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Auditor Brand Name and Financial Reporting Fraud of Listed Companies in Nigeria

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ARTICLE INFO	ABSTRACT
	This paper examines the influence of auditor brand name proxied by the Big4 auditors on financial reporting fraud represented by discretionary accruals (DA). We employ 88 listed companies in Nigeria through 440 firm-year observations for the period of five years from 2012 to 2016. The data for the study are extracted from the annual reports of the listed companies and Thompson Reuters DataStream. We adopt accruals model to proxy for financial reporting fraud. Multiple regression is used to estimate the model of the study. After controlling for monitoring and firm-specific attributes, we find that non-Big4 auditors are more likely to detect financial fraud as they might have more excellent knowledge of local markets and better relations with their clients. Consistent with the resource dependence theory, we find that a high proportion of financial experts on the board reduces the extent of financial reporting fraud, thus leading to better financial reporting quality. The study informs regulators and policymakers on the importance of auditor brand name in curtailing financial reporting fraud in the listed companies of Nigeria. The findings are robust to the alternative estimation. The results contribute to the debate on the role of auditor brand name in curtailing financial reporting fraud.

1. Introduction

Financial reporting fraud is one of the major threats in the contemporary business world. It is a situation where companies are engrossed in specific premeditated practices to conceal or manipulate the accounts to mislead or attract investors. Financial reporting is a dual process, where suppliers of the financial information make it available to the users, who use them with the hope that it will assist them to improve their financial decisions [1]. The objective of financial reporting is to prepare financial statements about the firm that are relevant to stakeholders in making decisions in their positions as capital providers [2]. Thus, financial reports are imperative means for managers to communicate a company's performance and governance to external investors [2]. Therefore, providing high financial reporting quality is imperative since it will affect stakeholders in generating

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investment, credit and making similar resource allocation decisions to enhance overall market productivity.

Invariably, a financial report should not be deliberately prepared to deceive the users; it must convey pertinent, reliable and appropriate information to support users in decision-making. Thus, for financial statements to be pertinent and dependable, there is the need to make available some means to encourage the practice of better financial reporting processes. For that, there is need to engage the services of independent auditors to provide their independent views on the accuracy and objectivity of companies' financial reports. This will function as a substitute for the monitoring mechanism that can enrich financial reporting, and in turn, raise stakeholders' confidence about the firm's performance and its image. It is argued that disclosure can assist in mitigating principal-agent conflicts [3]. This is because high-quality information is likely to lessen asymmetric information problems between the firm and its investors, and accordingly, cut the agency costs [4]. However, the anxiety about the financial reporting quality as well as its association with audit quality has been growing over time because of the collapse of some prominent corporations due to financial fraud by its managers. As a result of this, regulators and stakeholders often question the work of external auditors as the audited financial statements have been affirmed to be deceitful and misleading in several recent financial scandals [5, 6]. Therefore, there is a need to examine how audit quality can influence management fraud, which has an adverse effect on financial reporting quality.

As a result of the foregoing statements, this study examines the relationship between auditor brand name proxied by the Big4 and financial reporting fraud represented by the earnings management (EM) model. The study is motivated by the recent rapid increase and dominance of Big 4 auditors in the audit market in Nigeria. However, the question of whether Big N auditors provide higher financial reporting quality than the non-Big N auditors has remained a debatable issue [7]. This paper is divided into five sections. Section one provides the introduction, section two reviews the literature and hypothesis development, section three explains the methodology and model specification, followed by results and discussions in section four and conclusion in section five.

2. Literature Review and Hypothesis Development
2.1 Auditor Brand Name and Financial Reporting Fraud

Audit quality is tantamount to greater assurance of high financial reporting quality. For instance, DeAngelo [8] defined audit quality as the *"market-assessed joint probability that a given auditor will both detect a breach in the client's accounting system, and report the breach".* As such, high quality audit is known for its independent assurance of the steadfastness of financial reports, which in turn, promotes investors' protection and enhances their confidence. Thus, audit quality improves financial reporting quality by enhancing the integrity of the financial reports [8, 9]. DeFond *et al*., [9] contends that audit quality is an incessant construct of financial reporting quality. They also argue that financial reporting quality is a function of audit quality. This suggests that audit quality and financial reporting quality are jointly perceptible outcomes. Consequently, many proxies have been adopted by various studies as measures of audit quality. However, there are inconclusive arguments on which measures are superior, and thus, there are limited methodical directions on the comparability of one proxy as opposed to another [8, 9]. Audit quality is categorized into input-based, output-based and perception-based measurements. The latter comprises the earnings responses, big N auditors and stock market reactions. The input-based measurement consists of audit firm size proxied by Big4 auditors and audit fees. In contrast, the output-based measurement includes accounting conservatism, restatements, audit opinion, accruals quality, big N auditors, audit fees and market reactions.

