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Effect of Audit Reports on the Share Prices of Manufacturing Companies in Ogun State of Nigeria

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ABSTRACT

The study examined the effect of audit reports on the share prices of manufacturing companies in Ogun State which was intended to evaluate the influence an auditor's report has on the share price of quoted manufacturing companies in Ogun state. The study used secondary data collected from annual reports of the manufacturing companies in the sample from the year 2016-2020. The population of the Study is 17 manufacturing companies (both industrial and consumer goods manufacturers) in Ogun State listed on the Nigerian Stock Exchange. The population includes companies with their head office, those with only their manufacturing plants or factories, and companies with their branch office in the state. *Data were analyzed using descriptive analysis Johansen test, Hausman test, and regression analysis. The findings from the study show that the F-stat (F=102.225, p=.000) reveals that audit report is a significant driver of share prices. The study recommends that manufacturing companies should pay attention to their audit report in driving their share prices and that there is a need to pay attention to audit content since the report is a recommendation between the entity and the external parties.*

Key words: Audit reports, Share prices, Manufacturing companies.

1.0 Background to the study

As the need for accountability increases, the preparation of financial statements has become an essential aspect of every organization. Financial statements are official records of the financial activities and position of an organization. Within the context of a company, they include; statements of profit or loss and other comprehensive income, statements of financial position, statements of changes in equity, statements of cash flow, statements of value-added, and the director's reports. Financial statements enable an entity's management to provide helpful information about its financial position at a particular time and the results of its operations and changes concerning the financial position for a specific period. (Ajward & Dissabandara, 2015). These statements are one of the main tools that assist investors and significant stakeholders in selecting a particular organization for investment in their decisions to invest, buy or sell shares. However, the declining level of credibility and increase in financial misstatements and fraud in organizations brought about the independent checking of the statements. However, it is observed that the value of audit reports continues to be challenged and criticized in the contexts of audit and business failures.

Due to the distinct separation of ownership from management, there arises the need for financial reporting, stewardship, and accountability. Therefore, this brought up the audit function to help confirm the fairness of the financial statements provided by the management. Auditing is an examination of a business's books of accounts and vouchers that allows the auditor to ensure that the balance sheet is appropriately prepared to provide a true and fair view of the business's state of affairs and that the profit and loss account provides a true and fair view of the profit/loss for the financial period, based on the best information and explanations given to him and shown by the financial statements. (Spicer and Pegler).

In Nigeria, the Companies and Allied Matters Act (CAMA) CAP C20 LFN 2004 has made it compulsory for every public limited liability company(plc) to have its annual financial statements audited before circulating them to members. Section 357(1) states explicitly that "Every company shall at each general meeting appoint an auditor to audit the financial statements of the company…" The primary purpose of the auditing function is the production of reliable financial reports for decision-making. Macharia and Gatuhi (2013) confirm that the auditing of financial statements serves as a control mechanism for reducing information irregularity and protecting the interests of the different claimants or stakeholders by ensuring that the audited financial statements are free from contents misstatements. A determining factor of investors' decision is represented mainly by auditing financial statements carried out by an audit firm because investors appreciate the quality of the auditing service in terms of image, size, and reputation of the audit firm. The proper functioning of the capital market is obtainable only when investors and other stakeholders have adequate confidence in the audited financial statements (Baffa &Yero, 2017). Auditors help to reduce the dangers of significant misstatements by ensuring financial statements are prepared according to preset standards. A good audit can help to manage income so that earnings per share are at the required level. Profits or revenue can be manipulated to ensure that earnings per share meet analyst expectations. Because current income signals expected cash flows, failure to meet analysts' earnings per share expectations might result in a depressed share price, whereas meeting these expectations results in stock price maintenance or growth.(Jordan, Clark, & Hames, 2010)

The fluctuation of stock prices is a sudden and negative reversal in investors' prospects about a firm's shares. Studies of stock price fluctuations revealed two significant factors that contribute to them: management activities and accounting systems. (Khajavi & Zare, 2016). Management tries to misrepresent earnings, which leads to a positive increase in investors' Prospects about a company's earnings increase its share price more than the actual amount. Furthermore, management raises or hides bad news illogically until they cannot prevent it from being broadcast. At this point, the stock market's reaction to such bad news is to crash dramatically. (Kim &Zhang, 2015). The reported earnings should be influenced by the quality of an audit process and vigorously affect investors' confidence. Audit quality plays an essential role in developing investors' confidence over a company's information, and they react; accordingly, their reaction is indicated in stock prices fluctuations. Conventionally, an external audit role is required to improve the trustworthiness of financial reports. However, with the pockets of corporate failures, there is a concern about auditing quality; this concern could also be extended to the underlying fluctuations in market prices of shares over time.

