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Audit Services and Financial Performance of Nigerian Insurance Firms

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ABSTRACT

In recent years, the business environment has been fraught with a plethora of risks and uncertainties as a result of dynamic market preferences, advanced technological gaps, innovative business fronts, insecurity, and cybercrime, among other factors. The current trend of business risks and uncertainties beckons insurance business managers with an increased scope of expectations from policyholders and other stakeholders. However, the fundamental issues of information asymmetry and conflict of interest that characterized the contractual relationship between business shareholders and their managers continued to point to the need for auditing services in quoted companies for a true and fair view. This study therefore examined the effect of independent auditing services on the corporate financial performance of quoted insurance firms in Nigeria. Ex-post facto research design was employed for the study. Secondary data was obtained from the annual reports of a cross-section of the quoted insurance firms. A linear regression model was adopted with the aid of a statistical package for social sciences (SPSS) to analyze the data. The two hypotheses tested indicated that auditing fees were positively and significantly related to the Return on Assets (ROA) and Profit after tax (PAT) of insurance firms quoted in Nigeria. The findings were justified by the coefficient of correlation (.R) at approximately 69.9% and 71.2%, respectively, while the linear effect was significant at (Sig.0.002 and 0.003 respectively) against a 5% level of significance. It was concluded that the engagement of independent auditors' services in insurance firms was not only relevant to reducing the problems of information asymmetry but also to securing the market confidence in the credibility of financial reports and fostering the contribution to actualizing target financial performance. This equipped the firms with the financial impetus to assume the obligation to policyholders and other stakeholders. Hence, it is recommended that the services of external auditors be utilized as required statutorily irrespective of their charges.

Keywords: Independent, Auditing Services, Audit Fee, Profit After Tax, Return On Assets.

INTRODUCTION

The resilient drive to actualize the predetermined corporate objectives of any entity has often occupied the forefront of managerial concerns. Like other sectors of the Nigerian economy, the financial service sector has witnessed a diverse and turbulent business environment, which includes intense competition, strict regulatory requirements, dynamic customer preference, investor expectations, among other stakeholders' interests. These changing business forces are more compelling in the financial services sub-sectors, with an emphasis on the insurance firms that insure business risks. In response to the teaming forces and expectations of stakeholders, the audited corporate report has served as a tool of confidence in managerial stewardship. Deden, Giawan and Zamri (2019) opined that the presence of auditing services play a crucial role in moderating the conflict between the business owners and management interests as projected in agency theory. Consequently, Ogbeifun and Olorunsola (2020) explained that achieving quality financial reporting depends on the role that external audit plays in supporting the quality of financial reporting of quoted companies. The investment communities and other interest parties to quoted companies especially the investors in insurance firm rely on the credible reports from independent audit services to foster the business activities of the quoted entities that measure financial performance. Similarly, Ado, Rashid, Mustapha, and Ademola (2020) asserted that a quality audit forms the basis for confidence in the integrity and credibility of the financial report. It is one of the most important issues in audit practice today. A financial report audited by a reputable independent firm upholds market confidence more than one audited by inexperienced audit firms. The financial statement audit and other audit related assurance services constitute a monitoring mechanism that helps to reduce information asymmetry, fraudulent practices, errors, and material misstatement, safeguard assets, and evaluate the effectiveness of internal control systems by providing reasonable assurance that the financial statements are free from material misstatement. These professional roles of independent auditors make a significant contribution to the financial performance of quoted companies among insurance firms (Okoye, Adeniyi and Nwankwo, 2019.). The aspect of contributions to financial performance underlined here refers to the sustained confidence of the market and public trust in the financial reports of the quoted companies due to the justification of their credibility by the audit firm. The insurance business in Nigeria requires a huge capital outlay and intensive operational resources to meet obligations to the clients, just like other corporate entities without recourse to auditing inputs, which could signal business risk of financial loss. Ironkwe and Osaat (2019) aptly put it that the insurance industry offers solutions to risks faced by players in other industries. It helps in spreading financial risks among other firms and individuals who keep to the premium of their policy contract. An entity which accepts the transfer of specialized business and financial risks from clients among its corporate risks should secure business healthy performance and sustain it. However, there is scanty scholarly information about the financial information of insurance companies (Ado *et al*, 2020). The prevailing scenario presents a background need for this study.

