

# Audit Firm Size and Market Price Per Share of Quoted Companies in Nigeria

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## ABSTRACT

This study investigates the influence which audit firm size exerts on the market value per share of companies in Nigeria. Based on a sample of 342 companies – year observations from the NSE and applying audit firm size as a measure, comprehensive multivariate analyses were conducted on archival data covering 2006 – 2011. The result showed that audit firm size exerts significant relationship and significantly influences market price per share of the companies in the sample. It is suggested that companies in Nigeria should improve their earnings quality only through sales growth and cost control strategies and present distinct reports on earnings quality. Furthermore, company auditors should issue Integrated Audit Quality Assurance Reports based on earnings quality assessment, statutorily backed by earnings monitoring of companies in Nigeria while regulatory agencies should issue authoritative codes of best practice in Nigeria.

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## Introduction

A number of studies have ventured into establishing the existence of any distinct relationship between audit firm size and earnings mappings and to demonstrate whether the relationship has any influence on the market price per share of quoted companies in many countries (Becker, Defond, Jiambalvo & Subramanyam, 1998; Bauwhede, Willekens & Gaeremynck, 2000; Heninger, 2001; Ebrahim, 2001; Piot & Janin, 2005; Gerayli, Yanesari & Ma'atoofi, 2011). These studies show that the quality of audit is expected to minimize the extent of a firm's manipulations of reported income and this reflects on the market value per share of companies. However, majority of the findings appear to suffer from discrepancies and inconsistency.

The demand for audit of companies' accounts is created by the agency problems which are related to the separation of corporate ownership from control (Eilifsen and Messier, 2000; Gerayli, Yanesari and Ma'atoofi, 2011). The agency problem arises from the existence of asymmetric information in the principal – agent contracts (Jenson and Messier, 2000). Some studies (Trueman and Titman, 1988; Dye, 1988; Schipper, 1989; Warfield, Wild and Wild, 1995) have shown that the existence of information asymmetry between corporate management and shareholders is a necessary condition for the perpetration of earnings management practice. The audit of a company's accounts is a monitoring and control mechanism that diminishes information asymmetry and protects the interests of the principal.

Management of organizations built on the response divergent stakeholders perspectives has been perceived as a pragmatic approach. Khan (2006) has argued that for an organizational success, attention must be paid to all relevant stakeholders as those relationships can impact on and are affected by the achievement of the organization's goals. Arrunada (2000) shows that the demand for auditing services arises from a need to facilitate dealings between the parties involved in business relationships – shareholders, creditors, public authorities, employees, customers, etc. Exchanges between such parties are usually costly since information asymmetries give rise to uncertainty concerning the performance of contractual obligations. The presence of information asymmetry makes it difficult for shareholders to detect earnings management.

Auditors' theory of inspired confidence offers a linkage between the users' requirement for credible financial reports and the capacity of the audit processes to meet those needs. It sees through the development of these needs of the public (stakeholders) and the audit processes over time. The theory suggests an inspired confidence bestowed on the auditor as a confidential agent who derives his function in society extensively from the call for professional and autonomous assessment as well as the necessity for skilled and objective opinion sustained by tests and attestations. The public expectation of a low rate of

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audit failures means that audit process must minimize the risk of undetected material misstatements and the accountant must not betray the confidence which he commands before the rational person. However, the accountant may not produce what is greater than the public expectation (Limperg Institue, 1985). The confidence determines the existence of the process and its betrayal logically terminates the process or function. Carmichael (2004) argued about the social significance of audit and affirmed that when the confidence that society has in the effectiveness of the audit process and the audit report is misplaced, the value relevance of the audit is destroyed. The auditors' maintenance of reasonable quality assurance eliminates audit failure, provides guarantee to the stakeholders and supports confidence in the capital markets along with financial reporting, corporate governance and regulations.

Signaling through auditor choice stands on the agency theory, and is a manner by which managers and/or directors may impart to the market additional information about their company and their own behaviour. Signaling theory suggests that companies with good performance use financial information disclosure to send signals to the market. Companies are provided an incentive to signal, other than through transparency in their notes to the accounts and other voluntary disclosures, through their choice of auditor. Moreover, even voluntary disclosures that may be used as signals achieve enhanced credibility only in the presence of a quality audit.

A high quality audit sends a signal to the market that the financial statements are more credible than those audited by lower quality auditors. The market perceives size and specialist auditors to be of a higher quality than others and rewards (punishes) companies with larger improvements or falls in share prices accordingly (Teoh and Wong, 1993; Krishnan & Yang, 1999; Menon & Williams, 1994). Signaling theory does not actually require higher audit quality; it merely needs the market to believe that Top Tier firms are associated with higher audit quality because of the fee premiums they are able to command (Moizer, 1997). This study assumes that the market's perception of the quality of a company's auditor influences the company's share price.

Lev (1989) shows that the value of a company's shares represents the value of its future earnings and this clarifies the reason for investors central interest in the earnings reports. This study defines earnings management as the strategy used by company managers to deliberately manipulate company earnings to match a predetermined target and involves the planning and execution of certain activities that manipulate or smooth earnings, activate elevated income intensity and sway the firm share price (Schipper, 1989; Healy & Wahlen, 1999). Cash - based earnings management is achieved by the manipulation of the operating activities of a company. Roychowdhury (2006) defines cash - based earnings management as departures from normal operational practices, motivated by managers' desire to mislead, at least, some stakeholders into believing that certain financial reporting goals have been met in the normal course of operations. This study assumes that earnings management in an emerging market like the Nigerian Stock Exchange (NSE) is likely to present some problems for a true and qualitative earnings report.

