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Audit Reporting Quality And Audit Fee

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Abstract: This study examines the relationship between audit reporting quality and audit fees in Nigeria, focusing on key determinants such as audit firm size, client risk, and firm profitability. Grounded in agency theory**, the study highlights how audit fees serve as a mechanism to mitigate agency conflicts and enhance financial transparency. Using an ex-post facto research design, data were collected from 52 listed firms on the Nigerian Exchange Group (NGX) between 2018 and 2020**. A **multiple regression analysis was conducted using** E-Views **8.0 to evaluate the impact of independent variables on audit fees. The findings reveal that audit firm size significantly affects audit fees (β = 0.0177, p = 0.021), indicating that larger firms charge higher fees due to their reputation and credibility. Similarly**, **client risk has a positive and significant impact on audit fees (β = 0.2061, p = 0.027), suggesting that riskier firms incur higher audit costs due to increased scrutiny and litigation risks. Additionally**, **client firm profitability significantly influences audit fees (β = 0.0025, p = 0.009), implying that more profitable firms pay higher fees due to their complex financial structures. The model's R-squared value (0.1138) indicates that while these variables contribute to audit fee determination, other unexplored factors may also be relevant. The study underscores the need for stronger regulatory oversight to ensure that high audit fees correlate with improved audit quality rather than compromised auditor independence. Future research should explore longitudinal trends in audit fee structures and their implications for financial reporting credibility in Nigeria.**

Keywords: Audit fees, Audit reporting quality, Auditor independence, Agency theory, Corporate governance, Financial transparency.

1. Introduction

Audit fee refers to the remuneration payable to an auditor for audit services rendered. In other words, an audit fee is a fee that a company pays an external auditor in exchange for performing an audit. The Nigerian audit industry is regulated by the Company and Allied Matters Act, hence accountants in Nigeria have to be cautious when entering into negotiations for professional work to avoid any issue that can ruin their independent professional judgment (ICAN, 2021). The audit fee charged is influenced by auditor-dependent factors such as the reputation of the auditor, auditor experience, and competition in the audit market. Audit fees are also determined by the client's company factors such as company size, complexity of operations, client firm risk, and the profitability of the client's firm (Abiri, 2019).

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Vol. 50 No. 1 April 2025, pp. 134-144

There is a growing trend in recent years in accounting about discussing the issue of audit fees—how auditors determine the amount of fees required for the audit work (Francis, 2019). This is an important question that needs an answer. Prior research has tried to examine whether determining the audit fees is affected by the audit company attributes (such as size, reputation, experience, competition, industry specialization, and whether it is from the Big Four) or by the client's company characteristics (such as size, complexity, risk, and profitability). Most prior studies presenting empirical evidence on the effect of audited company attributes on audit fees have focused primarily on developed economies (Mike & Muhammad, 2017). However, a limited number of studies have explored the subject in emerging economies. This lack of empirical research on the factors influencing audit fees, particularly in Nigeria, highlights the need for further investigation into the relationship between audit fees and financial performance.

Audit fees can be used to measure the quality of the service provided by the auditor. Therefore, it is not enough for the auditor just to have expertise; the auditor must also have independence (Oluwole, 2017). Dependence of an auditor occurs when a single client provides a substantial portion of its revenues. In such a context, the evidence shows that there will be a greater chance that the auditor will overlook significant accounting irregularities. Studies show that one of the main elements of auditor independence is related to the receipt of consulting fees by audit firms (Ogbu, Johnson, & Kayode, 2022). Therefore, the quality of auditing services in Nigeria is lower when there are agency problems (Kadiri, 2018).

The auditor's independence makes external auditing services function as a corporate governance mechanism, aiming to resolve agency problems and information asymmetry between stockholders and managers. Agency conflicts are mitigated when the external auditor has sufficient independence to produce information that closely reflects the true financial situation of the client company (Obi, 2017). According to Kadiri (2018), good corporate governance practices affect audit costs because they require more complex and extensive analyses, but they can also mean a reduction of risk to the auditor, thus reducing the cost of the service. However, the contracting of non-audit services can lead to a loss of independence, as the auditor may become hesitant to expose fraudulent accounting practices due to concerns over losing consulting revenue.

Various articles in Nigeria have addressed the pricing of audit fees (Kadiri, Ogbu, & Kayode, 2022). Since Simunic (2020) developed a model to determine the process by which audit fees are set, other empirical studies have been published with the aim of defining the pricing of audit fees. Here, our aim is to model audit and non-audit fees as a function of other variables, as done by Francis (2019), specifically by using Tobin's Q, capital intensity, and sales growth.