Although many researchers have investigated the relationships between audit report and Share prices of organisatoions, contradictory findings are reported. On one hand, an audit has a significant relationship with stock prices(Hoti, Ismajli, Ahmeti, & Dërmaku, 2012). On the other hand, an audit has no relationship with companies' stock prices (Al-Thuneibat, Khamees& Al-Fayoumi, 2007). Due to these contradictory findings, it becomes difficult to establish the effect of audit reports on stock prices in manufacturing companies in Ogun State. Therefore, it is necessary to explore this area and establish the effect of audit reports on the share prices of organisations, which is the main objective of this study.

Research hypothesis

$H0_1$: Audit reports does not have any significant effect on the share prices of manufacturing firms in Ogun State.

2.0 Empirical Review

The empirical association between audit reports and share prices have been extensively examined and studied in financial literature.

Asmau et al. (2017) examined the differential effect of auditor type classified as; Single Big4 audit firm; Single Non-Big4 audit firm; and joint audit team of Big4/Non-Big4 audit firms, on the value relevance of book values and earnings, while drawing his evidence from listed firms in the Nigerian Stock Exchange (NSE) over seven years (2009-2015). This study reveals that although Nigerian investors perceive firms' earnings audited by a Single Big4 to be of high quality, they seem indifferent as to whether it is audited by a joint audit team of Big4/Non-big4 or a Single Non-Big4 audit firm. They recommended that investors looking for a more value-relevant EPS focus on firms audited by single big4, as firms audited by big4 are more likely to have greater value-relevant earnings (with a stronger positive connection to price). This is relevant to this study as it shows that auditors, and therefore their reports, can affect a company's profitability.

Anvarkhatibi et al. (2012) divided the auditor's opinions into two groups; the unqualified and unacceptable opinions. He also based on the researched theories in the group of differences in prices and returns of examined shares to testify the effect of the kind of opinion on price and return differences. The study aimed to investigate the effect of auditor's opinions on shares prices and returns in the Tehran Stock Exchange. The interpretation of their reports was based on secondary data extracted from the stock exchange in Tehran. The results of their research showed that the auditors' opinion does not influence share prices or returns. They also suggested that future researchers should discuss the effect of audit qualification's opinion on the return and price of the shares in their research work and discuss the effect of the auditors' opinions on the liquidity of shares and free shares in research, among others.

Okolie and Izedonmi (2014) used archival data extracted from annual reports of 57 companies listed on the Nigerian Stock Exchange (NSE) from 2006 to 2011. The study's goal was to determine if Audit Quality has a substantial effect on and relationship with Market Value per Share of firms in Nigeria. Results showed that Audit Quality measures significantly influence the Market Value per Share of quoted companies in Nigeria. They also suggested that regulatory agencies such as professional accounting bodies, the Financial Reporting Council of Nigeria, the National Assembly, and the Securities and Exchange Commission issue authoritative standards and frameworks for audit quality to improve audit quality and reduce earnings manipulation by firms in Nigeria.

Ajwardetal (2015) examined the effect of the qualified audit reports on share prices and returns by examining companies listed on the Colombo Stock Exchange (CSE) from 2010 to 2014 as a developing and untested market. Out of 78 qualified audit reports issued during this sample period, 26 were selected as the final sample. Reports with continued qualifications, lack of clarity of the publication date, and contaminated events were removed. The study results show a lack of significant impact on the stock prices and returns by qualified audit reports, indicating a lack of information content of qualified audit reports. The study ignored dividends due to the differences in dividends declaration and the unavailability of data on these dividends.

Kayed Abdullah Al-Attar (2017) explored the impact of auditing on the stock prices of the Amman stock market. The study was conducted based on primary data collected from finance managers of listed companies of the Amman stock market. The results of the study showed that audit has a direct impact on the stock prices of firms in the Amman stock market. In contrast, improved audit quality results in the improved financial performance of the firm indicated in their stock prices.

Okolie (2014) concluded that audit quality significantly influences the Earnings Response Coefficient of quoted firms in the Nigerian Stock Exchange by examining annual reports of 57 companies from 2006 to 2011. He also suggested that professional accounting groups, the Financial Reporting Council of Nigeria, and the National Assembly provide authoritative audit quality guidelines. Corporations should only increase their earnings quality through sales growth, cost control, and cost-cutting initiatives.

