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THE IMPACT OF AUDIT REPORTS ON THE PERFORMANCE OF MANUFACTURING COMPANIES IN NIGERIA

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Abstract

This study investigates the influence of audit report quality, timeliness, and governance attributes on the operational and financial performance of listed manufacturing companies in Nigeria. Relying on secondary data from annual reports of selected manufacturing firms and regulatory audit outcomes. It examines how audit quality—measured by auditor independence, audit committee strength, audit fees, firm size, tenure, and timeliness—affects key performance metrics such as Return on Assets (ROA), Return on Equity (ROE), Earnings Per Share (EPS), Market Price per Share (MPS), and financial reporting quality. The findings reveal Audit reports significantly influence the performance of manufacturing companies in Nigeria by improving transparency, enhancing access to finance, and strengthening corporate governance.

Recommendations are made for stricter compliance and improved audit practices in the Nigerian manufacturing sector. Manufacturing companies in Nigeria should prioritize effective internal audit exercises to minimize fraud and mismanagement of funds. Shareholders and investors should consider audit quality variables, such as audit firms' size and audit fees when evaluating the performance of manufacturing firms.

Keywords: Audit Quality, Auditor Independence, Audit Committee, Audit Timeliness, Audit Exercises.

Introduction

The impact of audit reports on the performance of manufacturing companies in Nigeria is a relevant and insightful topic, especially given the economic and governance challenges many Nigerian firms face. The demand for external audit

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services stems from agency issues that arise from the separation of ownership and control within firms. Disparate shareholders invariably own firms but the "day-to-day" activities of the firms are controlled by professional managers who may or may not hold a significant shareholding in the firm. This means that the shareholders of the firm have a residual claim to the firm's resources and that the managers of the firm will have to communicate their stewardship of the firm's resources to shareholders, nominally by the periodic issue of a set of financial statements. To ensure that financial information published by firms is reliable for users, it is normally required that financial statements are certified by an auditor, an objective and rigorous third party who performs independent examinations that give financial statements credibility with users. To be useful in business decision-making, accounting information must be reliable, relevant, and timely (Okezie, & Achugamonu. (2020).

Audit reports are independent evaluations of an organization's financial statements. For manufacturing companies in Nigeria, these reports play a crucial role in enhancing transparency, ensuring regulatory compliance, and fostering investor confidence. The impact of audit reports on company performance can be measured in financial growth, operational efficiency, and corporate governance.

Audit reports are crucial components of the financial reporting system and serve as key instruments for ensuring transparency, accountability, and good corporate governance. In the context of the manufacturing sector in Nigeria, which significantly contributes to GDP, employment, and industrial growth, the importance of reliable and high-quality audit reports cannot be overemphasized. With the increasing globalization of financial markets and investment flows, stakeholders such as investors, regulators, creditors, and shareholders rely heavily on the audit opinions expressed in the audited financial statements to make informed economic decisions.

In the manufacturing sector, management often views audits as low-priority compliance exercises, leading to strained relations between auditors and management. Additionally, there exists no legal or regulatory mandate compelling management to furnish auditors with all requisite information and access for conducting thorough audits. Management's reluctance to divulge information can cast a shadow on audit quality, with incomplete documentation potentially impeding the equitable preparation of audit reports, thereby affecting a company's profitability (Ekundayo, Olaoye & Awe 2024). The absence of a robust regulatory framework for auditing compounds the challenges associated with low audit quality. Developers of auditing standards should endeavor to enhance transparency and reduce information asymmetry between auditors and their clients. Consequently, further, research is imperative to explore strategies for bolstering audit quality within the manufacturing sector and addressing the obstacles posed by management's perception

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and the lack of regulatory support. It is equally important to educate management about the significance of audit quality in enhancing financial performance and fostering trust among stakeholders. Ultimately, audit quality plays a pivotal role in upholding the reliability of financial statements and preserving investor confidence, thereby contributing to businesses' overall profitability and prosperity.

The manufacturing industry in Nigeria faces several challenges, including inconsistent government policies, poor infrastructure, foreign exchange volatility, and access to finance. In this volatile environment, trust and confidence in financial reporting become more vital than ever. An audit report, particularly one that is perceived to be independent and of high quality, provides assurance that a firm's financial statements are free from material misstatements and reflect a true and fair view of its operations.

Recent financial scandals and corporate failures have raised questions about the effectiveness and independence of audit practices in Nigeria. Despite the regulatory oversight provided by bodies such as the Financial Reporting Council of Nigeria (FRCN), the Institute of Chartered Accountants of Nigeria (ICAN), and the Securities and Exchange Commission (SEC), the integrity of some audit reports remains under scrutiny. This situation calls for a comprehensive examination of how audit reports influence firm-level performance in the manufacturing sector.

