AUDIT QUALITY AND EARNINGS QUALITY REPORTING OF NIGERIAN LISTED OIL AND GAS COMPANIES: THE MODERATING INFLUENCE OF AUDIT COMMITTEE

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Abstract: *This study investigates the extent audit committee moderate the link between audit quality and earnings quality reporting of listed oil and gas companies in Nigeria. The study used random sample technique to select a sample of four (4) out of the total population of eleven (11) listed oil and gas companies in Nigeria as at 31st December, 2021. The data was sourced from the audited annual reports and accounts of the companies between 2017 and 2021 and analysed with descriptive, correlation and ordinary least square regression technique. The result indicates that the extent audit committee moderate the link between audit quality and earnings quality reporting of listed oil and gas companies was negative and insignificantly. The study concludes that an increase in the members of the committee elected by board of directors would not enhance the link between audit quality and earnings quality reporting of the listed oil and gas companies in Nigeria. The study recommends among other that the shareholders of listed oil and gas companies in Nigeria should not increase the members of the audit committee among the board of directors because it would not enhance the link between audit quality and earnings quality reporting both at short and long runs.*

Keywords: *Audit Quality; Audit Committee; Agency Theory; Earnings Quality Reporting; Listed Oil and Gas Companies in Nigeria.*

***JEL Classification**: M42.*

1. Introduction

The study of earnings quality has gained tremendous attention due to its relevance to the investors and other users for decision-making. In an organisation, earnings are essential area of consideration according to Adegbie, Salawu, and Shiyanbola (2019) because it determines the firm's success and sustainability. Earnings represent the net profit of a company's operations and the amount on which corporate tax is charged. Earnings quality reporting signals lower earnings management by a company; it enables market participants respond positively to information by reducing information asymmetry and increase transparency of the firm. In addition, earnings quality reporting may be used by investors in the stock market to assess the performance, predict future earnings and estimate the investment risk or credit risk because it indicate lower earning manipulation. Quality earnings reporting have significant value relevance to investors according to Ibrahim (2017) because it influences their investment decisions, thus it can be influenced by many factors such as audit quality and audit committee mechanisms.

Audit quality reveals the accurateness of information given by an auditor to an investor to make more accurate estimations of company value. Audit quality is indicated by financial reports that do not present the material misstatement. According to Yusuf (2020), investors required the external audit to provide external examination that will add to the reliability, objectivity, and soundness of financial reports, increase accountability, lessen any astute conduct of the board, and increase the proficiency and adequacy of internal controls, just as that of internal audit. It is believed by the investors that the external auditors increase the credibility of financial reports through their competency and independent review.

However, to enhance the auditors' independence in his opinion, especially if there is need to express reservations about management's accounting policies, is whittled down, the need emanated to have subcommittee of the board of directors: audit committee, comprising only of independent directors, be appointed to act as an arbiter between external auditors and management (Emmanuel & Emem, 2020). This is based on the assumption that the committee is more likely able to protect the best interest of the owners (shareholders) of the business organisation. The audit committee is importance in improving financial reporting quality and according to Galal, Soliman and Bekheit (2022) it is one of the most important components of corporate governance systems and a strong instrument for managing and controlling management.

Despite the expected roles the audit committee to plays particularly to act as an arbiter between external auditors and management which in turn to enhance financial credibility, quality earnings reporting by firms in the recent times is still gaining immerses global academic research interest due to high rate of earning manipulations by managers of companies. For instance, apart from the case of Enron and WorldCom in the last decade where it was observed series of corporate accounting scandals associated with a number of accounting manipulations (Beslic, Beslic, Jaksic & Andric, 2015), in Nigeria, according to Orbunde, Oyewobi and Musa (2021) the operations of the oil and gas industry have been associated with allegations of scandalous financial practices under the watch of the big 4 audit firms that are expected to constrain such unscrupulous practice. This failure of the auditors has made the stakeholders including the shareholders lost confidence and reliability on the auditor as well as the financial reports prepared by management (Directors) for decision making.