Ugwunta et al. (2018) also studied the effect of audit quality on share prices, but their primary focus was on the Nigerian oil and gas sector. His findings showed that audit quality would enhance reported earnings and therefore share market prices.

Dui Li et al. (2019) examined the effects of audit quality on shareholders' earnings and stock predictability by studying the annual reports of 11 manufacturing companies from 2009-2018.audit quality was proxied by auditors' independence (ADI), audit firm size (AFS), auditor tenure (ADT), and Audit Firm Specialization (ADS). At the same time, shareholders' earnings were measured by Earnings per Share – EPS and stock predictability by Market Price of Stock - MPS). Results show that auditor's independence, audit firm size, and auditor's firm specialization have a significant and positive impact on EPS and MPSin cement manufacturing companies.

Farouk et al. (2014) studied the effect of audit quality on financial performance in cement manufacturing companies. The findings show that auditor size and auditor independence significantly impact the financial performance of quoted cement firms in Nigeria. The study recommends that the management of listed cement firms in Nigeria increases auditors' remuneration to improve their financial performance and that management should employ audit firms whose character and integrity are beyond question.

Taiwo et al. (2016) studied the effect of audit reports on financial statements in cement manufacturing companies. Audit reports were proxied by auditor's independence, auditor's opinion, level of compliance, and Material misstatement. The study revealed a significant relationship between auditor's independence, auditor's opinion, level of compliance, quality of financial report and material misstatement, and the quality of financial report of quoted cement manufacturing companies in Nigeria. The study made many recommendations: there should be an implementation of peer assessment to ensure that audits are carried out with utmost professionalism and mutual respect. At the same time, every limited liability company should set up an audit committee to evaluate the audit work done.

3.0 Methodology

The research design adopted in this study is the correlational research design. The area chosen for ths study is Ogun State, Nigeria. Ogun state is chosen as the area of study because it has a concentration of a large amount of manufacturing companies and an industrial estate. The population of the Study is 17 manufacturing companies (both industrial and consumer goods manufacturers) in Ogun State listed on the Nigerian Stock Exchange. The population includes companies with their head office, those with only their manufacturing plants or factories, and companies with their branch office in the state. The sampling method used by the researcher is the purposive sampling method, where the sample chosen is based on the researcher's judgement. The sample for this study is only the manufacturing companies with their head office in the state, and there are only seven quoted companies with their head offices in the state. Out of the seven companies chosen, two of the companies have been delisted from the Nigerian stock exchange due to failure to publish annual reports as required by the Exchange. One other company is in the process of being delisted for the same reason. The final sample for this research is four companies (McNicholsplc, Pharmadekoplc, Fidson Healthcare plc, and Premier plants plc). The study used secondary data consisting of audit opinions, share prices, and other information needed for this research were collected from annual reports of the study sample and websites. This study used descriptive statistics which includes tables and graphs to describe auditors' reports and share prices of manufacturing companies. The study further used inferential statistics to examine the effect of auditors' reports on share prices of manufacturing companies. The multiple regression model for this study is:

Y = A+ X1AudP+X2Audxlc+ u

Where;

- Y = the value of the dependent variable.
- { βi; i=1,2,3,} = The coefficients representing the various independent variables.
- {Xi; i=1,2,3} = Values of the various independent (covariates) variables.
- e is the error term that is assumed to be normally distributed with mean zero and constant variance.

Y= share prices, price-to-earnings ratio, earnings per share.

X1= unqualified reports, X2= Qualified reports, X3= Audit reports content

4.0 RESULTS AND DISCUSSIONS

This section provides information on the analysis of data and the interpretation of the results on investigating the effect an auditor's report has on quoted manufacturing companies' share price. The section shows the result of the descriptive analysis and Johansen test results, Hausman tests and the result of the regression analysis, and the discussion of findings.