Anecdotal as well as empirical evidences on the effects of audit firm size on earnings misstatements of non-financial institutions exist in the developed countries. Only a few studies may have been done on the relationship between audit firm size and earnings and market price per share of firms in transition economies. In the case of Nigeria, evidences are not available to transmit the effects and association between audit firm size and market value per share of quoted companies in the non - financial institutions.

### **Problem Analysis**

During the past decade, corporate collapses and financial scandals permeated the global corporate landscape proceeding from the case of Enron to Worldcom. In Nigeria in particular, shocking corporate failures proceeded from Cadbury Plc and African Petroleum Plc to the collapse of several Deposit Money Banks. This has apparently undermined the credibility of the audit process, the audit function and the auditors' reports. Consequently, there has been strong advocacy for greater reliance on continuous audit assurance and assurance reports (Alles, Kogan & Varsarhelyi, 2004). The audit process assesses the probability of material misstatements and reduces the possibility of undetected misstatement to an appropriate assurance level (Watts & Zimmerman, 1986; Knechel, 2009). Audit quality is recognized to influence financial reporting and strongly impact on investors' confidence (Levitt, 1998). Conventionally, external auditors play critical and highly challenging roles in assuring the credibility of financial reports (Mautz & Sharaf, 1961; Wallace, 1987).

The acknowledged inability of audit process to arrest financial misstatements in its celebrated, long-established and time-honoured domain of attestation has provoked the ostensible upsurge of interest and attention in general financial reporting. The perceived failure of audit to fully alert equity and other stake holders concerning misrepresentations in financial position and to sufficiently report accurate operational earnings has made investors helpless and unable to undertake rational financial decisions affecting companies generally. This is because the quality of reported earnings and the ability of audit quality to effectively constrain earnings manipulations of companies across the world and Nigeria in particular, have become appreciably doubtful due to latest corporate accounting scandals (Badawi, 2008; Enofe, 2010). Variations in audit quality result in disparity in the credibility of auditors and the reliability of the earnings reports of companies. This endemic financial menace creates a great threat to the veracity, credibility, utility and value relevance of the audit function. Alles et al (2004:184) assert that “the degree to which assurance adds value to communication between an auditee and its audience is directly related to the credibility of the auditor. Whatever may be their real cause, the effect of the current series of corporate scandals, especially Enron and the subsequent collapse of Arthur Anderson, has been to undermine public confidence in the audit programme”.

Badawi (2008) reports a list of companies involved in cases of accounting scandals related to poor audit quality and earnings manipulations in the past decade. In Nigeria, corporate scandals include the cases of Cadbury Nigeria Plc and African Petroleum Plc (Okolie and Agboma 2008); Savannah Bank and African International Bank (Odia, 2007); Wema Bank, Nampak, Finbank and Spring Bank (Adeyemi & Fagbemi, 2010); and more recently Intercontinental Bank Plc., Bank PHB; Oceanic Bank Plc. and AfriBank Plc. These are known publicly reported cases that resulted in misleading financial reports. There is therefore a concern about the quality of accounting income and its relationship with the quality of the auditing process which has been observed to increase over time following the periodical clusters of business failures, frauds, and litigations. The issue is whether these corporate collapses are not the outcome of poor audit quality and the inability of the audit function to arrest earnings misstatements.

The focus of external users on reported earnings as a central variable for making decisions and recent corporate scandals means that earnings misrepresentations has become a matter of great concern. Using numbers, management may abuse “big bath” restructuring charges, premature revenue recognition, reserves and write-offs of purchased in-process research and development (Healy & Wahlen 1999). These practices can threaten the credibility of financial reporting. There are concerns regarding earnings reports which require factual and not fictional accounting to accentuate the importance of company accounts that are true and fair. The essence of this requirement is that companies must not distort, hide, fabricate and present, in whole or in part, deceitful financial reports that tend to heighten earnings intensity and sway company market prices. .

Subsequent to the focus on reported income statement, earnings analysts and investors may center more on cash flows rather than the income statement of a company. As a result of corporate scandals analysts and stakeholders may have lost faith in accounting income-based measurements. Sufficient cash flows from operating activities are essential for these companies to remain profitable and viable in the future. Lack of cash flows could result in bankruptcy or for a company to turn into a takeover prey. Since investors use the cash flow statement to make investment decisions, highly motivated and intelligent management teams could be involved in cash – based earnings management to create ways to influence the true picture of a company’s cash flow from operations (CFO).

Given the above scenario, the major problem of this study is to determine whether the size of audit firms significantly influences the market value per share of quoted companies in Nigeria. The study attempts to ascertain and establish whether there are significant relationships between Audit firm size, the level of cash earnings mappings and the Market Price per Share (MPS) of quoted companies in Nigeria.

## **Literature Review**

Extant literature relating to this study covers the concepts of Audit firm Size and Audit Quality; and the relationship which subsists between Auditors Reports, Share Prices and Earnings Management of Companies.

### **Concept of Audit Firm Size and Audit Quality**

Prior studies (DeAngelo, 1981; Palmrose, 1988; Deis & Giroux, 1992; Becker *et al*, 1998; Francis & Krishnan, 1999; Krishnan & Schauer, 2000; Kim, Chung & Firth, 2003 and Krishnan, 2003) which use size of audit firm to measure audit quality treated it as dichotomous variable and a dummy assuming 1 and 0 for large and non large audit firms. Audit firm size signifies various types of qualities. It is assumed that size (Big 4 or Big 5, Big 6 ... Big 8, etc.) of audit firms suggest reputation, international affiliation, and integrity which are reflected in the audit report on the accounts of their clients. This reflects the Limperg Institutes' (1985) theory of inspired confidence. It has severally been argued that the large audit firms significantly determine the disclosure of policies of the companies they audit.

