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MODERATING EFFECT OF AUDIT COMMITTEE INDEPENDENC ON AUDIT FIRM ATTRIBUTES AND AUDIT QUALITY OF QOUTED INSURANCE COMPANIES IN NIGERIA

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Abstract

This study investigates the moderating effect of audit committee independence on the relationship between audit firm attributes (specifically audit tenure and audit fees) and audit quality of listed insurance companies in Nigeria. Using a longitudinal research design and secondary data extracted from annual reports and accounts of sixteen insurance companies over a ten-year period (2014-2023), logistic regression and longitudinal balanced panel models were employed for analysis.The findings reveal a significant negative effect of audit tenure and audit fees on audit quality. However, audit committee independence was found to strengthen the effect of both audit tenure and audit fees on audit quality.Based on the findings, the study recommends that regulatory authorities such as the Financial Reporting Council of Nigeria and the Securities and Exchange Commission in Nigeria should consider periodic rotation of audit firms or engagement partners to mitigate the risks associated with prolonged auditor-client relationships. Additionally, regulators should promote greater transparency and fairness in fee negotiations and audit engagement terms to mitigate fee-driven incentives that may compromise audit quality. Furthermore, audit committees should be tasked with closely monitoring and evaluating audit tenure to ensure that auditors maintain independence, objectivity, and quality throughout the engagement period. Moreover, regulators and audit committees should monitor the fee-to-service ratio, ensuring that audit fees are commensurate with the level of audit services provided. These recommendations aim to enhance corporate governance practices, regulatory oversight, and audit quality in the Nigerian insurance sector, ultimately boosting investor confidence and audit quality.

Keywords: Audit committee independence, Audit firm attributes, Audit quality, Audit tenure Audit fees

1.Introduction

The monitoring role of external auditors is crucial for ensuring the accuracy and integrity of financial statements, as they provide independent verification that enhances the credibility of accounting information. This is particularly important in preventing accounting irregularities, which could erode trust in auditors' ability to protect shareholder interests (Rajgopal et al., 2021; Kalia et al., 2023). Audit quality, as defined by Pontoh and Yolanda (2021), ensures that financial statements are free from material misstatements and comply with relevant standards, making it central to effective corporate governance. The relationship between audit firm characteristics, such as audit tenure and fees, and audit quality has been widely studied, with findings showing that while longer audit tenures can enhance quality by providing deeper insights into a client's operations (Singer & Zhang, 2018), they may also reduce auditor independence and objectivity (Qawqzeh et al., 2018). Higher audit fees are typically linked to better audit quality due to the resources allocated for thorough audits, though fee pressures can also compromise auditor independence (Ayoola, 2022).

Audit committees play a vital role in overseeing the audit process, ensuring transparency and protecting shareholders' interests. Independent audit committees reduce agency costs and conflicts by ensuring that auditors remain objective and impartial, particularly in decisions related to audit tenure and fees (Obermire et al., 2021). These committees are crucial for maintaining trust in the audit process and audit quality by overseeing and regulating the auditor's independence and objectivity. Despite the importance of audit firm attributes, previous studies have produced mixed results, often overlooking the moderating role of governance mechanisms like audit committee independence. This study aims to address this gap by examining how audit committee independence moderates the relationship between audit firm attributes, audit tenure, audit fees, and audit quality in Nigeria's listed insurance firms, hypothesizing that audit committee independence does not significantly moderate these relationships in this context.

2. Literature Review

2.1 Conceptual Definitions

2.1.1 Audit Quality

Audit quality is the likelihood that an audit will identify and report material misstatements in financial statements. Benzouai and Tiar (2020) define audit quality as comprising both technical quality, including reputation, capital, expertise, and independence, and service quality, which relates to client satisfaction, responsiveness, and the provision of audit and non-audit services. Furiady and Kurnia (2015) further suggest that audit quality is a joint probability where auditors detect and report violations in the client's accounting system. This study defines audit quality as the ability of auditors to reliably detect and report material misstatements in the financial statements of listed insurance companies in Nigeria, with a focus on the auditor's capability and independence, which are vital for ensuring high audit standards and maintaining investor confidence in the sector.