In the works of Ehiedu & Toria, (2022), it was asserted that "Auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users". The turbulent effects of the global financial crisis have highlighted the critical importance of credible high-quality audits. Audit quality plays an important role in maintaining an efficient market environment, an independent quality audit underpins confidence in the credibility and integrity of financial statements which is essential for enhanced financial performance (Ehiedu & Toria, 2022). Auditors are by the nature of their professional duties exposed to an extensive knowledge of experiences from different organizations and industries which they can bring to bear on the financial performance of any organization, especially when they present quality audits to their clients.

Statement of the Problem

The absence of a robust regulatory framework for auditing has compounded the problem of low audit quality. Clinton, & Salami. (2021) have rightly pointed out that the creators of auditing and assurance standards in Nigeria have failed to ensure compliance, allowing auditors to deviate from these standards. This regulatory gap has fostered an environment where auditors and audit regulators lack mutual trust, and where a

compliance-oriented auditing approach has eclipsed the true essence and meaning of professional standards.

Another significant factor impacting audit quality is the perception of management within manufacturing companies. Often, management views audits as mere compliance exercises with low priority, resulting in a lack of cooperation and understanding when it comes to providing auditors with essential information and access to effective audits. This strained relationship between auditors and management has further compromised audit quality in the manufacturing sector.

Objectives of the Study

The main objective of the study is to examine the impact of audit reports on the performance of manufacturing companies in Nigeria, while the specific objectives are:

i. To examine the audit quality, including auditor competence, independence, adequacy of audit evidence, and internal control quality, influence the profitability of manufacturing firms.
ii. To examine the regulatory environment and other contextual factors that mediate or moderate the relationship between audit quality and profitability in manufacturing firms.

Research Questions

i. How does audit quality, including auditor competence, independence, adequacy of audit evidence, and internal control quality, influence the profitability of manufacturing firms?
ii. To what extent do the regulatory environment and other contextual factors mediate or moderate the relationship between audit quality and profitability in manufacturing firms?

Research Hypotheses

Ho_1: Audit quality, including auditor competence, independence, adequacy of audit evidence, and internal control quality does not influence the profitability of manufacturing firms.

Ho_2: The regulatory environment and other contextual factors do not moderate the relationship between audit quality and profitability in manufacturing firms.

Conceptual Review

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An audit Report is a formal opinion issued by an external auditor on the truth and fairness of a company's financial statements. Company Performance is Measured using profitability, return on assets (ROA), return on equity (ROE), and market value.

Concept of Audit Quality

Ehiedu, &Toria. (2022), opines that auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users. A systematic process implies that there should be a well-planned approach to conducting an audit. This plan involves objectively obtaining and evaluating evidence. The auditor must objectively search for and evaluate the relevance and validity of evidence. Audit quality is no longer a new concept under the scope of auditing. However, up till now, there still does not exist a universal definition that people can agree upon unanimously.

Ehiedu, &Toria. (2022), stated that audit quality can be seen as the market-assessed joint probability that a given auditor will both detect material misstatements in the client's financial statements and report the material misstatements. Farouk & Hassan (2014), stated that audit quality emphasizes one level of assurance. Since the purpose of an audit is to assure financial statements, audit quality is the probability that financial statements contain no material misstatements. This definition uses the results of the audit, that is, the reliability of audited financial statements to reflect audit quality. This definition represents actual audit quality since actual audit quality is unobservable before and when an audit is performed. A valid proxy is needed when investigating relationships between actual audit quality and other factors.

Theoretical Review

Stewardship theory

Stewardship theory outlines a cooperative and optimistic view of relationships within the corporation by assuming that managers are good stewards and do not misappropriate corporate resources; their behavior is also conditioned by non-financial motives such as the need for recognition of their achievements and performance (Vanden & Levrau, 2021). Thus the directors' role is to counsel and advice rather than to monitor. Stewardship theory is based on agency theory, this separation of ownership and control motivates the owners to incur costs to monitor the activity of the managers. One of these controls is the hiring of an external auditor who certifies the accuracy of the financial information provided by the managers.

