impact on business value. Service companies should shorten audit tenure and hire reputed auditors at higher rates to increase reliability and improve corporate performance.

Khomidah & Setiawan (2022) studied the relationship between capital markets and accounting information in the banking sector of ASEAN countries. They found that earnings and book value have a positive impact on stock prices, while revenue is more related to value than other variables.

Chen, Chen, Lobo & Wang (2010) examined the effect of auditor size (a factor of audit quality) on interest management and capital costs for two categories of Chinese companies. Khaled (2009) examined the impact of audit quality measured by financial statements audited by the big four accounting firms on investors' ability to predict future earnings for profitable and unprofitable firms. Knechel and Vanstraelen (2007) carried out research on the relationship between auditor tenure and audit quality, using going concern opinion as an audit quality proxy. Dang *et al.* (2004) found out that there exists a positive association between actual audit quality and market-perceived audit quality, i.e., the ability of investors to use current accounting information to value firms' future performance. They conclude that investors' perceived audit quality, measured by the value-relevance of accounting information, can proxy for actual audit quality. The paper opined that the market appears to rely less on accounting numbers when audit failures occur, even though formal allegations of audit failure may not appear until years after their occurrence.

The review of related literature revealed that most empirical researchers from Nigeria and around the world have based their studies on audit quality and auditor attributes and the relevance of financial reports. However, value relevance studies in Nigeria have failed to use the Earnings Response Coefficient model to determine the value relevance of reported

earnings. This study examined actual external audit characteristics such as audit objectivity, audit efficiency, audit competence, and audit timeliness against the earnings response coefficients of the firms.

### 3. Research Design

The study adopted an ex-post facto research design. The study used historical data to test the hypotheses. It also assists in the collection of data on the observations made in the NGX group using seven trading days by tracking the stock market operations of the companies under review. This was done looking into three days before the announcement of the annual report (t-3), on the day of the announcement (t), and three days after the announcement of the financial report. This was to basically ascertain the stock market reactions before, during, and after the announcement period.

The population of this study comprises 156 firms that are listed on the Nigerian Exchange Group as of December 31, 2022 (NXG, 2023). The listed firms were selected from the various sectors namely: Conglomerate/Agriculture, Consumers Goods, Construction/Real Estate, Financial Service, Health care/ ICT, Industrial goods, Oil and Gas & Natural Resources and Services

The sample size was 16 listed firms drawn from the population. The sample was selected using a systematic and judgmental sampling technique. The 16 listed firms constituted 10% of the total population, which is considered an appropriate sample size for the study. This is in line with the works of Balsley & Clover (1988), quoted in Tapang, Bessong & Ujah (2015); Tapang, Basse & Bessong (2012), suggesting that the use of 10 percent of the sample size is normal in research studies since the sample size of 10 percent of the universe has been shown to be more than sufficient in research projects.

The main criteria for judgmentally selecting the firms after a systematic approach are:

1. They must be listed on the Nigerian exchange group during the period under investigation and must also be operational during the relevant period.
2. Each firm selected must also have complete data covering the period under investigation intended for use according to the proxies (2013–2022).
3. The firms should not have changed their financial accounting year during the research period.
4. They must be consistent in profit-making over the relevant period.

Using the above conditions as criteria for selection, 16 firms were systematically selected to form the

sample size; the names of the firms selected are as listed above.

The descriptive statistics used were summarized from the collected data in a clear and understandable way using a numerical approach. The multiple (panel) regression technique using the ordinary least squares (OLS) method was adopted in investigating the relationship between the dependent and independent variables. The study adopted the preliminary test for incidences of co-linearity in the model, which was also necessary. In doing this, the Dublin Watson unit root test and the co-integration test statistics was deployed.

For the purpose of this study, the dependent variable is the earnings response coefficient, and the independent variable is the external audit characteristics'; these are external audit objectivity, external audit efficiency, external audit competence, and external audit timeliness.