DeAngelo (1981) theoretically analyzed the relation between the quality of audit and auditor's size and argued that large audit firms have more clients and their total fees are allocated among those clients. Defining the auditor's independence by the conditional probability that the auditor will disclose any misstatement in financial statements given that this misstatement was already discovered, DeAngelo (1981) assert that large audit firms are more independent and therefore, provide higher quality of audit. In considering auditor size and earnings management, DeAngelo (1981) argues that Big-4 auditors provide better quality audits than non-Big4 auditors. This position has gained extensive support of subsequent empirical studies including Palmrose (1988); Deis and Giroux (1992); Becker, *et al* (1998); Francis and Krishnan (1999); Krishnan and Schauer (2000); Kim, Chung and Firth (2003); Krishnan (2003).

Teoh and Wong (1993) find higher earnings response coefficients for clients audited by Big-4 firms compared to those audited by non-Big4 firms. Becker et al (1998), Francis et al (1999) and Krishnan (2003) demonstrate that Big4 auditors are better at constraining client earnings management compared to non-Big4 auditors. In addition, Zhou and Elder (2001) find that Big-4 auditors are associated with less earnings management.

The results of studies by Davidson and Neu (1993); Lennox (1999); DeAngelo (1981); Dye (1988); Colbert and Murray (1998) provide additional support for the use of auditor size as proxy for audit quality. Davidson and Neu (1993) used an indirect method to support the argument that size is a good proxy for auditing quality. They argued that managers have incentives to manipulate the reported earnings to meet the analysts' forecasts. Using data for Canadian firms, their results support the expectation indicating that the auditor size is a good proxy for auditing quality. Lennox (1999) looked at the two explanations of the hypothesized positive relation between audit quality and auditor size:

1. the reputation hypothesis suggested by DeAngelo (1981) who argues that large auditors have more incentives to be accurate because they have more client-specific rents to lose if their reports are not accurate, and
2. the deep pockets hypothesis used by Dye (1988) who argued that larger audit firms tend to be more accurate because they have greater wealth that is exposed to risk in case of any litigation.

Lennox (1999) examined the relation between auditor size and litigation and found greater support to the deep pocket hypothesis than reputation hypothesis. Colbert and Murray (1998) focused on small CPA firms and the peer review activities between such firms and found some evidence that the auditor quality is positively associated with firm size.

This study adopts the auditor size (the brand name approach) as the measure to capture audit quality and assume that the higher audit quality generated, the higher the information credibility and information quality resulting in higher quality of financial statements. In accounting context, higher audit fees are reflected in higher costs resulting from greater audit quality. Some results have shown that larger audit firms receive larger audit fees than smaller audit firms (Palmrose, 1986; Copley, 1991; Wooten, 2003). Hence, Moizer (1997) asserts that audit fee is associated with higher audit quality resulting in higher reputation of the auditors. The essence of the arguments is that an individual has an economic incentive to incur above average costs in order to produce a service of above average quality. Eventually, consumers recognize this improved quality and are prepared to pay a higher fee in order to receive the service.

Craswel, Stokes and Laughton (2002) extended the argument to show that auditor independence may be related to audit fee dependence. Using the propensity of auditors to issue qualified audit reports measured by the ratio of audit fee to total national fee of the audit firm, Craswel *et al*, (2002) argued that in a situation where public disclosure of audit fee and non-audit fee is mandatory, auditors may be willing to issue

qualified audit opinions irrespective of the economic importance of the client to the auditor and issue unqualified opinion if otherwise.

Audit Independence may be defined as an auditor's unbiased mental attitude in making decisions throughout the audit and financial reporting. Independence refers to the quality of being free from influence, persuasion or bias. In the absence of independence, the value of the audit service will be greatly impaired (Sweeney, 1994). An auditor's lack of independence increases the possibility of being perceived as not being objective. This means that the auditor will not likely report a discovered breach. Prior studies contend that high fees paid by a company to its external auditor increase the economic bond between the auditor and the client and thus the fees may impair the auditor's independence (Frankel, Johnson & Nelson, 2002; Li & Lin, 2005). The impaired independence results in poor audit quality and allows for greater earnings management resulting in lower earnings quality.

DeAngelo (1981) theorizes that larger firms perform better audits because they have a greater reputation at stake. In addition, because larger firms have more resources at their disposal, they can attract more highly skilled employees. Others have theorized that large auditors attract a fee premium because their greater wealth reduces clients' exposures in litigation (the deep pockets theory). Others have theorized that there is no real audit quality difference, but the perception exists because large firms are well known and have gained a reputation for high quality. On the whole, the evidence is mixed, but it appears that there is some relationship between audit firm size and audit quality. What is unclear is whether this difference is actual or perceived. Based on DeAngelo's (1981) reports, many other studies use auditor size to differentiate audit quality levels (Copley, 1991; Clarkson & Simunic, 1994; Becker, Defond, Jiambalvo, & Subramanyam, 1998; Bauwhede, Willekens & Gaeremynck, 2000; Zhou & Elder, 2001; Krishnan, 2003).

Some studies have used audit fees as quality measures. Palmrose (1986) finds that there is a significant association between audit fees and auditor size measured by Big 8 vs non - Big 8 dichotomy. Copley (1991) finds that using audit fees as audit quality measure, has greater power than Big 8 vs non - Big 8 dichotomy in explaining variation levels of local government disclosures. Colbert and Murray (1998) measure audit quality using the results of peer review.

Summing up, DeAngelo (1981); Palmrose (1988); Deis & Giroux (1992); Becker, *et al* (1998); Francis and Krishnan, (1999); Krishnan and Schauer (2000); Kim, Chung and Firth, (2003) and Krishnan, (2003) agree on audit quality as a function of audit firm size and demonstrate that larger audit firms possess greater capacity to measure audit quality. Wooten (2003) found that detecting material misstatements is influenced by how well the audit team performs the audit, which in turn is influenced by the quality control system and management resources of the audit firm. The major proposition of this study is that earnings management depends on audit quality and audit quality is a function of audit firm size.