AIM AND HYPOTHESES

Consequent to the above problem, the aim of the study is to examine the effect of independent auditing services on the corporate financial performance of quoted insurance firms in Nigeria. To actualize this, the following formulated null hypotheses were tested:

1. Audit fee has no significant effect on the return on assets of quoted insurance firms in Nigeria.
2. Audit fee does not significantly affect the profit after tax of quoted insurance firms in Nigeria.

RELATED WORKS

Audit Services: Audit services play a crucial role in maintaining market confidence and public trust in the business financial reports of any entity on which economic decisions are anchored. Independent audit services performed in accordance with high quality auditing standards can promote appropriate implementation of accounting standards by reporting entities. According to Monametsi and Agasha (2020), it may also help to ensure that their financial statements are reliable, faithfully represented, comparable, understandable, and credible to enhance market confidence. The contributory functions of audit services are limitless; hence, it may be sufficient to recognize that sound audit practice reignites strong corporate governance principles, risk management tenets, and effective internal control mechanisms that result in prudent financial management and commendable business performance. Similarly, Mawih and Zaroug (2015) explained that the demand for audit services has been motivated by the need to manage conflicts and information asymmetry that characterize the relationship between shareholders and management. Also, Ado *et al.* (2020) affirmed that managers of insurance companies can pursue their self-interest at the expense of the stakeholders of the business if not under the watchdog-oriented services of an audit firm. Independent audit services provide a panacea to minor anomalies that result in major corporate financial scandals, as in Enron Corporation in 2001, WorldCom in 2002, Tyco International in 2002, HealthSouth Corporation in 2003, et cetera, and trigger responsible financial reporting so as to attract ideal business performance. The aspect of the business scorecard indicator which measures the monetary implication of independent audit services on financial performance is its audit fee, as was employed in the context of the study.