#### A. Earnings response coefficient

The ERC is measured by the regression slope of the stock market price or market reactions (proxied by cumulative abnormal return) and accounting profit (proxied with unexpected earnings). The ERC is obtained by calculating the Cumulative Abnormal Return (CAR) of each sample and also calculating the Unexpected Earnings (UE) of the sample. According to Collins and Kothari (1989); the formula for ERC is presented below:

$$CAR = \alpha_0 + \alpha_1 UE$$

Where, CAR= Cumulative Abnormal Return

UE= Unexpected Earnings

$\alpha$  = Constant

$\alpha_1$  = Earnings response coefficient

#### B. Measuring Cumulative Abnormal Return

This can be measured using the following model:

$$AR_{it} = R_{it} - R_{mt}$$

Where:

$AR_{it}$ : - Abnormal return of firm i on day t

$R_{it}$  - Actual returns of firm i on day t

$R_{mit}$  - Daily market returns of firm i on day t

#### C. Actual returns of firm ( $R_{it}$ )

The actual return is earning that has been obtained by the investor in the form of capital gain.

$$R_{it} = \frac{P_{it} - P_{it-1}}{P_{it-1}}$$

Where:

$R_{it}$  = Actual return of firm i on day t

$P_{it}$  = Stock price of firm i on day t

$P_{it-1}$  = Stock price of firm i day t - 1



**D. Daily Market Return of firm (Rmt)**

$$Rmt = \Sigma(Rit)/T$$

Where: Rmt: Daily market return on day t.  
 (Rit): Actual return of security-I on period-t  
 T: The length of estimation period which is from t1 until t7

**E.  $UE_{it} = (EAT_{it} - EAT_{it-1}) / EAT_{it-1}$**

$UE_{it}$  – Unexpected Earnings  
 $EAT_{it}$  – Earnings after tax on period t  
 $EAT_{it-1}$  – Earnings after tax on period t – 1

**3.1. Model Specification**

The model used in this work was developed by Collins and Kothari (1989), adopted by Khamees (2018), Beredugo (2023), and Wijaya, Adhitya, Cahyadi & Salim (2020), and the model was adapted and modified to include multiple external audit characteristics variables as well as the value relevance (ERC) variable. Linear regression analyses were used to test the relationship between the dependent variable (ERC) and the identified independent external audit characteristics measurement variables.

The original model is specified below:

$$CAR = \alpha_0 + \alpha_1 UE + e_{i,t}$$

Where CAR= Cumulative Abnormal Return  
 UE= Unexpected Earnings  
 $\alpha_1$  = Earnings response coefficient  
 $\alpha_0$  = the intercept  
 e = stochastic error

The above model was modified to include other independent variables. This was premised on establishing the relationship between the dependent and independent variables. For the benefit of doubt, value relevance is the dependent variable, which is proxied as Earnings Response Coefficient (ERC), while the overall formula for ERC is CAR/UE. The components of the external audit characteristics serve

**4. RESULT AND ANALYSIS OF DATA**

The data for this study includes the data on Earnings Response Coefficient (ERC), External Audit Objectivity (EAO), External Audit Efficiency (EAE), External Audit Timeliness (EAT), and External Audit Competence (EAC) of the listed firms selected for this study from 2013 to 2022.

as independent variables and include: external audit objectivity, external audit efficiency, external audit competence, and external audit timeliness. These modifications were further presented in the equations below:

The model is expressed as follows:

$ERC_{it} = \alpha + \beta_1 EAO_{it} + U_{it}$  - - - Equation 1

$ERC_{it} = \alpha + \beta_1 EAE_{it} + U_{it}$  - - - Equation 2

$ERC_{it} = \alpha + \beta_1 EAT_{it} + U_{it}$  - - - Equation 3

$ERC_{it} = \alpha + \beta_1 EAC_{it} + U_{it}$  - - - Equation 4

Where;  
 $\alpha$  = Constant

**ERC** = earnings response coefficient (this is measured using the estimated slope (residuals) coefficient on a regression equation between cumulative abnormal returns and unexpected earnings at a time).

**EAO** = external audit objectivity (the log of the amount of money paid as an audit fee by the firm in a given year).

**EAE** = external audit efficiency (the amount of the audit fee divided by the net income of the firm in a given year).

**EAT** = External audit timeliness (the log of the number of days between when a company’s financial year ends and the day on which its audited financial statement is made public on the Nigerian Exchange Group).

**EAC** = external audit competence (code “1” for big audit firms and code “0” for other audit firms).

**it** = cross-section (i) at time (t)

**U** = the error term used in the model.

$\beta_1 - \beta_4$  = the beta coefficient of the independent variables.

