Direct Research Journal of Management and Strategic Studies
Vol. 5(1), Pp. 1-8, January 2024
ISSN: 2787-009X
DOI: https://doi.org/10.26765/DRJMSS431924020
Article Number: DRJMSS431924020
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https://journals.directresearchpublisher.org/index.php/drjmss

Establishing Financial Performance of Firms through Audit Quality in Nigeria

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Received 12 November 2023; Accepted 24 December 2023; Published 5 January 2024

ABSTRACT: This study examined the relationship between audit quality variables and firm performance in Nigeria between the periods of 2012-2021. The specific objective of the study is to examine the relationship between audit quality variables [Audit Independence (AI) and Audit Firm Size (AFS),)] and [firm performance proxy with Return on Assets (ROA)] in Nigeria. The focus is on consumer goods firms listed on the Nigeria Stock Exchange. Due to the difficulty in assessing their annual reports and accounts a sample of 10 firms was drawn out of the 28 consumer goods firms for the study. The data for the study was obtained from the annual reports and accounts of the fifteen (15) firms based on the variables under study and the data was analyzed using descriptive statistics, correlation, panel unit root test, Pedroni Residual Co-integration and multiple regression analysis. Based on the discussion of findings, it revealed that Audit Independence (AI) and Audit Firm Size (AFS)) has a negative significant effect on Return on Assets (ROA) with p-values of -0.0476, and -0.0826. This study concludes based on the findings that audit quality variables have a significant mixed effect on firm performance in Nigeria. It is recommended that firms should employ audit firms in the provision of non-audit services, such as risk assessment etc. In addition, listed consumer goods firms should make it a habit to adhere to the specified period for audit report.

Keywords: Financial performance, firms, audit quality, audit independence audit firm size

Citation: Iloba, K. and Okolie, A. (2024). Establishing Financial Performance of Firms through Audit Quality in Nigeria. Direct Res. J. Manage. Strat. Studies. Vol.5 (1); Pp. 1-8. This article is published under the terms of the Creative Commons Attribution License 4.0.

INTRODUCTION

Financial reporting is one of management's major tasks, as it allows for reporting on management. Managers of public companies are required to prepare and present annual financial reports to shareholders, and the company's owners, as well as other stakeholders for the purpose assess the reporting entity's performance and financial position (Amahalu and Obi, 2020).This means that financial reports that do not match the information needs of their users do not accomplish their goal.

Auditors are expected to make objective assessments of whether organizations are managed responsibly and successfully to achieve the desired goals in the business world. Investor confidence is critical to the successful operation of the world's financial markets, and it is one of the most hotly debated topics among auditors, politicians, the media, regulators, and the general public (Eshitemi and Omwenga, 2016; Matoke and Omwenga, 2016). The goal of an audit is to organize and conduct it in such a way that suitable audit evidence is obtained to support the conclusion presented in the auditor's report. Inadequate or improper audit evidence may lead to incorrect conclusions, lowering the report's quality (Amahalu and Obi (2020); Iliemena et al., 2019). The job of the external auditor is crucial to the functioning of the capital market, since both owners (shareholders) and professional managers would want to depend on the external auditor's report in furthering the often conflicting interests stemming from the owner/manager agency relationship that exists.

When the audit quality of a company's financial reporting is questioned, it's likely that the company may change auditors to avoid the capital market ramifications of incorrect financial reporting (Abdullahi et al., 2020). Researchers are concerned about the direct impact of audit quality on business performance of manufacturing firms listed on the Nigerian stock exchange (NSE).

Audit quality is examined in this study using five primary determinants: audit independence, audit firm size, audit fees, audit report timeliness, auditor tenure, and return on asset (ROA).

The problem

In Nigeria, there has been widespread fraud and unethical behaviour within and among a variety of institutions (Mustafa and Abdulwahab, 2018). Recent insider trading, widespread fraud as a result of corrupt practices, and an inefficient rubber stamped board have all contributed to the current firm's lack of success or failure, this can be seen in the banking sector in Nigeria widely reported many accounting irregularities, such as; Spring Bank, Fin Bank, Afri Bank, Union Bank, Oceanic Bank and Intercontinental Bank was because of lack of good supervision roles by the board and poor audit qualities (Ghosh and Moon, 2015). The events have had a severe impact on stakeholders in terms of investment losses. Hundreds of jobs have been lost as a result of the events, and non-financial sector is not an exception in case of Cadbury Nigeria Plc and African Petroleum (AP) (Okolie, 2014), and the share prices of most listed businesses on the Nigerian stock exchange have plummeted.The public and stakeholders were taken back, and the question of "how" such an earning management could have occurred when corporations were claiming billions of naira in profit remained unanswered (Ugwu et al., 2020).