2.1.2. Audit Tenure

Audit tenure refers to the length of time an audit firm has been engaged to provide audit services to a specific client. It is a crucial aspect of the auditor-client relationship, influencing the depth of understanding (van et al 2013). Kammenga, (2018) suggests that longer audit tenures are associated with lower audit quality. This is often attributed to familiarity threat, where auditors become overly comfortable with their clients, leading to reduced skepticism and thoroughness in the audit process. Additionally, longer tenure may compromise auditor independence and objectivity, as auditors may develop close relationships with client management, potentially influencing their judgment and decision-making (Dodgson, et al 2020).

2.1.3 Audit Fees

Audit fees refer to the compensation paid by organizations to external audit firms for the detailed examination of financial statements, internal controls, and regulatory compliance, reflecting the expertise, time, and resources invested by the auditors (Huang, 2016). The determination of audit fees is influenced by factors such as the company's size, complexity, operations, industry regulations, geographic presence, and risk exposure (Cho et al., 2021). Usman et al. (2022) suggest that higher audit fees can improve audit quality by enabling auditors to allocate more resources and time for thorough examinations, potentially leading to better detection of material misstatements and attracting more experienced auditors. However, other studies caution that higher fees do not always guarantee higher audit quality, as they may be influenced by unrelated factors like audit complexity, regulatory demands, or litigation risks, and may even threaten auditor independence if auditors prioritize client interests over objectivity (Kim et al., 2024).

2.1.4. Audit committee Independence

Audit committee independence refers to the ability of audit committee members to provide unbiased oversight of a company's financial reporting and audit processes, free from relationships or interests that could compromise their objectivity (Afenya, 2022). Independent audit committees play a critical role in maintaining high audit quality and ensuring the integrity of financial reporting by offering objective and rigorous oversight, challenging management and auditors when necessary (Lutfi et al., 2024). These committees can implement policies such as periodic reviews of auditor performance and auditor rotation to prevent complacency from long audit tenures. Additionally, they ensure that audit fees are negotiated fairly and do not influence auditor independence, safeguarding the thoroughness and objectivity of the audit process (Reschiwati et al., 2023).

2.2. Empirical Review

Saleh et al (2023) investigated the impact of audit fees on audit quality, different regression techniques was used, such as logistic regression, probit regression, ordinary least squares regression and fixed effects regression. The authors used panel data of 80 nonfinancial Egyptian-listed firms over 2016–2020. The authors found a significant positive relationship between audit fees and audit quality. The study focuses on nonfinancial firms listed in Egypt. The economic, regulatory, and corporate governance environments in Egypt may differ significantly from those in other countries. This context-specific focus may limit the generalizability of the findings to other regions or sectors.

Trianjani et al (2023) examined the effect of audit tenure, audit fees, size of public accounting firm, auditor specialization, and audit rotation on audit quality. The population in this study are Transportation and Logistics Service companies listed on the Indonesia Stock Exchange (IDX) for the 2017-2021 period which have been audited. The sample selection was carried out using purposive sampling method. The analytical method used to test the hypothesis is logistic regression analysis. The results of this study indicate that audit specialization has an effect on audit quality, while audit tenure, audit fees, size of a public accounting firm, and audit rotation have no effect on audit quality. The focus on transportation and logistics companies in Indonesia provides a unique context but also limits the generalizability of the findings. The study should discuss how sector-specific factors (e.g., regulatory environment, industry risks) might influence the results and whether these findings can be applied to other sectors or regions.