**Decision Rule:** Accept the null hypothesis if the calculated value is greater than the significant level of 0.05.

**Table1: Descriptive Statistics Analysis of Data for the Study**

Statistic	ERC	EAO	EAE	EAT	EAC
Mean	-0.7304	4.5054	2.2896	1.4809	0.6313
Median	-0.6930	4.4750	2.3182	1.4611	0.6313
Minimum	-24.80	3.40	0.00	1.40	0.00
Maximum	15.72	5.78	3.52	1.65	1.00
Std. Deviation	4.73314	.59441	.70792	.08329	.48398
Skewness	-0.462	0.370	-0.691	0.621	-0.549
Sum	-116.86	720.86	366.34	236.94	101.00
Observations	160	160	160	160	160

Source: Researcher’s Computation (2023) using E-view version 12

Table 1 shows the descriptive test results for the dependent variable, such as the value relevance proxy, Earnings Response Coefficient (ERC), and the independent variables, which include: external audit objectivity (EAO), external audit efficiency (EAE), external audit timeliness (EAT), and external audit competence (EAC). From the results, the mean and median of ERC were obtained as -0.73% and -0.69%, respectively. This indicates that the average ERC for all the sixteen (16) companies that were selected for this study over a period of 10 years is -0.73%, while the median ERC for all the companies is -0.69%. Furthermore, the standard deviation obtained for ERC is 4.73%, which indicates the presence of variability in the ERC of the companies. This has to do with the continuous changes in the earnings of these companies year-on-year. The level of variability in the ERC was further shown by the skewness results obtained with a value of -0.462. This indicates that the data on ERC is negatively skewed. This implies an asymmetry between the mean and the median in the distribution. The data on ERC could be said to be fairly negatively skewed.

The data characteristics of the proxies for external audit characteristics: external audit objectivity (EAO), external audit efficiency (EAE), external audit timeliness (EAT), and external audit competence (EAC) were also depicted by the outcomes of their mean, median, standard deviation, and skewness respectively. The mean values for EAO, EAE, EAT, and EAC were obtained as 4.50%, 2.28%, 1.48%, and 0.63%, respectively. The median values for EAO, EAE, EAT, and EAC were obtained as 4.47%, 2.3%, 1.46%, and 0.63%, respectively. Furthermore, the standard deviations for EAO, EAE, EAT, and EAC were obtained as 0.59, 0.71, 0.08, and 0.48, respectively, while the skewness values were 0.370, -0.691, 0.62, and -0.549, respectively. The skewness values all indicated that the EAE and EAC are all negatively skewed. However, this could be referred to as a fairly negatively skewed distribution since the values obtained lie between -0.1 and -0.7. This indicates a moderate level of asymmetry between the measures of the central tendency of these variables.

**Table 2 Simple Bivariate Analysis Results for the Variables**

	ERC	EAO	EAE	EAT	EAC
ERC	1.00000				
EAO	0.12310	1.00000			
EAE	-0.04100	0.12823	1.00000		
EAT	0.20671	-0.19410	0.00512	1.00000	
EAC	-0.02801	0.57612	0.04511	-0.12921	1.00000

**Source: Researchers' Computation (2023) using E-view version 12**

Table 2 shows that the correlation coefficient between Earning Response Coefficient (ERC), and the independent variables which include EAO, EAE, EAT, and EAC was obtained as 0.12310, -0.04100, 0.20671 and -0.02801 respectively. This shows that the correlation between ERC and variables such as EAE and EAC is negative, while the correlation between ERC and EAO and EAT is positive. Critical assessment among the independent variables shows a correlation result ranging from 0.12310 to 0.57612. In all, the entire correlation table suggests that multicollinearity among the independent variables is not a problem as none of the Pearson Correlation exceeds 0.7

**Table 3: Panel Unit Root Analysis Results for Variables**

Variable	LLC Statistic	Prob.	Im, Pesaran and Shin W-stat	Prob.	ADF-Fisher Statistic	Prob.	Order of Integration	Decision
ERC	-27.3223	0.0000	-9.8862	0.0000	81.7337	0.0000	I(1)	Stationary
EAO	-23.8087	0.0000	-7.70832	0.0000	61.4589	0.0000	I(1)	Stationary
EAE	-2.90211	0.0006	-1.99842	0.0110	34.5795	0.0082	I(1)	Stationary
EAT	-1293.13	0.0000	-299.580	0.0000	63.9117	0.0000	I(1)	Stationary
EAC	-4.90215	0.0000	-3.61522	0.0001	56.0516	0.0001	I(1)	Stationary