Prior study that looked at the impact of audit quality on business performance yielded mixed results, resulting in inconsistency. Abdullahi et al. (2020), for example, discovered that audit fee had a positive but small connection with ROA. This means that if the amount paid to auditors for audit services is reduced, the financial performance of Nigerian listed businesses will improve. Auditor size has a large positive association with ROA, which supports the agency argument. This positive figure shows that as the number of enterprises audited by Big4 grows, so does financial performance (ROA). Auditor independence is likewise linked to the ROA in a positive and statistically meaningful way.

As a result, the issue remains: what effect does audit quality have on the financial performance of Nigeria's listed consumer goods firms? These are some examples of prior research's inconsistencies. As a result of the above investigations, it is clear that previous researchers have failed to demonstrate a clear direction of the effect of audit quality on financial performance. Prior research has produced mixed results and inconclusive findings, indicating a knowledge gap. The distinctiveness of this research above previous earlier studies, to the best of the researcher's knowledge, is that the size of an audit firm, audit fees, audit report timeliness, and audit tenure in relation to financial performance has only been explored by few authors in Nigeria before. However, employing a longer period of time and expanding the scope of research by studying non-financial enterprises will help to provide a more in-depth explanation, which could lead to more accurate findings, as no study in Nigeria has ever examined non-financial organizations, This is the gap that the current research aims to fill, by proxing audit quality with Audit Independence (AI) and Audit Firm Size (AFS),} while financial performance is proxy with Return on Assets (ROA) of manufacturing firms (firms listed on consumer goods sector) in Nigeria.

Objectives

1. Ascertain the influence of Audit Independence (AI) on Return on Assets (ROA) of manufacturing firms in Nigeria.
2. Examine the effect of Audit Firm Size (AFS) on Return on Assets (ROA) of manufacturing firms in Nigeria.

Literature review

Concept of audit quality

An audit is defined as an objective and systematic examination of the financial accounts of an organization by an independent person (the Auditor) in order to express an opinion on the truth and fairness of the financial statement assertions in an accounting period (Okolie and Izedonmi, 2014). According to the Carp and Istrate (2021), an external auditor is appointed to provide an independent opinion on the true and fair view of the financial statements of a company in order to give assurance to stakeholders on the reliability of the financial statements. One of the major threats that face investors appears to be the failure of auditors to detect material misstatements in the financial statement of a firm, questions reliability of financial statements of firms in Nigeria (Iliemena and Okoye, 2019). Audit quality plays an important role in maintaining an efficient market environment; an independent quality audit underpins confidence in the credibility and integrity of financial statements which is essential for well-functioning markets and enhanced financial performance (Farouk and Hassan, 2014).

Components of audit quality

`Conceptually, there are varied determinants and factors which affect audit quality. This is revealed to include audit fees, audit firm rotation/tenure, audit committee oversight, audit firm size, audit independence and personal characteristics of the Auditor which include his competence, independence, qualification and experience (Okolie, 2014). These factors seem to be related as the bigger the size of the audit firm is the higher the audit fees,

competence, audit plan, independence, qualification and experience, which also increases the quality of the audit and increases the tendency for true and fair view on the financial statements so audited (Okolie and Izedonmi, 2014; Reza and Quraishi, 2015). This is further asserted by Azizi (2010) who states that the bigger the audit firm size is the longer the tenure and the higher the quality of the audit and the lower his or her motivation for manipulating profit to reach personal interests and the higher would be the reliability of financial statements.