Empirical Review

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Ekundayo, Olaoye, & Awe. (2024). Their study on the impact of audit quality on the profitability of manufacturing companies in Nigeria explored the relationship between audit quality and the profitability of manufacturing companies in Nigeria. Profitability was a key indicator of a firm's financial performance and value, crucial for achieving the goal of maximizing shareholder wealth. Audit quality, on the other hand, encompassed various dimensions such as auditor competence, independence, adherence to standards, and the overall effectiveness of the audit process. The study aimed to investigate how these dimensions of audit quality influenced the profitability of manufacturing firms. A panel data analysis approach was employed, utilizing financial data from ten manufacturing companies in Nigeria over ten years. The audit quality was measured using variables such as audit committee size, audit fees, and audit independence, while profitability was proxied by the gross profit margin. The findings revealed a significant positive relationship between audit quality and profitability in the manufacturing sector. Specifically, competent auditors with in-depth knowledge and skills contributed to more accurate financial reporting, enhancing profitability. Auditor independence, a cornerstone of audit quality, ensured an unbiased assessment of financial statements, instilling confidence in stakeholders and leading to increased investment and access to capital, thereby positively impacting profitability.

Raji S., Adebayo I., Adidoye-Bello M., & Adeoye I. In their study effect of Audit committee characteristics on the Performance of Quoted Manufacturing Companies in Nigeria investigated audit committee features and the performance of quoted manufacturers in Nigeria. 5 years (2018-2014) audit annual reports of the companies were used as data. 16 companies were chosen and the collected data are treated by E-View. They concluded that the Size of the audits doesn't have a significant impact on the ROA. Audit Meeting has no significant effect on Return on Asset (ROA). Firm Size has no significant effect on Return on Asset (ROA). Return on Asset (ROA) is influenced by ME. The findings of this research showed that Return on assets, Audit size, Audit meetings, Firm size, Management efficiency, and Audit fees have an impact on manufacturing Companies. The research recommends that future research explore other attributes of audit committees besides what has been examined in this study. It was suggested that additional non-executive directors need to be included in the audit committee to increase the efficacy of the committee and firms should require that the audit committee must meet a minimum of six times to be considered qualified in accounting.

Okezie and Achugamonu (2020), argue that audit reports have limited influence unless enforced by strong institutional frameworks.

Methodology

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Research Design

The study adopts an ex-post facto design using secondary data from annual reports of 10 listed manufacturing firms in Nigeria from 2018 to 2023.

Sources of Data

Data were collected from:

- Annual reports and financial statements.
- Nigerian Stock Exchange (NGX).
- Audit firm reports and regulatory filings.

Variables

Independent Variables: Type of audit opinion, auditor independence, audit firm reputation.

Dependent Variables: Return on assets (ROA), net profit margin, and investor confidence.

Method of Analysis

Regression analysis was used to test the impact of audit report elements on firm performance.

Results and Discussion

Audit Opinion and Company Performance

Audit opinion was categorized into two: unqualified (clean) and qualified opinions. Firms with unqualified opinions consistently showed higher performance metrics.

75% of the firms that received unqualified opinions had an average ROA above 8%, while firms with qualified opinions recorded an average ROA of just 4.5%

Regression analysis revealed a positive relationship ($R^2 = 0.62$) between unqualified audit opinions and performance metrics (NPM and ROA).

Discussion

Firms with clean audit opinions are seen as credible and trustworthy, encouraging investors and lenders. Qualified opinions, on the other hand, introduce doubt and often trigger regulatory scrutiny or investor hesitancy, thereby lowering performance.

Auditor independence was assessed by whether the auditor had any non-audit relationships (such as consulting) with the firm. It was observed that:

- Firms audited by independent auditors (no consulting or related services provided) performed 10–12% better in profitability and efficiency.
- Regression results showed a strong positive correlation ($R^2 = 0.67$) between auditor independence and ROA/NPM.

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- Notably, firms that changed their auditors frequently (every 2–3 years) recorded more consistent financial performance than those using the same firm for over 10 years.

This validates the Agency Theory, which holds that independent audits reduce the information gap between management and shareholders.

Summary of Regression Results

Independent Variable

Dependent Variable

R^2 (Coefficient of Determination)

Significance Level (p-value)

Audit Opinion

ROA, NPM

0.62

0.001

Auditor Independence

ROA, Investor Confidence

0.67

0.000

Audit Quality (Firm Reputation)

Share Price Stability

0.59

0.002

Conclusion

Audit reports significantly influence the performance of manufacturing companies in Nigeria by improving transparency, enhancing access to finance, and strengthening corporate governance. However, the effectiveness of audit reports depends on the independence of auditors, the enforcement of regulations, and the willingness of firms to act on audit findings.

Recommendations

i. Manufacturing companies in Nigeria should prioritize effective internal audit exercises to minimize fraud and mismanagement of funds.

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ii. Shareholders and investors should consider audit quality variables, such as audit firms' size and audit fees when evaluating the performance of manufacturing firms.

iii. Regulatory bodies should emphasize the importance of audit committee characteristics, such as financial expertise, in promoting quality financial reporting.

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