**Source: Researcher's Compilation (2023) using E-view version 12**

The null hypothesis before the conduct of this test is that all the variables have a unit root problem. However, the conduct of the panel unit root test based on Levin, Lin, and Chu (LLC), Im, Pesaran, and Shin W-stat, and Augmented Dickey Fuller (ADF) Fisher Chi-square methods at level (order of integration equal to zero) indicates that the null hypothesis was not rejected given that none of the variables were found to be stationary. This is based on the returned probability statistics for each of the variables across Levin, Lin & Chu (LLC), Im, Pesaran, and Shin W-stat and Augmented Dickey Fuller (ADF) Fisher Chi-square statistics, which were found to be beyond the acceptable 5% region. The panel unit root test was further conducted at First Difference (order of



integration equal to 1) to establish the possibility of the data series for each of the variables being free from unit root as earlier found. At First Difference, all the variables returned probabilities for the Levin, Lin & Chu (LLC), Im, Pesaran, and Shin W-stat and Augmented Dickey Fuller (ADF) Fisher Chi-square statistics that were within the 5% acceptance region. Thus, Earning Response Coefficient (ERC), External Audit Objectivity (EAO), External Audit Efficiency (EAE), External Audit Timeliness (EAT), and External Audit Competence (EAC) were all found to be stationary at First Difference (order of integration = 1). This indicated the absence of a unit root in these variables.

Based on this, the panel unit root test was re-conducted at Second Difference (Order of Integration equal to 2). At this order of integration, all the variables Earning Response Coefficient, External Audit Objectivity (EAO), External Audit Efficiency (EAE), External Audit Timeliness (EAT), and External Audit Competence (EAC) were found to be stationary. All the variables return probability values for the Levin, Lin & Chu (LLC), Im, Pesaran, and Shin W-stat and Augmented Dickey Fuller (ADF) Fisher Chi-square statistic that were all less than 0.05. Based on this, the null hypothesis of the presence of a unit root in the data series was rejected, and the alternative hypothesis of the absence of a unit root was accepted. Thus, all the variables can be applied to the estimation panel cointegration using the Kao cointegration method and further linear regression estimation in this study.

**Table 4: Kao Cointegration Results**

Kao Residual Cointegration Test  
Series: ERC EAO EAE EAT EAC  
Date: 09/17/23 Time: 1:42  
Sample: 2013 2022  
Included observations: 160  
Null Hypothesis: No cointegration  
Trend assumption: No deterministic trend  
User-specified lag length: 1  
Newey-West automatic bandwidth selection and Bartlett kernel

	t-Statistic	Prob.
ADF	-5.011301	0.0000
Residual variance	587.5301	
HAC variance	442.7704	

**Source: Researcher's Computation (2023) using E-view version 12**

Table 4 presents the Kao cointegration result for the variables. From the extracted results, there is cointegration between the variables used in the study. The Kao cointegration result in Table 4 shows that the variables in the study may possess long-term relationships. This is because the null hypothesis, which posits that there is no cointegration among the variables, was rejected given that the estimated probability value of 0.0000 is within the 5% acceptable region.

**Table 5: Heteroskedasticity LR result**

Panel Cross-section Heteroskedasticity LR Test  
Null hypothesis: Residuals are homoscedastic  
Equation: UNTITLED  
Specification: ERC EAO EAE EAT EAC

	Value	Df	Probability
Likelihood ratio	288.9503	15	0.0000
LR test summary:			
	Value	Df	
Restricted LogL	-548.5861	149	
Unrestricted LogL	-479.1528	149	

**Source: Researcher's Computation (2023) using E-view version 12**

Table 5 presents the heteroskedasticity results of the variables adopted in this study. From the result, a probability value of 0.0000 was obtained. This probability is less than 0.05. This indicates the absence of heteroskedasticity in the model, which implies that the variance of the error term in the model is constant.