In the light of the preceding, we suggest auditor brand name proxied by the Big4 auditors as a surrogate for audit quality due to the following reasons:

i. It is one of the surrogates that appears in all the above three classifications; and

ii. Big4 auditors is a robust proxy for audit quality because such auditors are expected to have strong motivation and greater proficiencies to deliver high-quality audit [8] Thus, it has fairly greater construct validity [9].

The foregoing arguments are empirically confirmed by most of the prior studies on audit quality and financial reporting quality. They indicate that employment of Big N auditors is connected to lower EM and higher financial reporting quality. This is affirmed by Frankel *et al.*, [11] who examined the influence of audit fees and EM in the US. The study shows Big5 audit firms have an inversely significant influence on EM. This is validated by Carmona *et al.*, [12] who examined the effect of audit quality in Spain. The finding indicates that Big4 auditors have an inverse and significant relationship with abnormal accruals. This suggests that companies audited by Big4 auditors display less EM than companies audited by non-Big4 [12,14]. In contrast, Abdullah *et al.*, [15] contend that EM is significantly low among firms that engage the services of Big4 auditors than firms audited by non-Big4 auditors. From the emerging markets, Abidin *et al.*, [17] studied the effect of auditor's industrial specialization and reporting lag in Malaysia for year 2007. They reveal that Big4 auditors are inversely and significantly associated with audit reporting lag. This infers that firms audited by Big4 auditors have better inclination to faster reporting. This is confirmed by a recent study of Amahalu *et al.*, [18] who examined the determinants of audit quality among listed banks in Nigeria. They reveal that Big4 auditors have a positively significant influence on audit quality.

In contrast, recent empirical evidences have shown that firms audited by Big4 auditors are more likely to engage in financial reporting fraud in the form of DA and income smoothing practice. For instance, Ozili [19] examined income smoothing and audit quality of African banks. He reveals that African banks that were audited by the Big4 have more probability of smoothing their reported earnings than those banks that were audited by the non-Big4. This validates the findings of [19-21] who document a positive association between Big4 auditors and earnings manipulation by firms. More so, Ishak *et al.*, [21] studied the influence of leadership organization, gender variety and audit quality on earnings manipulation of listed entities in Malaysia. They argue that engaging Big4 auditors to audit listed firms in Malaysia does not curtail managers' fraud in the form of EM. This affirms the finding of Abidin *et al.*, [17] who reveal that Big4 auditors do not minimize audit reporting delay in the listed firms in Malaysia. Thus, in the light of the foregoing arguments, it is hypothesized that:

H_1 Auditor brand name has a negative relationship with financial reporting fraud of listed companies in Nigeria.

3. Methodology

The population comprises 170 listed companies on the Nigerian Stock Exchange as at 31st December 2016. From this total, 55 companies were identified as financial services; thus they were left out, leaving a total of 115 companies. Furthermore, 15 companies were delisted by the Nigerian Stock Exchange in 2016. After subtracting these 15 delisted firms, 100 companies were left. Out of these 100 firms, 12 companies did not provide complete information. Consequently, a final sample of 88 companies was employed. The period of study covers five years from 2012 to 2016. This period was selected as it covers the aftershocks of the financial scandals by Cadbury Nigeria PLC in 2006, African Petroleum PLC in 2009 and the more recent Stanbic IBTC PLC in 2015. The data for the study were generated from the annual reports of the listed companies and Thompson Reuters DataStream.

3.1 Model Specification and Variable Measurement

For the purpose of the study, we follow Al- Rassas and Dechow *et al.*, [23, 24] by adopting the accruals model developed by [24] to serve as a technique for detecting financial reporting fraud. The error terms of the model represent the absolute discretionary accruals. This is estimated as

$$TAC_{i,t}/TA_{i,t-1} = \beta 1(1/TA_{i,t-1}) + \beta 2(\Delta REV_{i,t} - \Delta REC_{i,t}/TA_{i,t-1}) + \beta 3(\Delta PPE_{i,t}/TA_{i,t-1}) + \varepsilon_{i,t} \qquad (1)$$

where: TAC = Total accruals computed as net earnings minus cash flow from operations; $TA_{i,t-1}$ = Lagged of total assets of a firm; ΔREV = changes in turnover from present year to last year; ΔREC = changes in receivables from present year to last year; and PPE = gross property plant and equipment. After the extraction of the residuals, the following estimation model was run to examine the influence of auditor brand name on financial reporting fraud.