Consequently, lots of empirical research has been indicated on the effects of audit quality on earnings quality reporting by companies but most of these studies are foreign based and documented inconsistent and mixed findings (for examples, Idris, 2019; Hasan, Jatiningrum, Fauzi, & Abdul-Hamid, 2019; Orbunde, et al, 2021; Bala, Ahmad, Khatoon & Karaye, 2022) and this may be due to jurisdictional and sectoral differences. Also, it was observed that few of these studies have utilized audit committee to examine the moderating influence on the relationship between audit quality and earnings quality reporting.

Against this backdrop the following question is raised: To what extent audit committee moderates the link between audit quality and quality earnings reporting of listed oil and gas companies in Nigeria after the adoption of IFRSs? To address this question, the study aimed at investigating the extent audit committee moderates the link between audit quality and quality earnings reporting of listed oil and gas companies in Nigeria. The following hypothesis is formulated in null form for testing:

$H0_1$: The extent audit committee moderates the link between audit quality and quality earnings reporting of listed oil and gas companies in Nigeria after the adoption of IFRSs is not significant.

2. Literature Review

2.1 Conceptual Review

Earnings Quality Reporting: According to Ismail (2020), accounting literature provides several definitions for earnings quality reporting and Sepe, Nelson, Tan and Spiceland (2012) defined earnings quality as the ability of reported earnings to predict a company's future earnings. This means that for earnings to have high quality it must be used by investors to forecast the future financial activities that will result to their returns on investment. Earnings quality also refers to as financial reporting quality is the degree to which earnings reflect underlying economic effects.

Earnings are of higher quality according to Kirschenheiter and Melumad (2002), when they are more informative and closer to the long run value of the firm. Dechow and Schrand (2004) stated that a high quality earnings number is the one that accurately reflects the company's current operating performance, is a good indicator of the future operating performance, and is a useful summary measure for assessing firm value.

Some researchers such as Pagalung (2009) measures earnings quality with accrual quality measured by mapping the current accrual towards the past, present and future cash flow, earnings persistence measured by the regression coefficient of current earnings towards the future earnings, earnings predictability measured by the standard deviation of regression coefficient of current earnings towards the future earnings, earnings smoothness measured by the ratio of earnings variability towards the cash flow variability, earnings value relevance measured by the explanatory power or degree of return regression towards earnings, earning timeliness measured by the explanatory power or degree of earning reversal regression towards return, earnings conservatism measured by the ratio of reversal regression coefficient towards the negative return in the positive return coefficient, earnings quality index measured by the combination of change in the conservatism score and the comparison of conservatism score in the company industry median, earnings based on information contained measured by the explanation degree and the earnings regression coefficient, and earnings based on abnormal accrual measured by the total accrual towards the property, plant and equipment.

Audit Quality: Audit quality is defined by Seyyed, Mahdi, and Mohsen (2012) as a function of the auditor's ability to detect material misstatements and reporting the errors. Together with other similar definitions, they all emphasized on two of the most important aspects of audit quality, namely auditor ability or auditor effort, and auditor independence. Salawu, Okpanachi, and Yahaya (2018) stated that audit quality is the assessment of whether audits have served both the shareholders and other stakeholders' interests through increasing the accountability of managements and reinforcing trust and confidence in financial reporting. Ogadu, Okoughenu, and Igbeneweka, (2017) asserted that, high quality auditors are more likely to discover questionable accounting practices by clients and report material irregularities and misstatements compared with low quality auditors.

In theory, the auditing process is supposed to serve as a monitoring device that reduces management incentives to manipulate reported earnings, as well as to detect earnings manipulation and misstatements (Amat, Oscar, & Petya, 2014). Audit is a key contributor to financial stability and in other to re-establish trust and market confidence. The auditor is entrusted by law with the responsibility of conducting statutory audits and fulfilling an important role in offering an opinion on whether the financial statements are truly and fairly stated (Nwoye, Anichebe, & Osegbue, 2021). Therefore, for an audit firm to render a quality service, it means it must have greater monitoring strength, more closely to financial report and which will reflect the true economic circumstances of the client and the higher information quality (Orbunde et al, 2021).