**TABLE 6**

Lagrangian Multiplier Test of External Audit Characteristics and Value Relevance

H0: Variance = 0				
	Equation 1	Equation 2	Equation 3	Equation 4
chi <sup>2</sup> (1)	20.98	81.89	15.05	71.64
Pro > chi <sup>2</sup>	0.0002	0.000	0.0019	0.000

**Source: Researcher's Computation (2023) using E-view version 12**

The results of the Breuch Pagan Lagrangian Multiplier test for the models as presented in Table 6 show that the chi-square of  $X^2 = 20.98, 81.89, 15.05,$  and  $71.64$  for equations one to four, respectively, were all significant since the p-values were  $< 0.005$ . Thus, the null hypothesis is rejected for all the equations. This shows that the variance of random effects is not equal to zero and that the random effects model is appropriate for the relevant equations.

**TABLE 7**

Hausman Specification Test of External Audit Characteristics and Value Relevance

H0: difference in coefficient not systematic				
	Equation 1	Equation 2	Equation 3	Equation 4
chi <sup>2</sup> (1)	2.4	3.13	3.01	1.95
Pro > chi <sup>2</sup>	0.32	0.47	0.38	0.26

**Source: Researcher's Computation (2023) using E-view version 12**

The result of the Hausman specification tests for the equations as presented in Tables 4.7 shows that the chi-square  $X^2$  results of 2.4 for equation one, 3.13 for equation two, 3.01 for equation three, and 1.95 for equation four were not significant ( $p > 0.05$ ). The results for equations one to four suggest an insignificant difference between the coefficients of the random effects and the fixed effects models. A fixed-effect model was therefore used for the equations.

**TABLE 8: Normality test result**

	Kolmogorov-Smirnov <sup>a</sup>		
	Statistic	df	Sig
ERC	.898	129	.655
EAO	.594	129	.489
EAE	.707	129	.112
EAT	.083	129	.920
EAC	.483	129	.720

a. Lilliefors Significance Correction

**Source: Researcher's Computation (2023) using E-view version 1**

With  $p > 0.05$ , the test is insignificant for all dependent and independent variables, as can be seen above. A Kolmogorov-Smirnov test with  $p > .05$  indicates, that the sample distribution is not significantly different from a normal distribution. This outcome uncovers that all the variables consent to the normality supposition, thus, a linear regression technique is utilized to examine the data.

**TABLE 9: Fixed Effect Regression Results for Earnings Response Coefficient**

	Equation 1 ERC	Equation 2 ERC	Equation 3 ERC	Equation 4 ERC
<b>Variables</b>	<b><math>\beta</math> (t stat)</b>	<b><math>\beta</math> (t stat)</b>	<b><math>\beta</math> (t stat)</b>	<b><math>\beta</math> (t stat)</b>
<b>Constant</b>	-9.1361** (3.141)	- 2.560 (-1.949)	21.616** (3.236)	1.245** (1.946)
<b>EAO</b>	1.7791 (2.779) **			
<b>EAE</b>		0.6281 (1.145)		

<b>EAT</b>			-15.395 (-3.409)**	
<b>EAC</b>				0.194 (0.241)
R Square	0.0471	0.0801	0.262	0.019
F-Stat	7.7201 0.0061	1.312 0.2540	11.622 0.0011	0.0580 0.810

**Source: Researcher's Computation (2023) using E-view version 12**

*Notes: The coefficient values are presented with the t-statistics in the parenthesis, \* $p < .10$ ; \*\* $p < .05$ ; \*\*\* $p < .01$ , probabilities represent one-tailed when the direction of the coefficient is consistent with expectations, two-tailed otherwise).*

The results from equation 1 in Table 9 show that ERC was affected by an average of 314% if the independent variable (EAO) was held constant. Similarly, a unit increase in the external audit objectivity (EAO) score will lead to a 177% increase in ERC. The positive relationship between EAO and value relevance as proxied by the Earning Response Coefficient (ERC) was found to be statistically significant given that the computed t-statistic value of 2.779 was found to be higher than the critical t-statistic value of 1.860 (t 0.05).