$$DA_{it} = \beta 0 + \beta_1 AUBN_{it} + \beta_2 BI_{it} + \beta_3 BE_{it} + \beta_4 LEV_{it} + \beta_5 FAGE_{it} + \beta_6 SGROWTH_{it} + \varepsilon_{it} \qquad (2)$$

where: DA = absolute discretionary accruals from equation 1; AUBN is measured as 1 when a company is audited by the Big4 (KPMG, PricewaterhouseCoopers, Ernst & Young and Deloitte) and otherwise, 0; BI = board independence computed as ratio of independent directors on the board; BE = board financial expertise computed as ratio of financial experts on the board; LEV = leverage computed as long-term debt to total equity; FAGE = computed as year of observation minus year of listing; SGROWTH = Sales growth measured as log of sales; $\beta 0$ = Intercept, β = parameters; i = firm; t = time; and ε = error term.

Table 1
Variable measurements

Variable	Acronym	Definition	Source
Dependent:			
Financial reporting fraud	DA	Discretionary accruals	[15], [23], [26]
Independent:			
Auditor brand name	AUBN	Big 4 auditor	[12], [16], [26]
Control			
Board independence	BI	Percentage of independent directors on the board	[27], [28]
Board financial expertise	BE	Proportion of financial experts on the board	[29], [27], [28]
Leverage	LEV	Total debt to total equity	[30], [31]
Firm age	AGE	Measured as the year of observation minus listing	[33], [35]
Sales growth	SGROWTH	Change in sales divided by previous sales	[35], [36]

4. Results and Discussion

4.1 Descriptive Statistics

Table 2 portrays the descriptive statistics of the study variables. Table 2 shows that DA has an average value of 2.385 with the smallest and largest values of 0.525 and 6.397, respectively. It is revealed that the majority of the listed firms in Nigeria were audited by the Big4 auditors. BI has a mean of 0.715 with lowest and largest values of 0.060 and 0.923, respectively. This suggests that more than 70% of directors on the board of listed companies in Nigeria are independent directors. This indicates compliance with the stipulation by the Securities and Exchange Commission Code of Corporate Governance (SEC CCG) (2011) which recommends that the majority of directors should be independent directors.

BE has an average value of 50% with the least and extreme values of 25% and 75%, respectively. This also implies that 50% of board members are financial experts. LEV has a mean value of 0.067, while some companies report no LEV but others record up to 0.580. FAGE has a mean of 24 years with smallest and highest values of four to 42 years, respectively. SGROWTH has an average value of 4.036 and a minimum and maximum of 7.093 and 13.790, respectively. The next subsection describes the corrections matrix.

Table 2
Descriptive Statistics

Variable	Obs.	Mean	Std. Dev.	Min	Max
DA	440	2.385	0.998	0.525	6.397
AUBN	440	0.580	0.494	0.000	1.000
BI	440	0.715	0.112	0.060	0.923
BE	440	0. 500	0.140	0.250	0.750
LEV	440	0.067	0.611	0.000	0.580
FAGE	440	23.818	13.288	4.000	42.000
SGROWTH	440	4.036	6.397	7.093	13.790

Note: DA= discretionary accruals from equation; AUBN = (KPMG, PricewaterhouseCoopers, Ernst & Young and Deloitte); BI = board independence; BE = board financial expertise; LEV = leverage; FAGE = firm age; SGROWTH = sales growth.

4.2 Correlation Matrix

The correlation matrix in Table 3 reveals that AUBN has a strong and positive correlation with DA. This association is significant at 5%. Thus, this provides a key clue on the direction of the relationship between AUBN and DA in the regression model. Table 3 reveals that BE is negatively and significantly correlated with DA at the 10% level of significance. Also, BI and LEV have an insignificantly positive correlation with DA. In contrast, FAGE and SGROWTH have an insignificantly negative correlation with DA.

However, the results of the VIF test in Table 4 reveal that the tolerance values and the variance inflation factor are less than 1 and less than 10, respectively, endorsing that multicollinearity might not be a problem in the study [37].