Audit committee and firm performance

A firm's audit committee often oversees the financial reporting process of a company. It meets regularly with the outdoor auditors and internal monetary managers of the company to review the financial statements, audit process, and accounting controls of the company. Thus, audit committees doubtlessly serve a vital oversight role and may have an effect on the exceptional of reported earnings (Klein, 2012). Supporting this view, Volosin, (2017) reveals that corporations with nicely-set up audit committees are much more likely to have dependable financial reporting (i.e., the absence of mistakes, irregularities, or unlawful acts). Two traits of audit committees look like of precise significance whilst measuring effectiveness inside the U.S.: audit committee independence and monetary sophistication. Several research advise that greater impartial audit committees are more effective. For instance, Klein (2012) documents a terrible courting between audit committee independence and odd accruals. Carcello et al (2016) record that distressed corporations which have more independent audit committees are much less likely to be issued going-challenge reviews by using their auditors and greater impartial audit committees are extra powerful in protective auditors from dismissal when a new going-situation record is issued (Chi et al, 2009).locate that extra unbiased audit committees had been faster to disregard Arthur Andersen as their firm's auditor after Andersen's credibility turned into threatened across the Enron scandal. Krishnan (2005) unearths that impartial audit committees are extensively less in all likelihood to be associated with incidences of internal manage troubles.

Audit firm size and firm performance

Salehi and Mansoury (2019) asserted that the size of an audit firm has been used as a substitute for audit quality, meaning that larger audit firms have a bigger reputation to safeguard and therefore will ensure a more independent quality audit service. It was explained that these large firms have better financial strengths, research facilities and services, superior technology and more experienced employees to undertake large company audits (Matoke and Omwenga, 2016; Okolie et al, 2014). Their larger client portfolios enable them to resist management pressure, whereas smaller firms provide more personalized services due to limited client portfolios and are expected to succumb to management requirements (Ching, The, San and Hoe, 2015). Audit firm size has a positive effect on firm financial performance because many stakeholders believe that firms that are audited by the Big Four are free from material misstatement, which encourages and boost their confidence to invest more of their money in such firms (Okolie et al, 2014; Al-Attar, 2017). The most common and well-researched indicator of audit quality characteristics is whether an audit firm is one of the “Big 4” (DeFond and Francis, 2005).

Firm performance

Financial performance which assesses the fulfillment of a firm’s financial goals has long being a problem of hobby in managerial researches. Firm monetary overall performance pertains to the various subjective measures of ways nicely a firm can use its given assets from primary mode of operation to generate earnings. Kothari (2001) described the value of a firm as the prevailing cost of the anticipated future coins flows after adjusting for chance at the ideal rate of go back. To (Eyenubo, 2013) it's far the fulfillment in assembly pre-defined targets, objectives and purpose within a exact time goal. Qureshi, (2007), put forward 4 distinctive strategies in which the cost of a firm has been diagnosed in company finance literature. These are: the economic management method which awareness at the evaluation of coins flows and investment degrees earlier than identifying and assessing the effect of financing assets on company fee; the capital shape method which research the effect of capital shape adjustments on the price of company and the way different factors impact at once or inversely the debt and equity factor of the company capital shape (Monametsi and Agasha, 2020). The resource based approach and is the reason the cost of firm as an final results of firm’s assets; and sooner or later, the sustainable increase approach which is a precise of the above 3 tactics to company fee, taking into account the company’s running overall performance, its funding and financing desires, the financing assets, and its financing and dividend rules for sustainable improvement of company’s resources and maximization of company cost (Qureshi, 2007; Awa and Obinabo, 2020).This examine examines two key accounting measures of companies" monetary overall performance that are Return on Equity and Return on Assets.

Return on assets (ROA)

One of the broadly used accounting based measures of company governance in literature is the Return on Asset

(ROA) (Weir and Laing, 1999). It assesses the effectiveness of capital hired and presents a basis in which traders can measure the income generated via the firm from its investment in capital assets (Epps and Cereola, 2008). The go back on property (ROA) is a degree which indicates the quantity of profits that have been generated from invested capital. It is an indication of the variety of kobo earned on each naira really worth of assets. It lets in users, stakeholders and tracking companies to assess how properly a farm's company governance mechanism is in securing and motivating green control of the firm (Chagbadari, 2011). The ROA is the ratio of annual net earnings to common overall assets of a enterprise at some point of a economic year. It is measured consequently:

$$\text{ROA} = \frac{\text{Annual Net Income}}{\text{Average Total Assets}}$$

Theoretical review

Auditors' theory of inspired confidence

This study is anchored on Auditors' Theory of Inspired Confidence developed in Netherlands by the Limperg Institute in 1985, the theory of inspired confidence recognizes the auditor as a confidential agent who derives his function from the need for expert and independent examination as well as the need for an expert judgment supported by the audit work (JIvungu et al., 2019). This theory offers a connection between the users' needs for reliable financial reports and the ability of the audit work to meet those needs. Thus, auditors are required to know that the public expects a low rate of audit failure. Therefore, auditors are required to plan and perform their audit in a manner that will reduce to the barest minimum the risk of undetected material misstatements (Usifoh et al., 2019). The auditor is under obligation to conduct his work in a manner that does not betray his confidence (Limperg Institute, 1985).