Researcher provided different view on the relationship between audit quality and earnings quality. For instance, Lopes (2018) argued that audit quality has a relationship between the manipulation of financial statement and accruals reduce when the auditor's firm is a large audit company. Furthermore, Zandi, Sadiq, and Mohamad (2019) looked at the effect of audit quality on earning smoothen and the research argued that the Big 4 auditors are likelier to lessen earnings management. Also, Alzoubi (2016) argued that companies who hire Big 4 auditors have much less discretionary accruals than companies that do not hire Big 4 auditors. Contrary to these researchers, Knechel, Mintchik, Pevzner, and Velury (2018) argued that the Big 4 auditors are well established in states with strong levels of civic collaboration thus will not lessen earnings management. Almarayeh, Aibar-Guzmán, and

Abdullatif (2020) confirmed this by providing that the Big 4 auditors had no significant influence in emerging economies and less regulated environments.

Audit Committee: Audit committee is among corporate governance mechanism established by and responsible to the board of directors or commissioners to help perform the duties and functions of the board. In Nigeria, according to Ekumankama and Uche (2009) a new requirement in the Nigerian Companies and Allied Matters Act (CAMA) of 1990 is the introduction of audit committees as an additional layer of control and certification in the bid to make annual accounts of public corporations more acceptable and reliable. The audit committee was introduce under the circumstances that the ability of external auditors to remain truly independent, especially if there is need to express reservations about management's accounting policies, is whittled down. Audit committee size always determines the level of various divergent experiences, contributions and opinions of members according to Salawu, et al. (2018) during the committee's meeting and discussions with external auditor in ensuring audit quality. Generally, the idea of audit committee is that accountability will be enhanced if a subcommittee of the board comprising only of independent directors, be appointed to act as an arbiter between external auditors and management.

Audit committee can measured in many ways and according to Hasan, et al (2019), the measurement includes audit committee independence, audit committee financial expertise, audit committee meetings, and audit committee size. According to Garcia, Barbadillo, and Perez (2012), audit committee size is a very important attribute for monitoring earning management by managers of companies and it is related to high earning quality.

2.2 Theoretical Review

There are severer theories that underpinned the study of earnings quality on how it is affected by corporate governance mechanisms like audit committee. However, this study anchored on agency theory. The agency theory is introduce by Jensen and Meckling (1976) and the theory postulated that the relationship between principal (owners) and agent (manager) is when one or more principals engage another person (agent) to perform some services on their behalf which involves delegating some decision-making authority to the agent. This means that the principal employs the agents to carry out business in the interest of principals, including delegation of authorization for decision making from principals to agents. The different interests between agent and principals are often leads to problems or conflicts that are referred to as the agency problem. The agency problem relates to the difficulties or problems in motivating the agent to work in the best interests of the principal, where the problem arises because of inefficiencies and incomplete information (Rankin, Rankin, Stanton, McGowan, Ferlauto, & Tilling, 2012).

The main cause of agency problem is the principals cannot monitor the daily activities of the agents and ensure that they work under the interests of shareholders. According to Rankin, et al. (2012), this condition leads to imbalance information due to the managers having more information about the current and future prospects of the company than an outsider. The information asymmetry and conflicts of interest between the principals and agents provide an opportunity for managers to maximize their interests, one of which is to conduct earnings management in present information that is not true to the principal, especially if the information is related to the performance measurements of the manager.

Jensen and Meckling (1976) argued that good corporate governance mechanism act to reduce agency costs and to provide oversight by mitigating the opportunistic behavior of managers. Hence, the existence of an audit committee on the board will also enhances the quality of financial statements by reducing agency problems between managers and shareholders. In line with this, Othman and Mersni (2016) argued that an audit committee plays an important monitoring role in the corporate governance structure of the company that improves accounting information quality which is effective to limit the discretionary behavior of managers. However, according to Pincus (n.d) cited in Zgarni, Hlioui, and Zehri (2018) stated that the large size of audit committee can trigger conflicts so that they lose their focus and become less participative than smaller size, thus management will take advantages of audit committee size to achieve their own benefits where they will reduce audit committee involvement by increasing its size.