***Insurance Business*:** Risk is a common index among routine business activities and daily human endeavours. An insurance firm undertakes the business of assuming the insured risk. It is a non-bank financial services institution that provides both financial and non-financial services. According to Iyodo, Samuel and Inyada (2018), the insurance business provides financial support and reduces uncertainties in other businesses by offering coverage against the risk of losses through ensuring indemnity from premiums. Insurance firms facilitate the spread of risk from the insured to the insurer. The notion of insurance introduced the position of Weisbart(2018) who recounted that it is an evolving business in the Nigerian economy that deals in certain needs to drive economic affairs. It engages in contracts to restore policyholders in the event of loss, educates clients on risk-mitigating strategies, helps to stabilize the economic units in times of financial crisis, plays the role of social agent to promote the common good of society and preserve social order, and offers financial credits as well as reinsurance services. Hussien and Alam (2019) put the insurance industry into three broad categories of functions: non-life insurance, life insurance, and re-insurance, which pave the way for claim settlement. **Insurance Claims Settlement** is a prevalent measure employed in insurance dealings with policyholders to restore the affected client the value lost in financial magnitude to the occurrence of risk. Akpan, Nnamseh, Etuk, Edema, and Ekanem (2020) opined that insurance firms help in stabilizing the economy by providing risk management mechanisms to different sectors of the economy for individuals, business organizations, and the government who transfer different types of risks to the insurance companies for effective and efficient management.Tyokoso, U-ungwa, and Ojonimi (2017) affirmed that the corporate activities of the insurance business spread around engaging in contractual relations with other entities and individuals that seek to transfer risks, which eventually results in claim settlement. The insured clients who experience a loss for specified peril makes a claim against the insurer. These contractual obligations of the insurance firms are expected to be met as due by efficient management of resources and the financial performance of the insurance business. Financial Performance is a concept employed in the sciences of management with specific emphasis on the finance-oriented disciplines to measure how well the business assets had been managed to generate returns over a given period of interest. Verma (2021) aptly described financial performance as the process of measuring the results of a firm’s policies and operations in monetary terms. According to Maka and Suresh (2018), the financial performance of any firm gives an indication of how efficiently management utilizes the resources of the business to achieve actual results and meet budgetary expectations. It also establishes the liquidity and solvency of the firm in a given period. Dhiab (2021) submitted that in evaluating the overall financial health of any entity, the financial statements of the firms serve as veritable materials for the exercise. The statements, which include: statements of financial position, statements of income, statements of change in equity, cash flow statements, etc., disclose financial performance indices such as: revenue, gross profit, profit after tax, net assets, current liabilities, dividends, earnings per share, etc. Dabo, Andow, and James (2018) explained that financial indicators provide information to stakeholders for informed economic decisions, such as shareholders, employees, creditors, suppliers, government agencies, management, financial analysts, etc. In this study context, profit after tax and return on assets were used as performance measures.**Return on Assets** is a key indicator of the financial health of an entity. Nico and Wiwick (2019) pointed out that it is an indicator of how efficiently the management has utilized the available assets of the business to generate revenue and extend to net profit after tax. It is usually classified among financial ratios as a profitability ratio because it expresses the relationship between the business assets and the business profit for a specified period to ascertain the level of efficient management of assets. **Profit After Tax** is a significant measure of the firm's performance to indicate the actual amount of earnings or returns after deducting operating costs. It is seen as the profit available to the shareholders after paying all the expenses and taxes incurred by the business unit.

Amahalu and Obi (2020) examined the effect of audit quality on the financial performance of quoted conglomerates in Nigeria (2010-2019). Ex post facto research design was adopted. Secondary data was obtained and analyzed. The result showed that audit committee independence has a significant positive effect on return on assets of the conglomerates in Nigeria. It was recommended that conglomerate use include audit committee in the Board affairs. Similarly, Enekwe*et al*. (2020) assessed the effect of audit quality on the financial performance of listed manufacturing firms in Nigeria (2006–2016). Ex-post facto research design was employed for this work. Data was collected and analyzed. The findings indicated that the independence of the auditors has a positive and significant effect on the financial performance of the listed manufacturing firms in Nigeria. Therefore, it was recommended that audit independence should be enhanced among clients. Ugwu, Aikpitanyi, and Idemudia (2020) investigated the impact of audit quality on the financial performance of listed deposit money banks in Nigeria. The researchers adopted correlation and ex post facto design. Secondary data was obtained and analyzed. The result indicated a negative and significant relationship between the joint audit and return on assets. It also showed an insignificant relationship between audit fees and return on assets. Illiemena and Okolocha (2019) assessed the effect of audit quality on the financial performance of industrial goods companies in Nigeria. The researchers employed descriptive and ex post facto designs. Upon analysis of the data, the results indicated that audit quality has a significant positive effect on the return on assets that measured the financial performance of industrial goods companies in Nigeria. Ado et al (2020) examined the proof of the direct influence of audit quality on the financial performance of listed companies in Nigeria. It adopts a triangulation of methods using multiple regressions. The results showed that the auditors' independence was positively and significantly related to return on assets, which is a proxy for financial performance. Duonga and Quang (2017) investigated the effects of audit firm size, audit fee and audit reputation on audit quality while focusing on listed companies in Vietnam. Descriptive research design was adopted. The findings showed that audit firm size and audit fee affects the quality of audit positively and significantly. Nuhu, Umaru, and Salisu (2017) considered the effect of audit committee quality on the financial performance of the food and beverage industry in Nigeria. Ex post facto design was employed for data collection and analysis. The result revealed an insignificant negative effect of the audit committee's quality on financial performance. Sayyar, et al (2015),the impact of audit quality on firm performance for listed companies in Malaysia(2003–2012). The researchers used a descriptive design for the study. The result revealed an insignificant relationship between the audit fee and return on assets.