Our overall result was found to be statistically significant in explaining the variations in ERC, given that the computed F-statistic value of 7.7201 is higher than the critical F-statistical value of 3.909 ( $F_{3,144}$ ). This indicates a moderate predictive power of EAO to explain the variations in Earnings Response Coefficient (ERC). Based on this, the null hypothesis is rejected, hence it can be stated that external audit objectivity has a significant effect on earnings response coefficient of listed firms in Nigeria.

The result from equation two shows that ERC was affected by an average of -194% if the independent variable (EAE) is held constant. Similarly, a unit increase in the External Audit Efficiency (EAE) score will lead to a 114% increase in ERC. The positive relationship between EAE and value relevance as proxied by the Earning Response Coefficient (ERC) was found to be statistically insignificant given that the computed t-statistic value of 1.145 was found to be less than the critical t-statistic value of 1.860 (t 0.05).

The computed F-statistic value of 1.312 was shown to be less than the critical F-statistical value of 3.909 ( $F_{3,144}$ ). This indicates a low level of predictive power of EAE to explain the variations in Earnings response coefficient (ERC). Based on this, with the probability value of the F-statistics obtained being higher than 0.05 (0.2540), the alternative hypothesis that indicates external audit efficiency has a significant effect on earnings response coefficient of listed firms in

Nigeria does not hold, hence it is rejected. The null hypothesis which states that External audit efficiency has no significant effect on earnings response coefficient of listed firms in Nigeria holds, hence it is therefore accepted.

The results from equation three show that ERC was affected by an average of 216% if the independent variable (EAT) was held constant. Similarly, a unit increase in the External Audit Timeliness (EAT) score will lead to a 153% decrease in ERC. The negative relationship between EAT and value relevance as proxied by the Earning Response Coefficient (ERC) was found to be statistically significant given that the computed t-statistic values of -3.4091 were found to be higher than the critical t-statistic value of 1.860 (t 0.05).

The coefficient of determination ( $R^2$ ) value of 0.2621 indicates that 26.2% of the variations in ERC have been explained by EAT. The remaining 73.8% of the variations are unaccounted for by the independent variable, which means that they can be attributed to other variables that are outside the model being explained. This is captured in the study by the error term.

Furthermore, the overall model containing the independent variable was found to be statistically significant in explaining the variations in EAT, given that the computed F-statistic value of 11.622 is higher than the critical F-statistical value of 3.909 ( $F_{3,144}$ ), so the predictive power of the model can be said to be significant. This implies that external audit timeliness has a significant effect on the earnings response coefficient of listed firms in Nigeria. Hence, the null hypothesis is rejected, while the alternative hypothesis is accepted.

Results from equation four indicate that ERC will increase by an average of 124% if External Audit Competence (EAC) is held constant. Similarly, a unit increase in the External Audit Competence (EAC) score will lead to a 2% increase in the ERC. The direct relationship between External Audit



Competence (EAC) and ERC was found to be statistically insignificant given that the computed t-statistic values of 0.241 were found to be greater than the critical t-statistic value of 1.860 ( $t_{0.05, 8}$ ). Also, the probability value was found to be higher than the 5% acceptable region.

Our overall result using the computed F-statistic value of 0.0580 was less than the critical F-statistical value of 3.909. The null hypothesis of an insignificant effect of external audit competence on the earnings response coefficient of listed firms in Nigeria will be accepted, and the alternative hypothesis will be rejected. This shows that external audit competence does not significantly affect the earnings response coefficient of listed firms in Nigeria during the period covered in this study.

### Discussion of Findings

The result from hypothesis one reveals that external audit objectivity has a significant effect on the earnings response coefficient of listed firms in Nigeria. This is because external audit objectivity plays a significant role in confirming the value relevance of financial reports, and the remuneration paid to external auditors as a proxy for external audit objectivity is a representation of the auditor's objectivity that can induce a change in the ERC. This result supports our a priori expectation, which states that the higher the external audit objectivity, the higher the ERC. Our result was also supported by Mgbame *et al.* (2012), who assert that the enhancement of the relevance of financial reports is dependent on the auditor's objectivity and professionalism.

It was established in this study that external audit efficiency has no significant effect on the earnings response coefficient of listed firms in Nigeria. This result was contradicted by our a priori expectation, which states that the higher the external audit efficiency, the higher the ERC. However, this was supported by the result of Hsieh's (2011) meta-analysis on audit efficiency, which established a negative association between the firm's (client) profit and audit fee and the firm's earning response coefficient (ERC).