Table 3
Correlation Matrix

	DA	AUBN	BI	BE	LEV	FAGE	SGROWTH
DA	1.000						
AUBN	0.095**	1.000					
	0.048						
BI	0.009	0.094**	1.000				
	0.846	0.050					
BE	-0.078*	0.184***	0.185***	1.000			
	0.100	0.000	0.000				
LEV	0.030	-0.003	0.050	0.030	1.000		
	0.526	0.953	0.300	0.530			
FAGE	-0.057	0.060	0.041	0.130***	0.058	1.000	
	0.235	0.211	0.393	0.007	0.224		
SGROWTH	-0.013	0.032	0.039	0.062	-0.008	-0.072	1.000
	0.792	0.504	0.412	0.193	0.870	0.131	

Note: DA = discretionary accruals from equation; AUBN = (KPMG, PricewaterhouseCoopers, Ernst & Young and Deloitte); BI = board independence; BE = board financial expertise; LEV = leverage; FAGE = firm age; SGROWTH = sales growth.

Table 4
Collinearity Diagnostics

Variable	VIF	VIF	Tolerance	Squared
AUBN	1.050	1.030	0.948	0.052
BI	1.040	1.020	0.959	0.041
BE	1.090	1.050	0.914	0.087
LEV	1.010	1.000	0.993	0.007
FAGE	1.030	1.020	0.969	0.031
SGROWTH	1.010	1.010	0.988	0.012
Mean VIF	1.040			

Note: AUBN = (KPMG, PricewaterhouseCoopers, Ernst & Young and Deloitte); BI = board independence; BE = board financial expertise; LEV = leverage; FAGE = firm age; SGROWTH = sales growth.

4.3 Univariate Comparison

To further justify the results obtained from the descriptive statistics and correlation analysis, the study ran an independent t-test. Table 5 presents the results of the two-sample t-test with equal variances. The results from Table 5 reveal that there is a statistically significant difference between the two brand-name auditor (Big4 and non-Big4) at 5%. This is observed from the Table, indicating a p-value of 0.048 and average values of 2.276 and 2.466 for non-Big4 and Big4, respectively. The average value of 2.466 for the Big4 auditors indicates that the DA of firms that were audited by the Big4 auditors are higher than those audited by the non-Big4 auditors. The result can serve as an additional clue about the influence of auditor brand name on financial reporting fraud in the regression model.

4.4 Regression Results

Table 6 presents the regression results of the influence of auditor brand name and financial reporting fraud proxied by DA. AUBN shows a significantly positive relationship with DA. This is

observed from the Table 6 which discloses a regression coefficient and p-value of β> 0.238 and 0.045, respectively. This shows that AUBN is positively and significantly related to DA at the 5% level of significance. This implies that AUBN proxied by the Big4 auditors increases the probability of firms' managers manipulating their earnings through DA. This finding also suggests that non-Big4 auditors are more likely to decrease financial reporting fraud in the listed companies in Nigeria.

Table 5
Univariate Comparison between Big4 and Non-Big4 Audited Firms

Group		Observations	Mean	Std. Err.	Std. Dev.
Non-Big4	0	185	2.276	0.066	0.895
Big4	1	255	2.466	0.066	1.055
combined		440	2.386	0.047	0.994
diff			-0.190	0.096	
T-value		-1.987			
P-value		0.048**			

Table 6
The Relationship between Auditor Brand Name and Financial Reporting Fraud

DA	Coef.	Std. Err.	T>Value	P>Value	VIF	1/VIF
AUBN	0.238	0.082	2.890**	0.045	1.090	0.921
BI	0.165	0.131	1.270	0.275	1.040	0.959
BE	-0.692	0.205	-3.370**	0.028	1.040	0.961
LEV	0.092	0.145	0.640	0.559	1.030	0.972
FAGE	-0.004	0.002	-1.890	0.132	1.010	0.988
SGROWTH	0.000	0.000	-1.470	0.216	1.010	0.994
Cons	2.569	0.194	13.260***	0.000		
R2	0.026					
F-Stat	6.830					
P-Value(F)	0.042					
Hettest(Chi2)	39823					
P-Value	0.000					
Mean VIF	1.040					
Observation	440	440	440	440	440	440

Note: DA= discretionary accruals from equation 1; AUBN = (KPMG, PricewaterhouseCoopers, Ernst & Young and Deloitte); BI = board independence; BE = board financial expertise; LEV = leverage; FAGE = firm age; SGROWTH = sales growth.