Susanti and Annisa (2023) analyzed the effect of audit fees, audit tenure and company size on audit quality in mining companies listed on the Indonesia Stock Exchange in 2018-2021 with a research sample of 44 mining companies that meet the criteria. In analyzing the data, and the method used was purposive sampling, the data analysis technique used was logistic regression analysis. Based on the results of logistic regression analysis, it shows that Audit Fee has no effect on audit quality, Tenure Audit has no effect on Audit Quality, Firm Size has no effect on audit quality. The study focuses on mining companies listed on the Indonesia Stock Exchange. It is essential to consider how industry-specific characteristics and regulatory environments may influence the observed relationships. Moreover, the study period (2018-2021) may encompass significant economic or regulatory changes that could impact audit quality.

Reschiwati et al (2023) analyzed the moderating effect of audit committee effect of Audit Fee and Audit Tenure on Audit Quality. The research sample used purposive sampling method in financial sector service companies listed on the IDX in 2017-2022 and there were 36 companies with 216 data. The data analysis method . The results showed audit committee has no significant moderate effect on audit fees and tenure on audit quality. The study should provide practical implications based on its findings, even though the audit committee's moderating effect is not significant. Identifying potential factors that influence audit quality in financial sector service companies can inform managerial and regulatory practices.

Kristianto et al (2022) determine the effectof audit tenure, company size and audit delay on audit quality in non-financial companies listed on the IDX for the 2019-2021 period. This study uses quantitative methods, the sample used is 25 companies using the purpose sampling method, totaling 75 data. The techniques used in this research are descriptive statistical techniques, hypothesis testing, coefficient of determination test, classical assumption test and also multiplelinear regression. The results of the study reveal that there is a significant effect of audit tenure, company size and audit delay on audit quality in non-financial companies listed on the indonesian stock exchange.

Martani et al (2021) examined the effect of audit tenure and audit rotation on audit quality. This study also examines whether this effect of the rotation is different between the Big 4 and non-Big 4 audit firm. This research was conducted in Indonesia, which is one of the few countries that not only implementing audit partner rotation but also mandatory audit firm rotation. However, in 2015, the mandatory audit firm rotation in Indonesia was abolished. The results show that the relationship between the tenure of auditor and audit quality is not significant. Audit firm rotation positively impacts audit quality, and the positive impact is lower in Big 4. In non-Big 4, audit partner rotation has no effect on audit quality.

Atmojo and Sukirman (2019) analyzed the influence of tenure, specialty audit, Audit Firm's reputation on quality auditing, and third variable interaction of audit quality when moderated by audit committee. A number of manufacturing companies of 156 listed in IDX period 2011-2016 become the population this research. A number of 44 companies selected as samples by using purposive sampling technique. The Research used multiple regression analysis, while interaction variables tested with Moderated Regression Analysis (MRA). The results of this study showed tenure have no effect to audit quality. There are positive and significant influence of audit specialization to audit quality. Meanwhile, reputation of audit firm and significant influential audit committee with a negative direction against quality of audit. The study also proved that audit Committee was able to moderate the relationship of audit specialization to audit quality as well as relationship of audit firm reputation of quality audit. However, the audit committee is not able to moderate relationship of tenure with audit quality.

This work examines the moderating effect of audit committee independence on audit firm attributes and audit quality of listed insurances firms in Nigeria. To achieve this objective, it is therefore hypothesized that audit committee independence does not significantly moderate the effect of audit tenure and audit fees impact on audit quality of listed insurances firms in Nigeria.

2.3. Theoretical Framework

Agency Theory

Agency theory, proposed by Jensen and Meckling (1976), highlights the conflict between managers (agents) and owners (principals) when ownership and management are separated, leading to potential agency problems due to information asymmetry. Managers may possess more information than shareholders, creating opportunities for earnings misreporting or financial manipulations (Warfield et al., 1995). Audits serve as a control mechanism to mitigate these issues by ensuring that financial statements accurately reflect a company's financial position and protect the interests of the principal. This study applies agency theory to analyze how audit firm attributes, such as audit tenure and fees, affect audit quality, focusing on the moderating role of audit committee independence. The theory underscores that shareholders depend on auditors to reduce information asymmetry and offer independent assurance on the accuracy of financial statements, while audit committee independence serves as a monitoring mechanism to mitigate agency conflicts and improve audit quality.