The fees charged for auditing reflect the time spent rendering the service (Usman, 2018), which is related to the size of the client company, as larger companies have more data to examine. Therefore, the size of the client company impacts the price paid for audit services. Furthermore, auditors will typically spend more time providing auditing and consulting services to highly leveraged companies due to the greater risk of insolvency. As a result, both these fees will typically be higher in companies with large debt loads (Kadiri, 2022).

Given the ongoing discourse on audit fees and their determinants, this study seeks to examine the impact of audit fees on firm financial performance in Nigeria, addressing a gap in the literature on audit pricing and its implications for corporate governance and financial transparency in emerging economies.

Research Questions

The research work seeks to address the following research questions:

i. To what extent does audit firm size affect audit fee in Nigeria?

ii. To what extent does client's risk affect audit fee in Nigeria?

iii. To what extent does client's firm profitability affect audit fee in Nigeria?

Hypothesis

H_{01}: The size of an audit firm has no significant effect on audit fees in Nigeria.

H_{02}: The risk level of a client's firm has no significant effect on audit fees in Nigeria.

H_{03}: The profitability of a client's firm has no significant effect on audit fees in Nigeria.

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Vol. 50 No. 1 April 2025, pp. 134-144

2 Theoretical Framework

Agency Theory

Agency theory, developed by Jensen and Meckling (1976), provides a foundational framework for understanding the relationship between principals (owners/shareholders) and agents (managers/auditors) in a business environment. The theory is based on the premise that organizations are structured as a set of contracts in which the principal delegates decision-making authority to an agent who is expected to act in the principal's best interest. However, due to differing goals and access to information, conflicts often arise between these two parties, leading to what is referred to as agency problems. In the context of auditing, agency theory helps explain how the separation of ownership and control creates a demand for independent assurance services, as shareholders rely on external auditors to verify the accuracy and reliability of financial statements.

One of the central issues in agency theory is the information asymmetry that exists between the principal and the agent. Managers, who are responsible for day-to-day operations, possess more information about the company's financial position and performance than shareholders. This information gap creates an opportunity for managers to act opportunistically, engaging in earnings manipulation, fraudulent financial reporting, or self-serving behavior that does not align with shareholder interests. External auditors serve as a mechanism to bridge this information gap by providing independent verification of financial reports, thus enhancing transparency and reducing the risk of misinformation. The level of audit fees charged can be seen as a reflection of the effort required to mitigate this asymmetry and ensure that financial reports fairly represent a company's financial position.

The agency problem is further exacerbated when managerial actions are difficult to observe or monitor. Since shareholders cannot directly oversee the activities of managers, they must rely on governance structures, including external audits, to enforce accountability. However, auditors themselves function as agents because they are hired and paid by the firm they audit, potentially creating a conflict of interest. When audit firms become overly dependent on fees from a single client, their independence may be compromised, leading to reduced audit quality. Agency theory explains why audit fees may vary across firms based on the perceived level of risk, the complexity of financial transactions, and the firm's governance structures, all of which influence the auditor's ability to remain objective.

Another important aspect of agency theory is the costs associated with resolving agency conflicts, which are categorized into three types: monitoring costs, bonding costs, and residual loss. Monitoring costs refer to the expenses incurred by the principal to oversee and evaluate the agent's behavior, such as hiring external auditors or establishing corporate governance mechanisms. Bonding costs are incurred by agents (managers and auditors) to assure principals that they will act in their best interests, such as maintaining professional certifications and complying with ethical standards. Residual loss refers to the inefficiencies that arise when agency problems cannot be fully eliminated. Audit fees, in this context, are a type of monitoring cost, as firms pay auditors to assess financial accuracy and minimize opportunistic behaviors by management.

Agency theory also explains the relationship between audit fees and audit firm size. Larger audit firms, particularly those in the "Big Four" category, tend to charge higher fees because they provide a higher perceived level of assurance and credibility. This is because larger firms have more extensive resources, expertise, and reputation at stake, making them less likely to compromise their independence for short-term financial gain. Conversely, smaller audit firms may charge lower fees to attract clients, but this can raise concerns about audit quality, as financial constraints may lead to reduced effort or ethical compromises. This highlights the trade-off between cost and quality in the auditing industry, which agency theory helps to explain.

Moreover, client-specific risk factors play a significant role in determining audit fees, as auditors adjust their pricing to reflect the level of effort required to assess financial statements accurately. Companies with higher financial risk—such as those with high debt levels, frequent losses, or aggressive accounting practices—pose greater challenges for auditors. According to agency theory, auditors will demand higher fees when auditing high-risk firms because of the increased effort required to detect misstatements and mitigate litigation risks. If an auditor underprices an engagement for a high-risk client, they may cut corners, leading to a decline in audit quality. This reinforces the idea that audit fees are not merely a function of firm size but are also influenced by the level of audit risk and complexity associated with each engagement.