### **Auditors Reports, Share Prices and Earnings Management**

Financial reporting is essential for monitoring purposes. The external audit of company financial statements provides this monitoring and control. The principle of information disclosure is directed at ensuring the provision of relevant, reliable and sufficient information that enable stakeholders to take rational decisions. Investors, in particular require audited financial reports to make investments decision and to assess the risk and returns expectations on their investments. Audit specifically provides shareholders and potential shareholders reasonable assurance that financial statements prepared by management are free from material misstatements (Watts & Zimmerman, 1986). Investors therefore value the audit report as a means of improving financial information reported by companies.

Kedia and Philippon (2008), McNichols and Stubben (2008) and other studies on the consequences of earnings management have focused exclusively on stock price effects related to earnings management. Research has examined earnings management around specific corporate events such as IPOs, management buyouts, stock repurchases, and stock for stock acquisitions, and how ex-ante earnings management activities relate to observed post event abnormal stock returns.

In addition to examining post event stock returns, previous studies have also examined short-term capital market reactions around the announcements of fraudulent reporting. Evidence from studies by Foster (1979), Dechow, Sloan, and Sweeney (1996) and Beneish (1997) indicate that the market reaction to

disclosure of manipulation is on average negative. This implies that investors were surprised and interpret these as negative news.

One of the very first studies to investigate issues related to earning quality was conducted by Wilson (1987) of Harvard University. Wilson's key conclusions were that operating cash flows and total accruals (i.e. change in current accruals plus non-current accruals) are differentially valued and that both are value relevant. That is, the market appears to react to the disclosure of detailed cash flow and accrual data (value relevance) and that cash flows are more highly valued than accruals (value differential). Wilson's basic findings are also supported by a number of subsequent studies, including Rayburn (1986), Bowen, Burgstahler and Daley (1987), Chariton and Ketz (1990), Livnat & Zarowin (1990), Ali (1994), Pfeiffer, Elgers, Lo and Rees (1998), and Vickrey, and Bettis (2000).

Recent studies have shown that managers with large stock options portfolios are more likely to manipulate earnings measured by accruals in Bergstresser and Philippon (2002), and restatements in Burns and Kedia (2004), and that they succeed in manipulating stock prices and in making money on concurrent insider trading (Beneish & Vargus, 2002). However, Healy and Wahlen (1999) also point to a crucial question that the academic research has left unanswered: what is the effect of earnings management on the allocation of resources?

The fact that the market values a Naira of cash flow more than a Naira of current or non-current accruals implies that higher levels of accruals are indicative of lower quality of earnings. In other words, the degree to which a company must rely on accruals to boost net income results in lower quality of earnings. However, the first studies to investigate this issue (Sloan, 1996 and Swanson & Vickrey, 1997) found that, contrary to the efficient market hypothesis, disaggregating earnings into cash flow and accrual components is useful in identifying securities that are likely to outperform (or under-perform) in the future. Thus, the results of these studies imply that security prices do not fully reflect the information contained in the cash flow and accrual component of earnings.

Following in the path of Sloan (1996) as well as Swanson and Vickrey (1997), academic researchers are currently focusing on the development of simple empirical models that objectively assess earnings quality in order to predict future return performance. Chan, Jegadeesh and Lakonishok, (2001) found that companies with relatively high levels of accruals tend to under-perform while companies with relatively low level of accruals tend to outperform for periods of 12-36 months after the disclosure of detailed financial data. Specifically, the study found that the return spread between stocks with the highest level of accruals (lowest earnings quality) and the lowest level of accruals (highest earnings quality) is as high as 21.7% depending on the approach used by the authors in forming portfolios. The implications are that measures of earnings quality can be used in forming profitable investment and trading strategies and more effectively managing risk.

Prior studies (Burgstahler & Dichow, 1997) focus directly on earnings management or income smoothing, and find that firms manage earnings to meet analyst expectations and avoid losses and earnings decreases. Benefits from smoothed earnings include a perception of lower risk and a consequent reduced cost of capital, and by extension a high market price perception.

## **Methodology**

This study is based on 342 companies – year observations from the NSE for the fiscal years, 2006 to 2011. We apply audit firm size (AFS) in terms of Big-4 and Non-Big-4 audit firms after controlling for the effects of audit fees (AF) as a measure of auditor independence.

## **Market Price per Share (MPS)**

Market price per share is derived directly from [www.cashcraft.com](http://www.cashcraft.com). The model used to test for the effect and relationship between audit firm size and Share prices of quoted companies in Nigeria is Ohlson's (1995) valuation model. Ohlson (1995) analytically demonstrates that a company's market value can be expressed by its contemporaneous abnormal earnings and book value. This model was adopted by Amir (1996), Amir & Lev (1996) and Collins, Maydew & Weiss (1997). This present study applies the Ohlson (1995) model modified to include audit firm size variable and other control variables. The second hypothesis of this study applies to Market Price per Share as follow:

H<sub>0</sub>: Audit Firm Size does not significantly influence the share prices of quoted companies in Nigeria.

**Model Specifications**

In this section, we specify the models used to deal with the effects and relationships between the dependent and independent variables contained in the hypothesis. Linear regression analyses were used to test the relationship between the dependent variable (MPS) and the identified independent Audit Firm Size.

$$MPS_{i,t} = a_0 + \beta_1 AFS_{i,t} + \beta_2 AF_{i,t} + \beta_3 CFO_{i,t} + \beta_4 CoySize_{i,t} + \beta_5 Gwth_{i,t} + \beta_6 Lev_{i,t} + \beta_7 EPS_{i,t} + \beta_8 BVPS_{i,t} + e_{i,t}$$

MPS<sub>i,t</sub> = market price per share for company i at time t obtained from CSCS cash craft page using *www.cashcraft.com*; EPS<sub>i,t</sub> = Company i reported EPS before extraordinary items for period t; BVPS<sub>i,t</sub> = company i book value of equity per share at time t estimated as net total assets divided by the number of ordinary shares for each of the companies. Other variables remain as described under table 3.1.