3. Methodology

3.1 Research Design

This study employed a longitudinal research design to examine the relationship between audit firm attributes and audit quality among listed insurance companies in Nigeria. The study focused on 16 insurance companies selected from the 22 listed on the Nigerian Exchange Group (NGX) as of December 31, 2023, based on criteria such as being listed before January 1, 2014, and having available data for the entire study period.

3.2. Data and Sources

Secondary data were collected from the annual reports and accounts of these companies over a ten-year period from 2014 to 2023, a timeframe chosen to capture significant changes in Nigeria's corporate governance code and the Insurance Act. The study aims to provide insights into the impact of audit firm attributes on audit quality within the Nigerian insurance sector.

3.3. Model Specification

In order to analyze the effect of audit firm characteristic on audit quality of quoted insurance companies in Nigeria, the study modified the model used by Enofe et al (2013).

$$AQ = \beta_0 + \beta_1 AT + \beta_2 AF + \beta_{3i} FS + \beta_4 \ldots\ldots \quad (1)$$

The moderating model is as follow

$$AQ = \beta_0 + \beta_1 AT*ACI + \beta_2 AF*ACI + FS + \mu \ldots\ldots (2)$$

Where:

AQ = Audit Quality.

β_0= Constant

AT = Auditor Tenure

AF = Audit Firm Fees

ACI= Audit Committee Independence

Fs = Firm Size

$\beta_0 \ldots, \beta_k$ is the regression model coefficients of the independent variables

ϵ_{it} is the random error

3.4. Method of Data Anaylsis

Logistic regression was employed for data analysis in this study to establish the relationships between the variables, particularly due to the dichotomous nature of the dependent variable. Additionally, longitudinal balanced panel models were utilized to examine the relationship between all pairs of variables. The strength of logistic regression lies in its ability to analyze the effect of one dependent variable against two or more independent variables, making it suitable for this study’s objectives of understanding the interactions among audit firm attributes, audit quality, and audit committee independence.

3.5 Variable and Measurement

Table 1: Variables and Measurement

S/N	Variables	Definition	Type	Measurement	Source
1.	AQ	Audit Quality	Dependent	Dichotomous variable for 1 firm audited by Big4, and 0 otherwise	Hundal, 2016
2.	AF	Audit Fees paid to the firm	Independent	Natural log of total audit fees	Enofe et al., 2013; Adeniyi et al., 2013
3.	AT	auditor tenure	Independent	1 if an auditor spends more than three years on the audit assignment otherwise 0	Enofe et al., 2013; Adeniyi et al., 2013; Babatolu et al., 2016
4	ACI	Audit Committee Independence	Moderator	Proportion of Outsiders/nonexecutive directors in the audit committee	Hassan & Bello, 2013; Salehi & Mansoury, 2009

Source: Researcher's Compilation, 2024

4. Results and Discussions

In this section, the results are presented and discussed in light of the research findings. First, a set of descriptive statistics and correlation results are presented, followed by the logistic regression results.

Table 2: Descriptive Statistics

Variables	Mean	Std. Dev.	Min	Max
AQ	.4708333	.5001917	0	1
AT	.7875	.4116577	0	1
AF	3.99544	.8642244	2.3483	5.7315
ACI	.2197918	.0825954	.166667	.5
FS	9.99319	.6850116	7.81954	10.9683

Source: STATA Output, 2024

Table 2 presents the descriptive statistics for the dependent and independent variables in the study. The dependent variable, audit quality (AQ), measured by the involvement of Big Four audit firms, has a mean value of 0.4708333 with a standard deviation of 0.5001917, indicating that, on average, audit quality is 47.08% across the dataset. Audit Tenure (AT), a dichotomous variable, has a mean of 0.7875, suggesting that most engagements have longer tenures, with a standard deviation of 0.4116577 showing variability in tenure lengths. The average audit fee is 3.99544, with a standard deviation of 0.8642244, and ranges from 2.3483 to 5.7315, reflecting a diversity in fees paid across the sample.