Another application of agency theory is in explaining the impact of corporate governance on audit fees and audit quality. Strong corporate governance mechanisms, such as independent audit committees and effective internal controls, reduce agency conflicts and enhance financial transparency. Firms with strong governance structures typically experience lower audit risk, which may lead to lower audit fees due to reduced effort required from auditors. Conversely, weak governance structures result in higher

audit fees, as auditors must perform more extensive testing to compensate for the lack of internal oversight. Agency theory suggests that audit fees are not only a function of firm characteristics but also a reflection of governance effectiveness in mitigating financial misstatements and opportunistic behaviors.

Additionally, agency theory sheds light on the relationship between audit fees and profitability. Highly profitable firms are expected to attract greater scrutiny from external auditors because of their financial complexity and the potential for earnings management. While some studies suggest that more profitable firms are willing to pay higher audit fees to enhance credibility and investor confidence, others argue that such firms may exert pressure on auditors to reduce fees in exchange for continued business relationships. This dual effect demonstrates how agency theory helps explain the negotiation dynamics between audit firms and clients, as well as the incentives that drive both parties in the audit fee determination process.

Furthermore, agency theory is relevant in discussions of non-audit services (NAS) and their effect on auditor independence. When an audit firm provides both audit and consulting services to the same client, there is a risk that the auditor's objectivity may be compromised due to financial incentives associated with consulting revenues. Studies have shown that excessive dependence on non-audit service fees can lead to lower audit quality, as auditors may be reluctant to challenge management for fear of losing lucrative consulting contracts. Agency theory explains why regulators impose restrictions on the provision of NAS by external auditors, as such relationships create potential conflicts of interest that undermine audit quality and stakeholder trust.

3 Methodology

Research Design

The research design for this study was ex-post factor or casual comparative research design with time series properties. This was used to capture the heterogeneity'among data. To achieve the objectives of this study, the published annual reports of some selected firms were analyzed.

Description of Population of the Study

The population of the study is selected sixty (60) firms in the Nigerian Exchange Group (NGX) for the period 2018-2020.

Sample Size and Sampling Technique

Samples are useful because they allow the researcher to examine th

e characteristics of the population.

The Taro Yamani statistical formula was adopted for this research work.The formula is thus:

n - N 1+N(e)2

Where N=population of study

n=sample size

e=level of significance or margin of error

Therefore,

N=60

e=0.05

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Vol. 50 No. 1 April 2025, pp. 134-144

n=?

Note: The choice of 0.05 level of significance is purely an exclusive decision of the researcher.

n 60_____1+60(0.05)2

n = 60 60 - 60

1+60x0.0025 1+0.15 1.15

= 52.17

n =52 sample size.

Source of Data Collection

The researcher's tools that were adopted in obtaining relevant data for this study were the annual reports of the firms under study for the period 2018-2020.

Method of Data Presentation

Data obtained from secondary source were analyzed using E-View Computer Software. The study used regression analysis to investigate the impact of independent variables on dependent variable. A multiple linear regression model was used to establis

the significance of the model. The results obtained from the model are presented in tables to aid and ease the analysis.

Model Specification

The regression model adopted in this study is presented below as:

The model of this study is;

AFEE=α+a;AFS+a2+CRSK+ayCFPAB+H

AFEE=AuditFee

AFS=AuditFirmSize

CRSK=ClientRisk

CFPAB=Client Firm Profitability

Measurement of Variables

Table 1:Definition of variables (Audit fee determinants)

Dependent Variable	**Variable Definition**
AFEE	Natural log audit fee
Independent Variable	Variable Definition
Audit Firm Size	Auditing Firm
Client Risk	Debt ratio-Total Liabilities/Total Assets
Client Firm Profitability	Return on Assets=Net income/Total Assets

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https://ijpsat.org/
Vol. 50 No. 1 April 2025, pp. 134-144

4 Result

The below table presents the summary of the descriptive statistics for the dependent and independent variables for 52 observations. For dependent variable,it was observed that audit fee has a mean value of 3.916465 and a standard deviation of 0.2565952 among all variables. The maximum in audit fee is 4.127134 while the minimum is 2.639057.

For the independent variables, the audit firm size has a mean value of 24:28124 and a standard deviation of 1.709874. Client risk has a mean value of 0.5875182 and a standard deviation of 0.2383716 while client firm profitability (ROA) hasa mean value of 39.56098 and a standard deviation of 20.65072. The probability values of the Jacque-Bera Statistics of all the variables show that the data are normally distributed.