**Techniques of Data Analyses**

The preliminary analysis involves descriptive statistics and correlation analysis of data. The regression assumption tests for the variables precede the multiple regression analysis conducted on the data. For robustness purposes, the regression analysis was conducted using the Pooled OLS, Panel OLS (without effects) and the panel OLS (with effects). A series of preceding statistical tests such as the Hausman test for fixed and random effects and the panel unit root were performed on the data.

**Table 3.1: Measurement of Variables**

S/N	VARIABLES	DEFINITION	TYPE	MEASUREMENT	Construct Validity Source
1	MPS	Market Price per share	„	Obtained directly from CSCS at <i>www.cashcraft.com</i>	Ohlson, (1995); Amir (1996); Collins, maydew and Weiss (1997).
2	AFS	Audit Firm Size	Independent	Dichotomous: '1' if company is audited by a Big4, '0' otherwise	DeAngelo, 1981; Deis and Giroux, 1992; Becker et al, 1998; Francis and Krishnan, 1999; Krishnan and Schauer, 2000; and Krishnan, 2003
3	AF	A measure of Auditor Independence	„	Natural Log of the Audit Fees Paid by the company.	Palmrose, 1988, Copley (1991), Frankel et al, 2002; Li & Lin, 2005; Gerayli et al, 2011
4	CFO	Cash Flow From Operations	Control	CFO as % of Total Assets at end of Year 't'.	Adapted from Dechow et al (1995); Yang (1999); Bauwhede et al (2000).
5	Gwth	Growth Prospects of the Company	„	(Market Value divided by Book Value of Equity) = MPS/BVPS	Zhou and Elder (2001); Bowen, et al (2005)
6	CoySiz <sub>e</sub>	Company Size	„	Natural log of company Total Assets	Bauwhede et al, 2000; Gerayli et al, 2011
7	Lev.	Leverage	„	<u>Total Debts</u> / <u>Equity</u>	Becker et al (1998), Watts & Zimmerman, (1986)
8	EPS	Earnings per Share	„	As reported in the Annual Financial statement	Ohlson, (1995); Amir (1996); Collins, maydew and Weiss (1997).
9	BVPS	Book value of equity per share	„	<u>Net Operating Assets</u> / <u>No. of Ord. Shares</u>	Ohlson, (1995); Amir (1996); Collins, maydew and Weiss (1997).

**Presentation and Analysis of Data**

The models specified in the previous section were examined empirically in this section and used to test the causal-relationships between audit firm size and market price per share of the sampled companies.

**Descriptive Statistics**

Table 4.1 below presents the result for the descriptive statistics conducted on the variables. It was observed that:

**Table 4.1: Descriptive Statistics**

	Mean	Median	Maximum	Minimum	Std.Dev	Jarque-Bera	Probability
MPS	37.92732	14.2	445.66	0.5	61.43473	2415.146	0.000
AFS	0.702771	1	1	0	0.457615	76.42107	0.000
AF	6.821742	6.9	8.22	5.04	0.577794	16.92742	0.000
CFO	11.66365	11.7	99.49	-126.16	16.67328	3494.981	0.000
GWTH	8.667909	2.7	1228.33	-24.64	72.64753	922498.7	0.000
COSIZE	9.879723	9.97	11.66	7.87	0.790002	10.88827	0.004
LEV	5.505743	1.39	685.82	-15.7	43.15786	696687	0.000
EPS	1.995959	0.755	30.23	-9.31	3.587965	3123.311	0.000
BVPS	9.415491	4.11	506.74	-43.19	27.37497	1248657	0.000

Source: computation derived from Eviews 7.0 by the author

**MPS** has a mean value of 37.927 and a standard deviation of 61.434. The maximum, minimum and median values stood at 445.66, 0.5 and 14.2 respectively. The Jacque-Bera statistic of 2415 alongside its p-value ( $p=0.00<0.05$ ) indicates that the data satisfies normality.

**AFS** is 0.702 (70.2%). This approximates to one (1) and suggests that on the average, over 70% of the companies in the sample were audited by the Big-4 audit firms. The standard deviation of 0.458 suggests considerable cluster of firm’s choice around the Big-4. The Jacque-Bera statistic of 76.421 alongside its p-value ( $p=0.00<0.05$ ) indicates that the data satisfies normality.

**AF** was observed to have a mean value of 6.8217 and a standard deviation of 0.5778 suggesting considerable clustering of audit fees for the distribution around the mean value. The maximum, minimum and median values are 8.223, 5.04 and 6.9 respectively. The Jacque-Bera statistic of 16.927 alongside its p-value ( $p=0.00<0.05$ ) indicates that the data satisfies normality.

**CFO** was observed to have a mean value of 11.664 and standard deviation of 16.673. The maximum, minimum and median values stood at 99.49, -126.16 and 11.7 respectively. The Jacque-Bera statistic of 3494.981 alongside its p-value ( $p=0.00<0.05$ ) indicates that the data satisfies normality.

**GRWTH** measured as the market value divided by book value of equity has a mean of 8.668 and standard deviation of 72.647. The maximum, minimum and median values are 122.833, -24.64 and 2.7 respectively. The Jacque-Bera statistic of 922498 alongside its p-value ( $p=0.00<0.05$ ) indicates that the data satisfies normality.