For the independent variable, Audit Committee Independence, the mean value is 0.2197918, indicating a moderate level of independence across audit committees, with scores distributed between 0.1666 and 0.50. This suggests a balanced range of independence within the dataset. The control variable, firm size, has a mean value of 9.99319 and a standard deviation of 0.6850116, indicating some variability in the size of the firms included in the study. These descriptive statistics provide insights into the key variables and their distributions, highlighting the variability in audit characteristics and governance structures across the sample.

Table 3: Correlation Result

Variables	AQ	AT	AF	ACI	FS
AQ	1.0000				
AT	-0.3487	1.0000			
AF	0.2230	0.1885	1.0000		
ACI	0.1715	0.1144	-0.0172	1.0000	
FS	-0.0988	0.1534	-0.0781	-0.0954	1.0000

Source: STATA Output, 2024

Table 3 presents the correlation analysis between audit firm characteristics, audit committee independence, and audit quality. It shows a negative relationship between audit tenure and audit quality, with a correlation coefficient of -0.3487. This negative correlation suggests that longer audit tenures may be detrimental to audit quality, potentially due to reduced auditor independence and professional skepticism over time. In contrast, the table indicates a positive correlation of 0.2230 between audit fees and audit quality, implying that higher audit fees are associated with better audit quality. This relationship may stem from the fact that increased fees allow auditors to allocate more resources, hire more experienced personnel, and use advanced technologies, all of which can enhance audit quality. Additionally, the analysis reveals a positive correlation of 0.1715 between audit committee independence and audit quality, suggesting that independent audit committees contribute to higher audit quality. Independent committees are more likely to challenge management, ensure thorough audits, and enforce rigorous professional standards. However, the firm size control variable shows a negative correlation of -0.0988 with audit quality, indicating that larger firms may face challenges in maintaining audit quality, possibly due to complexity or resource allocation issues. These correlations provide valuable insights into the factors that influence audit quality in the Nigerian insurance sector.

Table 4: Hosmer and Lemeshow's goodness-of-fit.

Step	Chi-square	Sig	
1 6	Hosmer–Lemeshow chi2(8) = 1 236.49	Prob > chi2 =	0.4060

The Hosmer and Lemeshow's goodness-of-fit test indicates that the logistic regression model used in the study fits the data well, with no significant discrepancies between observed and predicted values. This reinforces the validity of the study's findings on the moderating effect of audit committee independence on the relationship between audit firm attributes and audit quality in the Nigerian insurance sector.

Table 5: Summary of Logistic Regression Analysis (Direct Effect)

	Odds Ratio	Std. Err.	z	P>|z|
AT	-.2588283	.0851272	-3.04	0.003
AF	-.4154447	.1746512	-2.38	0.020
FS	.0066882	.0023187	2.88	0.005
Pseudo R2	27.790			
LR chi2(5) = 32.87				
Prob > chi2 = 0.0007				

Source: STATA Output, 2024

The logistic regression model in this study explains approximately 28% of the variation in audit quality for Nigerian insurance companies, with a Pseudo R2 value of 27.790. This indicates that audit tenure and audit fees significantly influence audit quality. The model is statistically significant, as evidenced by the LR chi2(5) = 32.87 and a P-value of 0.000. Before considering moderation effects, audit tenure has a significant negative effect on audit quality, with an odds ratio of -0.2588 and a p-value of 0.03. This suggests that longer audit tenures are associated with a decrease in audit quality, as each additional unit of audit tenure decreases the odds of achieving higher audit quality by a factor of approximately 4.91. This result led to the rejection of the first null hypothesis (H01).