THEORY

The **agency theory** conceptually portrayed the contractual relationship between the principal and the agent of business. According to Amahalu and Obi (2020), the theory originated from the work of Berle and Means in 1932, who explored the concept of agency in the study of the development of large corporations. In their findings, the gross differences and conflicts of interests that exist among managers, directors, and principals of business entities were highlighted. Matoke and Omwenga (2016) added that Jensen and Meckling (1976) advanced the concept of agency theory with the argument that the structure of the large corporation exists to minimize the cost of agents whose fiduciary responsibilities include working in the best interest of the principal and reporting stewardship. However, Iliemena and Okolocha (2019) argued that the agents often have more information than the principals, which adversely influences the principals' ability to monitor whether their interests are being properly served by the agents. Consequent to the issues of conflict of interest and information asymmetry that characterized the relationship between owners of business and management, the need for audit services was necessitated. To mitigate the extent of information asymmetry about business financial reports, the use of external audit services was sought. Audit services in the perspective of agency theory function to address the gap in stewardship between investor and manager.

Stakeholder Theory was viewed from the perspective of Edward Richard Freeman. According to Enekwe, Nwoha and Udeh (2020), Edward R. Freeman in 1963 and 1984 advanced the concept of "stakeholder" as those who affect or are affected by the operation of a business. He concluded that the focal point of the theory is for management to identify the group of stakeholders in a corporate entity and pursue their interests collectively. Similarly, Syder, Ogbonna, and Akani (2020) submitted that in order to succeed and be sustainable over time, business executives must keep the interests of customers, suppliers, employees, host communities, and shareholders aligned to go in the same direction. Okoye*et al.* (2019) recounted that such stakeholders are customers, suppliers, creditors, employees, the government, shareholders, and society. A critical look at the viewpoint reveals it aims at achieving business objectives with concern for return for interested parties. Such a return is attributable to financial performance; therefore, the theory was chosen to direct the focus of the dependent variable.

METHODOLOGY

Ex post facto design was employed for the study because it allows the aggregation of data on past economic events and business transactions for analysis to ascertain the behavioural relationship between the variables. Secondary data was obtained from the annual reports of a cross-section of twenty three quoted insurance firms in Nigeria for the period from 2009 to 2018. The data were analyzed by econometric and linear regression model with the aid of statistical package for social sciences (SPSS) version 21.

Model Specification:

$AF=b_0+b_1ROA+b_2PAT+e$………………. equ1

Where:

AF=Audit Fee
ROA=Return on Assets
PAT=Profit after Tax
e=Stochastic error term
b_0& b_{1-2} = Constant & Coefficient.

RESULTS AND DISCUSSION

H0$_1$: Audit has no significantly effect on return on assets of insurance firms in Nigeria

Table1: Model summary of Audit fee and Return on Assets

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics		Durbin-Watson
					R Square Change	F Change	
1	.699[a]	.549	.355	.828	.549	2.651	1.587

a. Predictors: (Constant), Audit fees

b. Dependent Variable: ROA

The model summary (Table1) showed that the coefficient of correlation (R.) is 0.699, which implies that there exists a highly positive relationship between audit fee and Return on Assets (ROA). The result also indicates that the strength of the positive relationship between Audit fee and Return on Assets (ROA) is approximately 69.9%. The coefficient of determination (R^2) showed a value of 0.549. This implies that approximately 55% of the variations in Return on Assets of insurance firms in Nigeria can be explained or attributed to Audit fee for the audit services. The Durbin-Watson statistic of 1.587 is between two critical values of 1.5≤ DW≤ 2.0, which indicates the absence of autocorrelation issues in sampled data series. The same view is observed with heteroskedasticity.