It was also established from the study that external audit timeliness has a significant effect on the earnings response coefficient of listed firms in Nigeria. This was supported by our a priori expectations and was corroborated by Shivaram *et al.* (2015), who mentioned that investors rely on audit reports to make investment decisions; therefore, audit reports that are timely help investors make timely investment decisions, but if the audit takes too much

time, it might lose its time value and be adjudged less relevant.

The result from the last hypothesis shows that external audit competence has no significant effect on the earnings response coefficient of listed firms in Nigeria. This was contradicted by our a priori expectation, which states that the higher the external audit competence, the higher the earnings response coefficient of firms. The result was contradicted by Amahalu & Ezechukwu (2017), who established that audit competence in line with external audit characteristics affects the confidence level of users of the audited financial statements as well as the value relevance of such reports.

## 5. CONCLUSION

## AND

## RECOMMENDATIONS

The effect of external audit characteristics on the value relevance of listed firms in Nigeria produced mixed results. External audit objectivity and external audit timeliness have significant effects on the earnings response coefficient of listed firms in Nigeria, while on the other hand, external audit efficiency and external audit competence have not significantly affected the earnings response coefficient of listed firms in Nigeria.

The mix of results indicates the strength of each audit characteristic to influence the value relevance of listed firms. This implies that some audit characteristics and features are predominant, while others are not, in their effect on the value relevance of selected listed firms in Nigeria. The external audit objectivity, which represents unbiased and independent auditor perceptions of the firms accounting numbers, would enhance the value relevance of the financial reports of listed firms in Nigeria. On the other hand, it was, however, a conundrum that external audit efficiency, which is orchestrated by the ratio of audit remunerations to clients' income, did not contribute to the value relevance of the financial reports of firms. The external audit characteristics must take into cognizance the number of days between when a company's financial year ends and the day on which its audited financial statement is made public on the Nigerian Exchange Group. The feature can significantly affect the value relevance of the financial numbers in the financial reports. A rather long audit may constitute a threat to the time-value relevance of the report, and in some cases, a relatively short audit is likely to be done in haste and might be characterised by errors resulting in wrong audit opinion.

Another significant feature of an external audit that does not enhance the value relevance of a firm's

financial report is audit competence, which in this case is a proxy for the comparison between the big audit and the non-big audit firms. There is no doubt that the big four audit firms have stood the test of time and proven their worth over the years, and this does not preclude the fact that the non-big audit firms have proven their worth. So the use of the big four audit firms as a proxy for external audit competence might not necessarily boost the value relevance of the firms listed on the floor of the Nigerian Stock Exchange. This is the reason why Choi et al. (2010) stated that audit quality is often tied to competence scales.

However, De Angelo (1981) maintains that big audit companies have superior audit quality since they have already invested in large audit technology and staff training, and thus they are more competent and accurate in detecting problems related to misstatements and going concern assumptions than small audit firms. These big four audit companies have been used as a surrogate for audit quality. This surrogate might not necessarily serve as a true representation of competence in the context of this study but instead the ability to safeguard audit firms reputations and ensure an independent quality audit service, which in recent times the non-big four firms have been doing very well. All in all, the relevance of the financial reports of firms can be better enhanced when audit competence is a prerequisite for audit quality. It can therefore be recommended that Audit firms' and regulatory agencies should ensure that external audit objectivity is sustained, as this is critical to enhancing the value relevance of firms' financial reports. Firms listed on the Nigerian Exchange Group should as a matter of necessity adjust the audit fee they pay to an average industry agreeable audit fee so as not to pay too much for a less complex audit function thus the external audit efficiency of the audit exercise is questioned.

In order to provide a robust enhancement to the value relevance of financial reports, firms must not only consider analysis between big four and non-big four audit firms as a proxy for external audit competence. These criteria alone cannot serve as a true representation of audit competence. The competence of an audit firm should also include, among others, their perceived skills, experience, and expertise to carry out a more credible audit. Organisations should also consider reducing the number of days between when the financial year ends and the audit is completed and the financial statement is made public on the Nigerian exchange group as a means of enhancing the confidence level of investors in the relevance of firm financial reports.

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