The logistic regression analysis also reveals that audit fees have a significant negative effect on audit quality, with an odds ratio of -0.4154 and a p-value of 0.020. This finding indicates that increasing audit fees is associated with a decline in audit quality, raising concerns about potential issues such as compromised auditor independence or reduced audit thoroughness. The significant negative relationship between audit fees and audit quality led to the rejection of the second null hypothesis (H02). These findings underscore the importance of considering both audit tenure and fees in discussions about audit quality in the Nigerian insurance sector.

Table 6: Logistic Regression Analysis (Moderating Effect)

	Odds Ratio	Std. Err.	z	P>|z|
AT*ACI	.3522792	.0995938	3.54	0.001
AF*ACI	.2811821	.1255202	2.24	0.025
FS	.5788436	.1240184	4.67	0.000
Pseudo R2	37.10			
LR chi2(5) = 48.12				
Prob > chi2 = 0.000				

Source: STATA Output, 2024

The Pseudo R2 value for the moderation of audit committee independence shows that audit tenure and audit fees together explain 37.10% of the variation in audit quality for listed insurance companies in Nigeria. The model's fit is confirmed by an LR chi2(5) value of 48.12 and a significant probability of chi2 = 0.000. After considering the moderating effect of audit committee independence, audit tenure exhibits a significant positive effect on audit quality, with an odds ratio of 0.3523 and a p-value of 0.00, indicating that longer audit tenures, when supported by effective audit committee oversight, improve audit quality. This suggests that audit committees play a crucial role in leveraging the knowledge and experience accumulated during longer audit engagements, leading to higher-quality audits, thus rejecting the first null hypothesis (H01), in line with Saleh et al. (2023).

Additionally, audit committee independence significantly moderates the relationship between audit fees and audit quality, with an odds ratio of 0.2812 and a p-value of 0.025. This finding underscores the importance of independent audit committees in ensuring that audit fees are appropriate and do not compromise audit quality, aligning with findings from Kristianto et al. (2022) and Martani et al. (2021). The study also found that firm size significantly influences audit quality, with a positive odds ratio of 0.5788 and a p-value of 0.000, indicating that larger firms, due to their resources, expertise, and established internal controls, tend to have higher audit quality. This further suggests that larger insurance companies are better positioned to ensure effective and comprehensive audits.

5. Conclusion and Recommendations

This study examined the moderating effect of audit committee independence on the relationship between audit firm attributes (audit tenure and audit fees) and audit quality among listed insurance companies in Nigeria. The findings revealed that longer audit tenures were negatively associated with audit quality, suggesting that prolonged auditor-client relationships could compromise auditor independence and objectivity. Similarly, higher audit fees were found to be negatively correlated with audit quality, raising concerns about cost pressures impacting audit integrity. However, the study highlighted the critical role of independent audit committees in moderating these relationships. Independent audit committees strengthened the effect of audit tenure on audit quality, mitigating familiarity threats, and ensured that audit fees aligned with the audit's scope, complexity, and risk profile, protecting audit quality from fee-driven pressures.

In line with the conclusions of the study, the following recommendations were proffered:

Regulatory authorities in Nigeria, such as the Financial Reporting Council and the Securities and Exchange Commission, should consider implementing periodic rotation of audit firms or engagement partners to reduce the risks associated with prolonged auditor-client relationships. Additionally, regulators should promote transparency and fairness in fee negotiations to prevent fee-driven incentives that could compromise audit quality. Audit committees should play a critical role in monitoring audit tenure, ensuring that auditors maintain independence and objectivity throughout the engagement. Regular assessments of audit quality and auditor performance should be conducted to identify potential threats to independence. Furthermore, audit committees should monitor the fee-to-service ratio, ensuring that audit fees align with the level of service provided, and consist of independent directors with expertise in financial reporting, auditing, and risk management to ensure rigorous oversight of both audit fees and quality.

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