A potential elucidation for these results may be that a considerable number of the sample firms were audited by the Big4 who might have lesser information of the local markets compared to non-Big4 auditors. This might produce a vacuum since non-Big4 auditors could have more excellent knowledge of local markets and better relationship with their clients. Thus, this may assist Big4 auditors to better identify irregularities in companies. Another possible explanation of the finding can be linked to the tenure of external auditors established by the SEC CCG (2011) which stipulates that external auditors could be engaged by companies for consecutive periods, subject to a maximum of 10 years. This duration may be considered too long as the exceptionally long tenure of external auditors might impair their independence because the longer they stay as auditors of the same firm, the more likely for them to be networking with the management and thus become less critical of

financial issues. Comparably, prior studies Amahalu *et al.*, Ozili, Bruynseels *et al.*, and Ishak *et al.*, [18-21] find that Big4 auditors are positively related to DA.

Table 6 shows that BI is positively but insignificantly related to DA. This implies that the proportion of independent directors on the board might not limit managers' opportunistic behaviour toward earnings of listed companies in Nigeria. This confirms the finding of [35, 39]. BE is negatively and significantly related to DA, having a regression coefficient and p-value of β >-0.692 and p > 0.028, respectively. Consequently, the results support the agency and resource dependence theories which recommend that high proportion of financial experts is imperative for enriching board monitoring since it leads to better financial reporting quality [41]. LEV is found to be positively but insignificantly related to DA. The result contradicts the argument that highly leveraged firms have inclination to reduce DA. FAGE and SGROWTH show reversal of signs in the model with FAGE having a negatively insignificant relationship with AUBN and SGROWTH, a positively insignificant relationship. This suggests that FAGE and SGROWTH have no meaningful effect on DA of listed companies in Nigeria. The result is consistent with the findings of Puat et al., and Pfeffer and Salancik [41, 42]; while Sun *et al.*, [44] find a negatively significant relationship between SGROWTH and DA. Gao *et al.*, and [35, Sun *et al.*, [44] find a negatively insignificant relationship between FAGE and DA.

4.5 Additional Analysis

An alternative measure of estimation was employed because the data used in the study comprise time-variant and firm-specific data. This may lead to inaccuracy that is clustered and correlated over time. Thus, the effect of the outcome variable and the predictor variables might be exaggerated, thus leading to distortive conclusions [46]. Consequently, "heteroskedasticity robust standard error clustered across firms" was adopted to re-estimate the prior model. Table 7 presents the results of alternative estimation as additional analysis. It can be perceived from Table 7 that the signs of all the parameters of the primary model are noticeably similar to those of the additional analysis. Therefore, it is established that our results of the relationship between auditor brand name and financial reporting fraud are robust to alternative estimation.

Table 7
Alternative Estimation on the Relationship between Auditor Brand Name and Financial Reporting Fraud

DA	Coef.	Robust Std. Err.	T>Value	P>Value
AUBN	0.230	0.096	2.390**	0.019
BI	0.152	0.326	0.470	0.641
BE	-0.676	0.354	-1.910*	0.059
LEV	0.058	0.094	0.620	0.539
FAGE	-0.004	0.004	-1.130	0.261
SGROWTH	0.000	0.000	-1.930*	0.057
Cons	2.577	0.240	10.720***	0.000
R2	0.023			
F-Stat	2.350			
P-Value(F)	0.038			
Observation	440	440	440	440

Note: DA= discretionary accruals from equation 1; AUBN = (KPMG, PricewaterhouseCoopers, Ernst & Young and Deloitte); BI = board independence; BE = board financial expertise; LEV = leverage; FAGE = firm age; SGROWTH = sales growth.

5. Conclusions

Financial reporting fraud is one of the major threats in the contemporary business world. It is an intentional falsification, omission or distortion of financial figures or disclosures of financial reports to deceive financial reporting users, predominantly investors and creditors. Thus, this paper examines the influence of auditor brand name (Big4 and non-Big4) on the financial fraud of listed companies in Nigeria. After controlling for monitoring and firm-specific attributes, we find that Big4 auditors are less likely to detect financial reporting fraud as they might have limited knowledge of local markets compared to non-Big4 auditors. Our finding is consistent with the resource dependence and agency theories which suggest that higher proportion of financial experts on the board decreases the magnitude of financial reporting fraud, thus, leading to better financial reporting quality. Our results of the relationship between auditor brand name and financial reporting fraud are robust to alternative estimation. The study provides insights to policymakers and regulators about the importance of auditor brand name in restricting financial reporting fraud in the listed companies in Nigeria.

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