**COSIZE** measured as the natural log of company total assets was observed to have a mean value of 9.8797 and standard deviation of 0.790. The maximum, minimum and median values stood at 11.66, 7.87 and 9.97 respectively. The Jacque-Bera statistic of 10.888 alongside its p-value ( $p=0.00<0.05$ ) indicates that the data satisfies normality.

**LEV** shows a mean value of 5.505 and standard deviation of 43.157. The maximum, minimum and median values stood at 685.82, -15.7 and 1.39 respectively. The Jacque-Bera statistic of 696687 alongside its p-value ( $p=0.00<0.05$ ) indicates that the data satisfies normality.

**EPS** has a mean value of 1.996 and standard deviation of 3.588. The maximum, minimum and median values stood at 30.23, -9.31 and 0.755 respectively. The Jacque-Bera statistic of 3123.311 alongside its p-value ( $p=0.00<0.05$ ) indicates that the data satisfies normality.

**BVPS** has a mean value of 9.4154 and standard deviation of 27.375. The maximum, minimum and median values stood at 506.74, -43.19 and 4.11 respectively. The Jacque-Bera p-value ( $p=0.00<0.05$ ) indicates that the data satisfies normality.



**Regression Assumptions Tests**

Table 4.1 above has revealed that the p-values associated with Jarque-Bera statistics for the variables are all less than 0.05 indicating the normality of data and suitability for generalization. It also suggests the absence of outliers in the data. Table 4.2 below presents the regression assumptions tests results.

The Breusch-pagan-Godfrey test for heteroscedasticity was performed on the residuals as a precaution. The results showed probabilities less than 0.05 which suggest the likely existence of heteroscedasticity. The Lagrange Multiplier (LM) test for serial correlation reveals that the hypotheses of zero autocorrelation in the residuals were not rejected. This was because the probabilities (Prob. F, Prob. Chi-Square) were greater than 0.05. The LM test did not therefore reveal serial correlation problems for the model. The performance of the Ramsey RESET test showed high probability values that were greater than 0.05, meaning that there was no significant evidence of misspecification.

**Table 4.2b Regression Assumptions Test for Model (Dependent Variable = MPS)**

Variance inflation test for Multicollinearity			
Variable	Coefficient Variance	Centered VIF	
C	1735.123	NA	
AFS	36.936	1.496	
AF	93.473	5.448	
CFO	0.022	2.859	
GWTH	0.003	2.859	
COSIZE	82.294	9.831	
LEV	0.005	2.079	
EPS	0.898	2.079	
BVPS	0.083	2.164	
Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	31.031	Prob. F(1,182)	0.000
Obs*R-squared	28.903	Prob. Chi-Square(1)	0.000
Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	5.739	Prob. F (9,184)	0.004
Obs*R-squared	10.853	Prob. Chi-Square (9)	0.004
Ramsey RESET Test			
	Value	Probability	
t-statistic	0.862159	0.3895	
F-statistic	0.743318	0.3895	
Likelihood ratio	0.777317	0.378	

Source: Computation derived from Eview 7.0 by the author. \* VIF exceeding or approximating to 10.

**Panel Unit Root Test**

In conducting the panel unit root, the Augmented Dicky Fuller test was utilized. In order to achieve robustness, the unit root was conducted using the Breitung t-stat and the Im, Pesaran and Shin W-stat. All tests are conducted at intercept and trend and the results are presented and analyzed:

Table 4.3a, b & c above provide summary reports of panel unit root tests on the residuals of the regressions reports. The p-values reported in Table 4.3a suggest that the hypothesis of no unit root can be rejected at least at the 5% level. The ADF Fisher statistic (570.45) and the Choi Z-stat. (-17.214) for the stacked residuals indicate that the null hypothesis of non-stationarity is strongly rejected. In addition, the Breitung Unit Root Test is also performed and the results shows that the Breitung t-stat (-7.2286) and p-value (0.00) as presented in table 4.3b suggest that the null hypothesis of non-stationarity is strongly rejected at 5%. The Im, Pesaran and Shin unit root test were also performed as an additional check to confirm the

stationarity of the data. The results show that the Im, Pesaran and Shin W-stat (-109.105) and p-value (0.000) as presented in table 4.3c suggest that the null hypothesis of non-stationarity is strongly rejected at 5%.

**Table 4.3a Augmented Dickey Fuller (ADF) Unit Root Test**

Null Hypothesis: Unit root (individual unit root process)		
Exogenous variables: Individual effects		
Automatic selection of maximum lags		
Automatic lag length selection based on AIC: 0 to 14		
Method	Statistic	Prob.**
ADF - Fisher Chi-square	570.45	0.000
ADF - Choi Z-stat	-17.2136	0.000

\*\* Probabilities for Fisher tests are computed using an asymptotic Chi-square distribution. All other tests assume asymptotic normality.

**Table 4.3b Breitung Unit Root Test**

Null Hypothesis: Unit root (common unit root process)		
Exogenous variables: Individual effects, individual linear trends		
User-specified maximum lags		
Automatic lag length selection based on AIC: 0 to 3		
Method	Statistic	Prob.**
Breitung t-stat	-7.22855	0.000

Source: Computation derived from Eview 7.0 by the author

**Table 4.3c Im, Pesaran and Shin unit root test**

Null Hypothesis: Unit root (individual unit root process)		
Exogenous variables: Individual effects, individual linear trends		
User-specified maximum lags		
Automatic lag length selection based on AIC: 0 to 3		
Method	Statistic	Prob.**
Im, Pesaran and Shin W-stat	-109.105	0.000

Source: Computation Derived from Eviews 7.0

**Multiple Regression Tests and Test Results**

The regression tests were conducted to include an examination of the sensitivity of the endogenous variables contained in the baseline equations to cater for the effect of inclusion of a second proxy (audit fees) as a control.