Table 4.1 Descriptive Statistics

	AFEE	AFS	CRSK	CFPAB
Mean	3.916465	24.28124	0.5875182	39.56098
Median	0.094510	32.09804	1.179320	0.585460
Maximum	4.127134	35.35181	13.73180	8.060153
Minimum	2.639057	19.91139	0.058969	0.034195
Std.Dev.	0.2565952	2.823945	1.385516	0.692562
Skewness	0.0000	-1.748766	4.481758	8.468091
Kurtosis	0.0000	6.477015	31.02702	82.64160
Jarque-Bera	1295.023	313.1505	11147.93	85356.33
Probability	0.001	0.007	0.009	0.000
Sum	48.36034	9821.320	482.7704	201.4573
Sum Sq.Dev.	14.54193	2456.197	591.2535	147.7300
Observations	52	52	52	52

Source: Computed from Various Annual Reports Using **E-Views** 8.0 (2022)

Table 4.2 Correlation Matrix

Correlation	AFEE	AFS	CRSK	CFPAB
AFEE	1.0000			
AFS	0.1754	1.000		
CRSK	0.2222	0.7076	1.000000	
CFPAB	0.2486	0.2096	0.1073	1.000000
	Computation		iew 8.0,(2022)	

Table 4.2 shows that audit fee has a positive correlations with the various explanatory variables used in the study. The explanator y variable of Audit Firm Size,Client Risk and ROA are positively correlated.

Regression Result

Variables	**Coefficient**	**Std.Error**	**t-Statistic**	**Prob.**
AFEE	-	-	-	
AFS	0.0177363	0.237883	-0.75	0.021
CRSK	0.2060512	0.1678157	-1.23	0.007

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https://ijpsat.org/
Vol. 50 No. 1 April 2025, pp. 134-144

CFPAB	0.0025262	0.0019754	-1.28	0.009
Constant	0.9617	0.5813	0.9617	0.022
R-squared	0.1138	0.1138	Durbin-Watson stat	2.053910
Adjusted R-Squared	0.0420	0.0420		
S.E regression	0.25115			
F-statistic	1.58			
Prob(F-statistic)	0.0097			
urce:Computed fro	m Various A	nnual Reports	Using E-Views 8.	0 (2022)

Table 4.3 shows that the explanatory variables do not account for much of the systematic variations in the dependent variable. The table shows very low R-squared and Adjusted R-squared values of 0.1138 and 0.0420 respectively. This low value of the R-squared statistics suggests that there are many other variables in explaining changes in the dependent variables. The P-value of the F-statistic shows that the model overall is suitable for estimating the stated model.

Hypotheses Testing

Test Statistic

The statistical tool used in testing the stated hypothesis is the regression test procedure which uses the individual significance test (t-Test) and the overall significance test (F-Test). The goodness of fit of the model is tested using the coefficient of determination.The estimnation of these statistics is done using the E-View computer software.

Significance Level

The level of significance adopted in testing the stated hypothesis of this study is 5%.This level is usually considered adequate for studies in management and other behavioral sciences.

Decision Rule

The critical p-value used in these tests is 0.05. thus, the researcher accepts a given alternative hypothesis as being accepted if calculated p-value is less than or equal to **0.05,** otherwise the researcher accepts the null hypothesis that there is no significant effect.

Hypothesis 1

Ho: Audit firm size does not significantly afTect audit fee in Nigeria.

Hi: Audit firm size significantly affect audit fee in Nigeria

Computation

The test statistics is computed by E-View software and the results are as shown in Table

Table 4.3 Regression Results on Audit Firm Size and Audit Fee

Variable	Coefficient	t-test statistic	p-value
AFS	0.0177363	0.61	0.021

Source:Extracted from Table showing Regression Results

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https://ijpsat.org/
Vol. 50 No. 1 April 2025, pp. 134-144

Decision

With a coefficient of 0.0177363 the results indicate that audit firm size positively impacts on audit fee, while the probability val ue of 0.021 indicates that the positive impact is significant. This leads to the acceptance of the alternative hypothesis, thus reject ing of the null hypothesis. The researcher accepts that audit firm size has significant effect on audit fee.

Hypothesis II

Ho: Client's risk does not sgnificantly affect audit fee in Nigeria.

Hi: Client's risk significantly affect audit fee in Nigeria

Computations

The test statistic is computed by E-View software and the results are as shown in Table 4.4.