2.3 Empirical Review

The study of Bala, et al (2022) investigated how audit committee accounting expertise (ACAE) influences the relationship between audit firms attributes (AUFA) and income smoothing (IS). The study employed 616 firm-year observations from 2013 to 2019 and robust logistic regression as a data analysis technique. The results showed that the Big 4 auditors and AUT had a negative and significant relation with IS in firms with a higher proportion of ACAE. The study also revealed that a higher proportion of ACAE overturned the positive effect of Big 4 auditors and AUT on IS.

Contrarily, it was revealed by Orbunde, et al. (2021) that audit committee financial expertise moderate audit proxy with audit firm size will not have an adverse effect on earnings management of the listed oil and gas marketing companies in Nigeria. Fourteen (14) listed oil marketing companies that had consistently published their audited annual financial reports from 2011 to 2020 was used by by the study to investigate the effect of audit quality proxied by audit firm size, auditor industry specialization, auditor tenure, and audit committee financial expertise on earnings management represented by discretionary accruals of listed oil marketing companies in Nigeria. In addition, Pooled Ordinary Least Square (OLS) regression technique was used by the study to analyse data and the findings indicated that the interaction between audit firm size had no significant effect on earnings management. The relationship between the effectiveness of audit committee and earnings management in one of the emerging economies, Jordan was investigate by Idris, et al (2018) and the study also examined how external auditor size might moderate this relationship. A panel data consisting of 64 industrial firms listed on Amman Stock Exchange (ASE) was used, covering the period between 2009 and 2014. The study had four characteristics used to measure the effectiveness of audit committee, namely audit committee independence, size, meetings and financial expertise and the result showed a positive interaction effect of external auditor size and audit committee effectiveness on earnings management, which is supportive of the substitute relationship between the external auditor size and effective audit committee in reducing earnings management and increase earnings quality.

Also, audit committee attributes and audit quality was examined by Uwuigbe, Aronmwan, Uwuigbe and Uwuigbe (2018) and the study focused on the specific requirements of the 2011 SEC code. The study applied the deductive approach via the ex-post facto research design and the Binary probit regression model in analyzing the various hypotheses put forward in study. Data used for the study were gathered for 150 firm-year observations from the annual reports of quoted companies on the floor of the Nigerian Stock Exchange and result revealed that audit committee size, frequency of meetings, number of expertise and overall effectiveness all have a positive relationship with audit quality. However, only size and overall effectiveness was significant in their relationship.

Also, the effect of the audit committee (AC) independence, financial expertise, internal audit function, and audit quality and ownership concentration on earnings quality (EQ) was examined by Al-Rassas and Kamardin (2016) and, consequently, the study ascertained whether the AC's independence and financial expertise has a moderating effect on the relationship between internal audit function and EQ. The sample studied was 508 firms listed on the Malaysia Stock Exchange for the years 2009 to 2012. EQ was measured using two modified Jones models of discretionary accruals by the study and the findings revealed that the independence of AC and investment in internal audit function, as well as the Big4 audit firm, ware related to greater EQ. The study provides evidence that AC's independence and AC's financial expertise moderates the relationship between internal audit function (investment in and sourcing arrangements of internal audit function) and EQ.

Based on the empirical studies reviewed, it was clearly observed that inconsistence, mixed and controversial evidence ware indicated by researchers and this calls for further empirical justification. Therefore, the study presented the following conceptual framework in Figure 2.1 describing the relationship between the explanatory variables and the dependent variable.

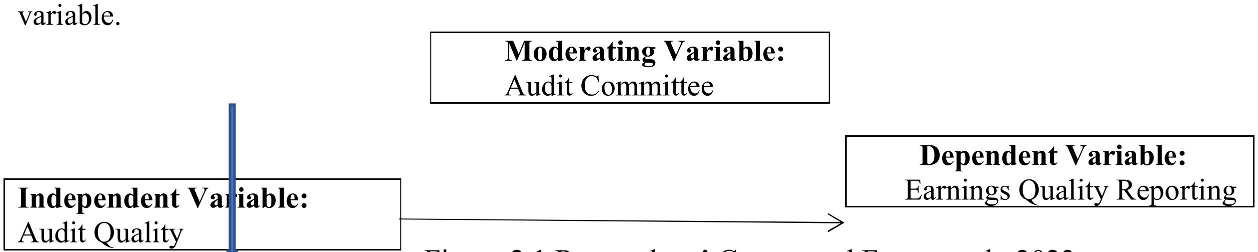

Figure 2.1 Researchers' Conceptual Framework, 2023.