**Table 4.5 Regression Tests (Dependent Variable = MPS)**

Variable	POOLED OLS	PANEL ELGS (NO EFFECTS)		PANEL OLS (FIXED EFFECTS)		
	Coefficient	Prob.	Coefficient	Prob.	Coefficient	Prob
<b>C</b>	7.73	0.759	4.017	0.893	66.92	0.000*
<b>EXPLANATORY VARIABLES</b>						
AF	-13.046	0.049*	-10.745	0.000*	-2.371	0.043*
AFS	14.914	0.003*	13.436	0.000*	-1.399	0.404
<b>CONTROL VARIABLES</b>						
CFO	-0.139	0.262	-0.142	0.198	-0.015	0.433
GWTH	0.058	0.010*	0.059	0.000*	0.180	0.045*
COYSIZE	8.243	0.067**	7.060	0.000*	-1.450	0.024*
LEV	-0.039	0.158	-0.038	0.177	-0.284	0.083**
R <sup>2</sup>	0.696			0.70		0.877
ADJ R	0.682			0.69		0.839
F-Stat	53.44			65.5		23.58
P(f-stat)	0.00			0.00		0.000
D.W	1.2			1.2		2.03

Source: Computation derived from Eview 7.0 by the author. \* significant at 5% \*\*significant at 10%

**Pooled OLS (Stacked) Regression Test Result (Dependent Variable = MPS)**

The pooled (stacked) OLS results has an R<sup>2</sup> value of 0.696 which suggests that the model explains about 70% of the systematic variations in the dependent variable with an adjusted value of 0.682. The F-stat (53.44) and p-value (0.00) indicate that the hypothesis of no significant relationship between the dependent and independent variables is rejected at 5% level. An evaluation of the effects of the explanatory variables on the MPS indicates that AFS impacts positively on MPS (14.914) and is significant at 5% (p=0.003) while AF impacts negatively on MPS (-13.046) and is significant at 5% (p=0.049).

Examination of the performance of the control variables shows that CFO appeared negative (-0.139) and insignificant at 5% (p=0.596); Gwth appears positive (0.058) and statistically significant at 5% (p=0.010); leverage is observed to be negative (-0.039) and statistically insignificant at 5% (p=0.158); CoySize showed a positive effect (8.243) which appeared to be significant at 10% (p=0.067). The D. W statistics of 1.2 indicates that the absence of serial correlation of the residuals in the model may be unlikely.

**Panel EGLS (Random Effects) (Dependent Variable = MPS)**

The Panel EGLS (Random effects) estimation shows the R<sup>2</sup> value of 0.70 and suggests that the model accounts for about 70% of the systematic variations in the dependent variable with an adjusted value of 0.69. The F-stat (65.5) and p-value (0.00) indicates that the hypothesis of no significant linear relationship between the dependent and independent variables cannot be accepted at 5% level. An evaluation of the effects of the explanatory variables on the MPS indicates that AFS impacts significantly (p=0.003) and positively (14.914) on MPS while AF is observed to impact negatively (-13.046) and significantly at 5% (p=0.049) on MPS.

The performance of the control variables indicates that CFO is negative (-0.142) and insignificant at 5% (p=0.198); Gwth impacts positively (0.059) and significantly at 5% (p=0.000) on MPS; leverage is observed to be negative (-0.038) and statistically insignificant at 5% (p=0.177). The D. W. statistics of 1.2 indicates that the absence of serial correlation of the residuals in the model may be unlikely.

**Panel OLS (Fixed Effects) Regression Test**

In line with the Hausman test result based on the fixed effects panel data analysis was conducted and the results appear to perform better and explain a significantly higher proportion of systematic variations in the dependent variable. The observed serial correlation in the pooled (stacked) OLS and panel EGLS (Random effects) was corrected in the fixed effects results as indicated by the D.W. statistics of 2.03. The R<sup>2</sup> stood at 0.877 which suggest that the fixed effects Panel regression explains about 88% of the systematic variations

in the dependent variable with an adjusted value of 0.823. The F-stat (23.58) and P-value (0.00) indicates that the hypothesis of no significant relationship between the dependent and independent variables is rejected at 5% level.

An evaluation of the effects of the explanatory variables (AFS & AF) on the MPS indicates that AF (-2.371) and AFS (-1.399) but only AF is significant at 5% ( $p=0.043$ ).

### **Discussion of Results**

In estimating the models, the pooled OLS and Panel effects estimations were employed. Preference is placed on the descriptive statistic and Hausman Test results as bases for discussing the variable estimates.

Descriptive statistics showed the mean value of Audit firm Size (0.702) and suggests that majority of the companies in the sample were audited by the Big-4 Audit Firms. This may be related to the level of perceived audit firm quality being associated with Audit Firm Size (in terms of the Big-4 audit brand names) by quoted companies in Nigeria. This result agrees with the findings of previous studies (DeAngelo, 1981; Copley, 1991; Clarkson & Simunic, 1994; Becker, et al, 1998; Bauwhede et al, 2000; Zhou & Elder, 2001; Krishnan, 2003). Other prior studies agree on audit quality as a function of audit firm size and demonstrate that larger audit firms possess greater capacity to constrain and minimise earnings management (Palmrose, 1988; Deis & Giroux, 1992; Francis & Krishnan, 1999; Krishnan & Schauer, 2000; Kim, Chung & Firth, 2003). The results show a considerable cluster of audit firm choice around the Big-4 audit brand names.