The main importance of this theory is that, the duties and responsibilities of the auditors are derived from the confidence and trust that the public bestowed on the success of the audit and the assurance given by the auditor (Cheng, Chen and Chen, 2018). According to Carmichael (2004), the confidence that the society has in audited financial statements is misplaced when the audit process fails to address the societal expectations giving rise to a loss in the value relevance of even the audit.

Empirical review

Erasmus and Akani (2021) investigated the relationship between audit quality and market value of quoted banks in Nigeria. To achieve this objective, theoretical, conceptual and empirical literatures on audit quality and market value were reviewed. Audit quality was proxied by audit fees, audit tenure and audit firm size while market value was proxied by market price per share. The population of this study consists of fourteen quoted banks in Nigeria. The study adopts judgmental sampling techniques to select twelve banks as sample size. Secondary data were obtained from audited annual financial report of quoted banks in Nigeria from 2006-2019. Hypotheses were tested using panel least squares regression through pooled effect, fixed effect and random effect determined by Hausman test, fixed effect was accepted, with the aid of E-views 10 econometric statistical software. Findings shows that audit fees have negative and insignificant impact on market price per shares. Empirical evidence indicates that audit tenure had negative and significant impact on market price per shares. Empirical evidence suggests that audit firm size had negative and insignificant impact on market price per shares.

Carp and Istrate (2021) estimated the impact of some characteristics of the auditors and of the audited companies on audit quality for the Romanian listed firms (943 observations for the 2007–2019 period), using as a proxy for the audit quality the level of discretionary accruals, measured following the Jones (1991) model, and the accruals quality, estimated through the Dechow and Dichey (2002) model in Abdulahi et al (2020). These dependent variables have been related to variables that reflect both the characteristics of the audit firm (for example, Big 4 membership) and the characteristics of the audited firms (dimension, financial leverage, accounting standards applied, growth and profitability). The results regression analysis showed that the auditor's Big 4 membership contributes to an increase in discretionary accruals, decreasing the quality of the audit. The transition to IFRS did not have a significant influence on the quality of the audit. The audit opinion may have an effect on the discretionary accruals and the accruals quality in the sense that a modified opinion leads to an increase in the quality of the audit in the following financial year(s).

METHODOLOGY

This study made use of Ex-Post facto studies layout due to the fact the data for the study is sourced from annual reports and accounts of the twenty-eight (2018) consumer goods companies under study, hence, the event recorded has already taken place and can't be manipulated by researcher. This kind of data will be suitable for the adoption of Ex-Post Facto research design. The population of this study was finite, that is, the total 287 the annual reports and accounts of manufacturing firm listed in the Nigeria stock exchange as at November 25th, 2021 according to Nigeria Guide. Judgmental sampling techniques, because the sample of 15 consumer goods firms were randomly drawn out of the 28 consumer goods manufacturing firms in a purposive

Table 1: Measurement of variables

Variables	Formula	Expected Signs	Type of Variable	Validity Source
Return on Assets (ROA)	Net Profit/Total Asset		Dependent Variable	Monametsi and Agasha (2020)
Audit Committee independence	Percentage of independent directors to total number of audit committee	+/-	Independent Variable	Erasmus and Akani (2021)
Audit Firm Size	It measured as the choice of a sampled company to employ the services of any of the Big 4 audit firms. A dummy value of 1 is used or '0' if otherwise. The Big 4 audit firms in Nigeria are; Akintola Williams Delloite, Price Water house Coopers, Ernst and Young, and KPMG.	+/-	Independent Variable	Adeniyi and Mieseigha, 2013; Enofe, Mgbame Enabosi, 2013

Table 2: Descriptive statistics output of the Independent and Dependent Variables.