Figure 2.1 is the conceptual framework for the study indicating that audit committee moderate the link between audit quality (independent variable) and earnings quality reporting (dependent variable) and this formed the null hypothesis one ($H0_1$) formulated in the study. It depict that audit committee interact the link between audit quality and earnings quality reporting.

3. Methodology

Ex post facto research design is used by this study because according to Awa and Obinabo (2020), the design enables researchers to makes use of existing data and it is not possible for the researchers to manipulate or exercise any authority over the available data. Therefore, the data used for this study are secondary data obtained between the period 2017 and 2021 from the audited annual reports and accounts of a total population of eleven (11) listed oil and gas marketing and production companies in Nigeria as at 31 December, 2021. The sample size for the study was determined using the Ewododhe (2011) formula which is one-third of the total population and the study arrived at four (4) listed oil and gas companies. In addition, the four (4) were selected by the using purposive sampling approach.

The study adapted DeAngelo (1981) model and the basic model is presented in equation 3.1 as followed:

$$ACit = NPATit - CFOit \quad \text{---} \quad 3.1$$

Where: ACit is the accruals component of earnings in year t for firm i representing the earning quality; NPATit is net operating profit after interest and tax in year t for firm i; CFOit is cash flow from operating activities in year t for firm i. Therefore, to test the formulated null hypothesis in the study, the basic model is modified as followed:

$$EQit = \beta_0 it + \beta_1 AQit + \beta_2 ACZit + \beta_3 AQit*ACZit + eit \quad \text{---} \quad 3.2$$

Where: EQ is the earnings quality reporting and measured as discretionary accruals; AQ is the audit quality and measured by auditor's compensation and fees; ACZ is the audit committee size and according to Hamdan (2020), it measured by the members of that committee elected by board of directors; AQit*ACZ is the audit committee moderating audit quality and is measured by the total amount payable to the auditor as compensation and fees multiplied by total number of audit committee members; β_0 is constants; β_1, β_2, β_3 is the regression coefficients; e is the error term.

4. Results and Discussions

The descriptive statistics of the variables specified in the model of the selected listed oil and gas companies in Nigeria for the period of 2017 –2021 is presented in Table 1.

Descriptive Statistics

Table 1. Descriptive Statistic

	EQ	ACZ	AQ	AQ*ACZ
Mean	0.020252	5.7	0.51525	29.22453
Median	0.04	6	47657.5	225210
Maximum	0.22	7	99750	598500
Minimum	-0.3	4	10500	63000
Std. Dev.	0.113352	0.923381	27154.14	171685.5
Probability	0.041258	0.508085	0.551054	0.373237
Sum	0.405048	114	1030500	5844905
Sum	0.405048	114	1030500	5844905
S.Sq. Dev.	0.244123	16.2	1.40E+10	5.60E+11
Observations	20	20	20	20

Sources: Researchers' compilations (2023) from Eview Version 9.0.

Table 1 show that on the average, EQ measured by discretionary accrual is 0.020252, AQ measured by the big-4 audit firm is on 0.51525, ACZ measured by the members of that committee elected by board of directors is 6 approximately and ACZ moderating the link between EQ and AQ (AQ*ACZ) is 29 approximately. Hence, this implies that some of the sampled oil and gas companies reported decrease while others increases at some periods within the time frame of this study.