The market perceives audit firm size (Big-4 audit) to be of higher quality than others and rewards (punishes) companies with larger improvements or falls in share prices accordingly (Teoh & Wong, 1993; Krishnan & Yang, 1999; Menon & Williams, 1994). Empirical evidence (Teoh & Wong, 1993; Krisnan & Yang, 1999) provides that audit quality measured in terms of auditors' brand names (Big-4 and non-Big-4) is positively associated with the client's quality of earnings and therefore the earnings response coefficient of companies. This study posits that audit quality constrains earnings management by reducing the impact information asymmetry on share prices of quoted companies in Nigeria.

The fixed effects estimation shows that AF impacts positively on MPS with a significant negative coefficient (-2.371) while AFS is impacts negatively on MPS (-1.399) but is insignificant (0.404). Only AF proves to be significant at 5% ( $p=0.043$ ). This result seems to move along the direction of auditor expertise hypothesis. In line with this hypothesis, some prior studies have shown that larger Audit Firms receive larger audit fees than smaller audit firms (Palmrose, 1986; Copley, 1991; Wooten, 2003), and on the basis of this, AF is significantly related to audit quality (Moiser, 1997).

Although, this evidence provides the basis to reject the null hypothesis ( $H_0$ ) and uphold the alternative hypothesis showing that Audit Firm Size exerts significant influence on the Market Price per Share of quoted companies in Nigeria, it appears that it is not necessarily the size of the audit firm but the perceived level of auditor independence measured in terms of the quantum of total audit fees received, that influence the investors' response to and the movements in the market price per share of the companies in the sample. Other variables also appear to exert greater influence on MPS of quoted companies in Nigeria than Audit Firm Size. For instance, the examination of the effects of the control variables shows that company growth prospects (gwth) and Leverage have strong significant effects on MPS of quoted companies in Nigeria.

### **Summary of Findings**

The summary of findings of this study is based on results of both the descriptive statistics and the various tests conducted on the OLS multiple regression models. The result of descriptive statistics imply that majority of the companies in the sample were audited by the Big-4 Audit Firms which is a possible reflection of the level of perceived audit firm quality being associated with Audit Firm Size (in terms of the Big-4 audit brand names) by quoted companies in Nigeria, while The results of the regression analyses show that Audit Firm Size exerts significant influence on the Market Value per Share of quoted companies in Nigeria.

### **Policy Implications of Findings**

The reported results and findings of this study present obvious implication for regulators such as the Securities and Exchange Commission in its supervisory position to distinguish between legitimacy, outright fraudulent reporting and earnings statements that reflect the desires of management rather than the underlying performance of the company and to impose appropriate disciplinary penalties on offenders.

### **Recommendations**

1. The management of quoted companies in Nigeria should, as a legal mandate, provide a “statement of the quality of its earnings” arrived at using acceptable and uniform criteria and make assertions that the earnings of the company have not been manipulated (managed) during the period. Management should be responsible for making an assertion about the company’s quality of earnings, *vis-a-vis* the presently required financial statement assertions.
2. The auditors of quoted companies in Nigeria should conduct Earnings Quality Assessment (EQA) using earnings management detection metrics and various techniques enumerated in this study and issue “Integrated Audit Reports” which will include EQA reports and Internal Control Reports in addition to normal annual audit reports. The conduct and completion of the EQA should be a legislative mandate while the auditors should be held responsible for EQA report they issue.
3. Attention should also be focused on companies’ attempts to smooth or increase earnings to beautify its attractions in the stock market through unnecessary manipulation of economic activities. Companies can only be permitted to generate quality income via sales growth and cost control activities that present rather predictable earnings from sales and cost reductions make the company’s income as qualitative attractive to investors.
4. In order to enhance high Audit Quality and minimize earnings misrepresentations, companies in Nigeria should adapt to or engage in an outright adoption of currently available best practices, codes, standards, frameworks and guidelines accompanied by statutorily backed earnings scrutiny of companies in Nigeria.

### **Contributions to Knowledge**

This study contributes to knowledge by providing significant basis for developing a uniform and consistent model for earnings quality by relating audit firm size to market value per share of companies in Nigeria as a recognized metric for handling perceived earnings fragilities and for considering issues that potentially shape future earnings yet are not overtly disclosed in financial reports. The study shows that the best accounting policy is that which evokes the greatest market response and the market seems to respond to earnings information more strongly than other information contained in financial statements.

### **Suggestions for Further Studies**

Further studies should focus on quoted companies in the financial services sector as the non-inclusion of financial institutions in this study is a major constraint to all the generalization of the findings of this study to all the quoted companies in Nigeria. Unquoted companies in Nigeria and other businesses located within the informal sector should also be studied since the financial data for such firms also need to be evaluated in order to be able to make general policies that will favourably affect such institutions and consequently the entire economy.

### **Conclusion**

This study has examined and documented evidences that are consistent with the association and effects which audit firm size exerts on market price per share of companies quoted on the Nigerian Stock Exchange. Based on a sample of 342 companies – year observations from the NSE for the fiscal years, 2006 to 2011, and using audit firm size after controlling for the effects of audit fees and other exogenous variables together for purpose of robustness, a comprehensive multivariate analysis was conducted. The result showed that audit firm size exerts significant relationship with and substantially influences the market value per share of quoted companies in Nigeria.

In arriving at the above conclusions, quoted financial institutions, unquoted companies and other firms located within the informal sector of the Nigerian economy were ignored; the sample covered six years data

drawn from annual reports of sampled companies. The effects of inflation on figures related to financial statements, market price share and earnings per share of quoted companies in Nigeria were also neglected. The reported results and findings of this study present obvious implication for regulators such as the Securities and Exchange Commission, the professional accountancy bodies, the Financial Reporting Council of Nigeria, the National Assembly, etc. in their supervisory responsibilities to distinguish between legitimacy, outright fraudulent reporting and earnings statements that reflect the desires of management rather than the underlying performance of the company and to impose appropriate disciplinary sanctions on offenders.

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