	ROA	AI	AFS
Mean	0.087960	0.779334	0.933333
Median	0.077446	0.833333	1.000000
Maximum	0.303786	2.250000	1.000000
Minimum	-0.340632	0.090909	0.000000
Std. Dev.	0.091777	0.516864	0.250279
Skewness	-0.625076	0.785548	-3.474396
Kurtosis	5.869709	3.182854	13.07143
Jarque-Bera	61.23816	15.63612	935.7462
Probability	0.000000	0.000402	0.000000
Sum	13.19398	116.9001	140.0000
Sum Sq. Dev.	1.255023	39.80508	9.333333
Observations	150	150	150

Source: E-VIEW 9.0 Output, 2022.

manner thereby making it convenient for the study. The annual reports and accounts of the 28 consumer goods firms during the financial years of 2012 to 2021 were used for getting data to measure the relationship between audit quality and firm performance in Nigeria for the period of 2012-2021 (10 years). To determine the stationarity of the panel data, descriptive statistics, a correlation matrix, and the panel unit root test were used, followed by the Pedroni Residual Co-integration Test to determine the long relationships in the variables in order to determine if it would be suitable for regression analysis. The multiple regression analysis using ordinary least square (OLS) method with the aids of E-VIEW 9.0 statistical computer software was used to analyze data in order to establish the kind of relationship that exist between the independent variables and the dependent variable used, which serve as the basis of testing the hypotheses raised in this study.

RESULTS AND DISCUSSION

Table 1 above bases its selection of variables on the theoretical proposition and evidence in the literature; two categories of variables were used; dependent and independent variables. The independent variables are audit independence, audit size, audit meeting and audit expertise while dependent variable is return on assets. The data set as indicated from the (Table 2) contained a total of 150 observations for fifteen (15) consumer goods firms listed in the Nigeria Stock Exchange over a period of ten years (2012-2021) for four independent variables [Audit Independence (AI), Audit Firm Size (AFS), and one dependent variable [Return on Assets (ROA)].

The minimum values of all the variables as indicated above ranges from minimum of 0.0909 and maximum of 2.2500 for Audit Independence (AI). The mean value of the Audit Independence (AI) which is measured by percentage of independent directors to total number of audit committee is0.7793 with a standard deviation of 0.5167. This implies that Audit Independence (AI) of the fifteen (15) consumer goods firms in Nigeria deviate from its mean value up to 26.26% (1.022619- 0.466900 = 0.2626 X 100).

The descriptive statistics also showed that the minimum value is 0.0000 and the maximum of 1.0000for Audit Firm Size (AFS). Audit Firm Size (AFS) of the fifteen (15) consumer goods firms as measured as the choice of a sampled company to employ the services of any of the Big 4 audit firms. A dummy value of 1 is used or '0' if other wise of the fifteen (15) consumer goods firms in Nigeria has a mean value of 0.9333 with standard

Table 3: Correlation matrix for the variables under study.

	ROA	AI	AFS	AF	ART
ROA	1.000000		-	-	-
AI	-0.154713	1.000000	-	-	-
AFS	-0.198075	-0.200954	1.000000	-	-

Source: E-VIEW 9.0 Output, 2022.

Table 4: Panel unit root test result

Variables	Method	Statistics	Probability	@Ist Diff.	Check for Stationary
ROA	Levin, Lin & Chu Test	-7.90580	0.0000	1(1)	Stationary
	ImPesaran and Shin W-Test	-3.47972	0.0003	1(1)	Stationary
	Augmented Dicker-Fuller's Test	68.1426	0.0001	1(1)	Stationary
	PP Fisher Test	162.878	0.0000	1(1)	Stationary
AI	Levin, Lin & Chu Test	-11.9059	0.0084	1(1)	Stationary
	ImPesaran and Shin W-Test	60.760	0.0009	1(1)	Stationary
	Augmented Dicker-Fuller's Test	68.4758	0.0020	1(1)	Stationary
	PP Fisher Test	52.5767	0.0000	1(1)	Stationary
AFS	Levin, Lin & Chu Test	-13.2059	0.0024	1(1)	Stationary
	ImPesaran and Shin W-Test	-0.85650	0.0159	1(1)	Stationary
	Augmented Dicker-Fuller's Test	18.4758	0.0020	1(1)	Stationary
	PP Fisher Test	62.5767	0.0000	1(1)	Stationary

Source: E-VIEWS, 9.0 Output (2022).

deviation of 0.2503. In comparison, this result shows that the Audit Firm Size (AFS) of the firms has rapid increase over the years since the standard deviation value is lesser than the mean value. This implies the volatility of Audit Firm Size (AFS) is 25.03%. Furthermore, the descriptive statistics above shows that the minimum value is -0.3406 and the maximum of 0.3038 for return on Assets (ROA). Return on Assets (ROA) has an average value of 0.0880 with standard deviation of 0.0918. In comparison, this result shows that the Return on Assets (ROA) of the firms has slow increase over the years since the standard deviation value is greater than the mean value.