Table 2: The Coefficient

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	8282.884	4205.754		1.052	.960
	Audit fees	.815	.740	.699	1.628	.002

a. Dependent Variable: PBT

Table 2 showed statistical evidence to demonstrate that the relationship between Audit fees and Return on Assets is not only positive in nature but also reveals that the value of the coefficient of regression (. B) of.815, which implied that every unit increase in audit fee has a resultant increase in Return on Assets of.815. The sig. value (.002), on the other hand, justified that the audit fee has a significant effect on the Return on Assets.We therefore reject the null hypothesis because the audit fee has a significant effect on the Return on Assets of the insurance firms in Nigeria.

H0$_2$: Audit fee does not significantly affect the profit after tax of insurance firms in Nigeria.

Table 3: Model summary of Audit fee and profit after tax

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics		Durbin-Watson
					R Square Change	F Change	
1	.712[a]	.663	.670	.869	.463	2.849	1.552

a. Predictors: (Constant), Audit fees

b. Dependent Variable: PAT

The result of the model summary on Table 3 revealed a positive relationship between audit fee and profit after tax of 0.712, which is the coefficient of correlation (.R). Also, the coefficient of determination (R^2) at 0.663 indicates that 66.3% of the variations in profit after tax (PAT) can be explained or attributed to a unit change in audit fee for audit services on insurance firms in Nigeria. The Durbin-Watson statistic of 1.552 is between two critical values of 1.5 DW≤ 2.0, which indicates the absence of autocorrelation issues in sampled data series.

Table 4: The coefficient

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	4365.723	6340.248		.112	.913
	Audit fees	.675	.096	.512	1.688	.003

a. Dependent Variable: PAT

From table 4, it is indicated that the relationship between audit fee and profit before tax is positive. Based on statistical evidence by the coefficient of regression (.B) at .675, it shows that every unit increase in audit fee has a resultant increase in profit before tax of.675. Finally, the Sig. value (.003) indicates that the audit fee has a significant effect on profit after tax. Therefore, we reject the null hypothesis and conclude that the audit fee impacts profit after tax significantly among insurance firms in Nigeria.

CONCLUSION AND FUTURE SCOPE

The above analysis of the first hypothetical test indicates that the audit fee, which measures independent audit services, has a significant effect on the financial performance (as return on assets) of the insurance firms in Nigeria. This finding implies that beyond providing risk mitigation strategies and coverage in the event of loss, the audit fee paid for audit services among insurance firm's impacts significantly on their financial performance. This empirical viewpoint is in conformity with Enekwe*et al*, (2020), Ugwu*et al.* (2020), Iliemena and Okolocha (2019) and Nuhu*et al.* (2017) who studied the implication of audit quality services on the financial performance of entities in different industries in Nigeria. However, it does not agree with the work of Sayyar*et al.* (2015) who studied the impact of audit quality service on the financial performance of listed companies in Malaysia. The second hypothetical test showed that audit fees have a significant impact on financial performance as measured by profit after tax for insurance firms in Nigeria. The implication of this finding is that, beyond the justification of credible financial reports, audit services paid for by stakeholders inspire confidence in stakeholders to foster investment in the insurance business against market scepticism due to resultant financial performance. This finding is in consonance with the standpoint of Enekwe*et al.* (2020), Ado *et al.* (2020) and Duonga and Quang (2017), who found that audit quality service has a positive and significant effect on financial performance in Nigeria. Consequently, it was concluded that independent audit services impact significantly on financial performance among listed insurance firms in Nigeria. Our empirical results justify the relevance of independent audit services among quoted insurance firms' financial reporting functions, which hold the public and market confidence while investing and taking policy with the firm. It is therefore recommended that the independent auditing service for a risk management entity should not be undermined on the altar of cost minimization at the expense of business financial performance. The services of independent auditors should be utilized since they uphold and secure the market's confidence and stakeholders' expectations.

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