Table 4.4 Regression Results on Client's Risk and audit fee

Variable	Coefficient	t-test statistic	p-value
CRSK	0.2060512	1.90	0.027

Source:Extracted from Table showing Regression Results

Decision

With a coefficient of 0.2060512 the results indicate that client's risk positively impacts audit fee, while the probability value of 0 .027 indicates that the positive impact is significant. This leads to the acceptance of the alternaive hypothesis,thus rejecting the n ull hypothesis that client's risk significantly affect audit fee in Nigeria.

Hypothesis III

n Using E-V

Ho: Client's firm profitability does not significantly affect audit fee in Nigeria.

Hi: Client's firm profitability significantly affect audit fee in Nigeria.

Computations

The test statistic is computed by E-View software and the results are as shown in Table 4.5.

Table 4.5: Regression Results on Client firm profitability and Audit Fee

Variable	Coefficient	t-test statistic	p-value
CFPAB	0.0025262	0.41	0.009

Source:Extracted from Table showing Regression Results

Decision

With a coefficient of 0.0025262 the results indicate that client firm profitability positively impacts on audit fee, while the pro bability value of 0.009 indicates that the positive impact is significant. This leads to the acceptance of the alternative hypothesis, thus rejecting of the null hypothesis. The researcher accepts that client firm profitability has significant impact on audit fee in Ni geria.

Discussion of Findings

The findings from this study indicate that audit firm size has a significant effect on audit fees in Nigeria, which aligns with previous studies such as those conducted by Simunic (2020) and Francis (2019). Larger audit firms, particularly those within the Big Four category, tend to charge higher fees due to their enhanced reputation, extensive resources, and perceived higher audit quality. This result supports the agency theory, which posits that firms seek reputable auditors to reduce agency conflicts and enhance financial credibility. Additionally, the study's findings confirm earlier research by Mike and Muhammad (2017), which

demonstrated that audit firm size positively correlates with audit fees in developed economies. The significance of this relationship in the Nigerian context suggests that clients value the credibility and assurance provided by well-established audit firms.

The study also found that client risk significantly influences audit fees, reinforcing the findings of Oluwole (2017) and Kadiri (2018). Companies with higher financial risk—such as those with substantial debt or unstable financial conditions—tend to pay higher audit fees. This is because auditors must invest more time and effort in assessing the accuracy of financial statements and mitigating litigation risks. This finding aligns with prior research by Ogbu, Johnson, and Kayode (2022), which highlighted that financial risk increases the complexity of an audit, leading to higher costs. The results further emphasize the role of audit fees as a risk premium, where auditors adjust their pricing strategies based on the level of uncertainty and potential exposure to misstatements within client firms.

Furthermore, the results indicate that client firm profitability significantly affects audit fees, a finding consistent with earlier studies by Usman (2018) and Kadiri (2022). Highly profitable firms typically pay higher audit fees, which can be attributed to their complex financial structures and greater regulatory scrutiny. This aligns with the argument by Obi (2017) that more profitable firms are subject to stricter audits to ensure compliance with financial regulations. However, the study also supports the argument that profitable firms may exert influence over auditors to negotiate lower fees, particularly if they have long-term relationships with their auditors. This dynamic underscores the potential conflict between audit fee dependence and auditor independence, a key concern raised in agency theory.

Overall, the study's findings provide empirical support for the agency theory, highlighting the role of audit fees in ensuring auditor independence and enhancing financial reporting quality. The significant influence of audit firm size, client risk, and firm profitability on audit fees in Nigeria aligns with global trends observed in prior research. However, the findings also underscore the need for stronger regulatory frameworks to mitigate conflicts of interest and ensure that high audit fees correspond to enhanced audit quality rather than compromised independence. Future research could further explore the long-term impact of audit fees on financial reporting accuracy and corporate governance in emerging economies like Nigeria.

5 Conclusion

This study has provided empirical evidence on the determinants of audit fees in Nigeria, highlighting the significant influence of audit firm size, client risk, and firm profitability. The findings align with prior research and support the agency theory, which exp lains the role of audit fees in mitigating information asymmetry and ensuring financial transparency. Larger audit firms command higher fees due to their reputation and expertise, while riskier and more profitable firms tend to pay higher fees due to the increas ed audit effort required. However, the findings also underscore concerns about auditor independence, particularly in cases where high audit fees may create financial dependence on clients. Given these insights, regulatory bodies and corporate governance fra meworks must strengthen oversight mechanisms to ensure that audit fees reflect genuine audit quality rather than compromised pr ofessional judgment. Future research should explore the long-term impact of audit fees on financial reporting reliability and corp orate governance effectiveness in Nigeria and other emerging economies.

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