The correlation coefficient of (r=-0.1547) (Table 3) for Audit Independence (AI), this shows a weak negative correlation between Audit Independence (AI) and Return on Assets (ROA). It's evident from the correlation coefficient of Audit Independence (AI) that it does not determine its Return on Assets (ROA). Also, there is a strong negative correlation coefficient between Audit Firm Size (AFS) and Return on Assets (ROA). The coefficient of correlation -0.1981 shows no statistical correlation between Audit Firm Size (AFS) and Return on Assets (ROA). In other words, increase in Audit Firm Size (AFS), will lead to a decrease in Return on Assets (ROA). The correlation result for Audit Fees (AF) and Return on Assets (ROA) shows a strong negative correlation as it evidence by the correlation coefficient.

Panel unit root test

This test is used to determine whether or not the data series are stationary. It's vital to remember that if a set of data isn't stationary, the conclusion obtained will be ludicrous, and hence the result will be unsatisfactory. A panel unit root test employing the Levin, Lin, and Chu Test, ImPesaran and Shin W-Test, Augmented Dicker-Test, Fuller's and PP Fisher Test is the best approach to ensure that a collection of panel data is stationary. The summarized result is shown in (Table 4). Table 5 shows the Multiple Regression result that displayed the coefficient and the p-value for the independent variable; Audit quality variables [Audit Independence (AI), Audit Firm Size (AFS),] on the dependent variable firm performance; [proxy with Return on Assets (ROA)] of fifteen (15) consumer goods firms listed in the Nigeria stock exchange.

Audit independence (AI) and return on assets (ROA)

The regression coefficient values recorded for Audit Independence (AI) and Return on Assets (ROA). Audit Independence (AI) with coefficient of -0.0476 has weak negative relationship with Return on Assets (ROA). It also showed that the relationship between Audit Independence (AI) and Return on Assets (ROA) is weak and negative. The p-value of 0.0020 is lesser than 0.05 level of significance and greater than the acceptable 95% confidence interval. This implies that there is a significant relationship between Audit Independence (AI) and Return on Assets (ROA).

Audit firm size (AFS) and return on assets (ROA)

The regression coefficient values recorded for Audit Firm Size (AFS) and Return on Assets (ROA). Audit Firm Size

Table 5: Regression results of the independent and dependent variables.

Dependent Variable: ROA				
Method: Panel Least Squares				
Date: 08/09/22 Time: 17:21				
Sample: 2012 2021				
Periods included: 10				
Cross-sections included: 15				
Total panel (balanced) observations: 150				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.190683	0.731280	-1.628218	0.1056
AI	-0.047566	0.015145	-3.140698	0.0020
AFS	-0.082600	0.029241	-2.824835	0.0054
R-squared	0.157758	Mean dependent var		0.087960
Adjusted R-squared	0.134523	S.D. dependent var		0.091777
S.E. of regression	0.085381	Akaike info criterion		-2.050625
Sum squared resid	1.057034	Schwarz criterion		-1.950271
Log likelihood	158.7969	Hannan-Quinn criter.		-2.009854
F-statistic	6.789872	Durbin-Watson stat		0.901948
Prob(F-statistic)	0.000049			

Source: E-VIEW 9.0 Output, 2022.

(AFS) with coefficient of -0.0826 has strong negative relationship with Return on Assets (ROA). It also showed that the relationship between Audit Firm Size (AFS) and Return on Assets (ROA) is strong and negative. The p-value of 0.0054 is lesser than 0.05 level of significance and greater than the acceptable 95% confidence interval. This implies that there is a significant relationship between Audit Firm Size (AFS) and Return on Assets (ROA).

Conclusion

Based on the discussion of findings, it was revealed that Audit Independence (AI) and Audit Firm Size (AFS) have a negative significant effect on Return on Assets (ROA).

Recommendations

1. Firms should employ audit firms in the provision of non-audit services, such as risk assessment etc.
2. In addition, listed consumer goods firms should make it a habit to adhere to the specified period for audit report.

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