Correlation Matrix

Table 2 Correlation Matrix

	EQ	ACZ	AQ	AQ*ACZ
EQ	1	-0.56444	0.014337	-0.16306
ACZ	-0.56444	1	-0.06076	0.232515
AQ	0.014337	-0.06076	1	0.352719
AQ*ACZ	-0.16306	0.232515	0.352719	1

Source: Researchers' compilations (2023) from Eview Version 9.0

Table 2 shows that the variables are positively and negatively correlated. In addition, according to Peck, Olsen and Devore (2015), correlation values: (1- 0.8) Strong; (0.8-0.5) Moderate; (0.5.-0.1) Weak; (0) Non-correlation. Since the result showed the relationship between the dependent variable (EQ) and independent variables (AQ, ACZ, AQ*ACZ) ranged between moderate and weak relationships, thus, it means that there is no serial correlations between the variables.

Regression Analysis

Dependent Variable: EQ
Method: Panel Least Squares
Date: 03/27/23 Time: 21:42
Sample: 2017 2021
Periods included: 5
Cross-sections included: 4
Total panel (balanced) observations: 20

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.75222	1.062567	0.707927	0.4892
ACZ	0.002492	0.282287	0.00883	0.9931
AQ	0.873683	3.437048	0.254196	0.8026
AQ*ACZ	-0.89058	3.434787	-0.25928	0.7987

R-squared	0.323266	Mean dependent var	0.020252
Adjusted R-squared	0.196379	S.D. dependent var	0.113352
S.E. of regression	0.101614	Akaike info criterion	-1.55841
Sum squared resid	0.165207	Schwarz criterion	-1.35927
Log likelihood	19.58414	Hannan-Quinn criter.	-1.51954
F-statistic	2.547658	Durbin-Watson stat	1.761161
Prob(F-statistic)	0.092399		

Source: Researchers' compilations (2023) from Eview Version 9.0

Table 3 shows that the goodness fit test had a coefficient of determination of R^2 = 0.32366 (13%) and adjusted R^2 is -0.196379 (-20%); this shows that 13% variation in the dependent variable (QFR) is explained by the independent variables (AQ, ACZ, AQ*ACZ). In addition, the effect of AQ on EQ is positive and not statistically significant given that the probability value is 0.8026 with a coefficient value of 0.873683. This implies that increase in AQ would not have significant increase EQ of listed oil and gas companies in Nigeria. However, the result shows that the effect of ACZ on EQ is positive and not statistically significant given that the probability value is 0.9931 with a coefficient value of 0.002492. The outcome implies that increase in the number serving in the audit committee would not enhance earnings quality at a long run.

Moreover, the extent ACZ moderates the link between AQ and EQ is negative and not statistically significant given that the probability value is 0.7987 with a coefficient value of -0.89058. This supports the notion that increases in audit committee size would not enhances the relationship between audit quality and earnings quality. Thus, the null hypothesis which stated that the extent audit size moderate the link between audit quality and earnings quality of listed oil and gas companies in Nigeria is not significant would be accepted. Importantly, this outcome agreed with the result indicated by Orbunde, et al. (2021) who concluded that the interaction between audit firm size had no significant effect on earnings management. However, the result did not agree with the result obtained by Idris, et al (2018) that showed a positive interaction between external auditor size and audit committee effectiveness on earnings management, which is supportive of the substitute relationship between the external auditor size and effective audit committee in reducing earnings management and increase earnings quality.

5. Conclusion and Recommendations

The extent audit committee size moderate the link between audit quality and earnings quality reporting of listed oil and gas companies in Nigeria was investigated by this study. Overall, the study showed that audit committee size does not positively and significantly influence the relationship between audit quality and earnings quality reporting of listed oil and gas companies in Nigeria. The study concludes that increase in the members of the committee elected by board of directors would not enhance the link between earnings quality reporting of the listed oil and gas companies in Nigeria.

The study recommends that the shareholders of listed oil and gas companies in Nigeria should not increase the members of the audit committee among the board of directors because it would not enhance the link between audit quality and earnings quality reporting both at short and long. In addition, shareholders of listed oil and gas companies in Nigeria should strengthen other corporate governance mechanisms such independence executive and ownership concentration to help monitor the activities of the management against earnings management which in turn would result to increase in earnings quality reporting.

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