4.1 Descriptive Statistics

Table 4.1: Descriptive Analysis

Variables	Obs	Mean	Std.Dev	Min	Max	Kurtosis	Skewness	JarqueBera	Prob.
AuditC	20	.700	.000	0	1	1.761	-.872	3.817	.148
Audi	20	.850	.000	0	1	4.843	-1.96	15.641	.000
EPS	20	-.092	.642	-1.5	1.22	3.355	-.451	.785	.675
PER	20	-6.27	29.04	-82.	40.62	4.623	2.31	9.736	.001
ShareP	20	4.004	2.55	.460	10.4	2.065	.851	3.146	2.065

Source: Author's Analysis (2021)

Table 4.1 reveals the descriptive analysis of the variables examined in the study. The result reveals that audit reports measured by qualified audit report and audit report content have a mean= 1. This implies that the values in the data set that causes the slightest error when compared to other values are minimal. The reality is that every value in the data set is included in the estimation is a significant feature of the sustainable banking practice. To prove a normal univariate distribution, values for asymmetry and kurtosis between -2 and +2 are considered acceptable (George &Mallery, 2010). According to Hair et al. (2010) and Bryne (2010), data is considered normal if the skewness is between 2 and +2 and the kurtosis is between 7 and +7. Hence, the skewness values for the audit committee fall within the accepted limits. The Jarque–Bera test shows that sample data have skewness and kurtosis similar to a normal distribution.

The analysis also reveals the descriptive analysis of the dependent variables (earnings per share, price to earnings ratio, and share price). The result shows that price earnings ratio (mean= -6.27, kurotsis=4.627, Skewness=-1,399, Jacque berra=8.736, p=.000), earnings per share (mean=-.091, kurotsis= 3.30, Skewness=3.35, Jacqueberra=...784, p=.675) are significant and within the accepted limits. However, share price (mean=4.004, kurotsis=2.065, Skewness=.851, Jacque berra= 3.146, p=.207) does not fall within the acceptable limit. The result also shows that the data are concentrated around the mean when the statistical significance is low, and data are more spread out when the standard deviation is high. A standard deviation near zero indicates that the data points are close to the mean. In contrast, a high or low standard deviation indicates that data points are above or below the mean, respectively.

4.2 Co-Integration Tests

The Johansen test determines whether three or more time series are co-integrated. It uses a maximum likelihood estimates (MLE) approach to assess the validity of a co-integrating relationship.

Table 4. 2: Johansen Co-integration Test

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.640052	107.9300	29.79707	0.0000
At most 1 *	0.403132	45.60036	15.49471	0.0000
At most 2 *	0.206648	14.12077	3.841465	0.0002

Trace test indicates 3 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.640052	62.32961	21.13162	0.0000
At most 1 *	0.403132	31.47959	14.26460	0.0000
At most 2 *	0.206648	14.12077	3.841465	0.0002

Max-eigenvalue test indicates 3 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level

Table 4.2 shows the Johansen co-integration as statistically significant (p=.0124), indicating that the study variables are co-integrated and have a long-run relationship. This further shows that the variables can be used to further predict the effect of an auditor's report on quoted manufacturing companies' share prices. Therefore, the null hypothesis for co-integration is rejected.

4.3 Test of Hypotheses

4.3.3 Hausman Test for the Hypothesis

The Hausman test was carried out to establish the appropriate regression method to use in explaining hypothesis one. The test ascertains whether there would be a need for a fixed-effect model. The outcome in table 4.7 reveals a P-Value =0.5802, which is greater than 0.05. Therefore, the random model was adopted for the hypothesis.

Table 4.3: Hausman Test for the Hypothesis

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1.088711	2	0.5802

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
AUDIT_CONTENT	0.285000	0.366363	0.011147	0.4409
QUALIFIED	-1.693333	-1.679119	0.001988	0.7499

Source: Author's Analysis (2021)

PER= 5.244 +.285 Audit Content -. -1.693Qualified+.715

Table 4.3 shows the effect of audit reports on the share price of manufacturing companies. The analysis shows that audit reports explain about 96.3% (R^2= ..963) variation in the share prices. The result also indicates that a unit increase in audit reports (β0=5.243) would increase the share price (p=.000). The coefficients reveal the relationship among the variables. The result reveals that audit report contents (β1=.285) do not significantly relate to the share price.

In contrast, the findings revealed that an unqualified audit report (β1=-1.793) has a significant relationship with but an inverse relationship with the earnings per share (p=.02). That is, when unqualified report increases, the share price falls. The t-stat of audit report contents (t= .285 p=..7271) does not significantly affect the share price. However, the result shows that an unqualified report (t=-2.591, p=.002) significantly affects the share price of the manufacturing companies. The F-stat (F=102.225, p=.000) reveals that audit report is a significant driver of share prices. The null hypothesis is rejected, and the alternative hypothesis is accepted.

4.4 Discussion of Results

The study reveals the findings on the effect of audit reports on share prices of manufacturing companies in Ogun State, Nigeria. Anchored on the theory of behavioral finance, the study shows how audit reports interact with the share prices of manufacturing companies. The findings from the analysis of the hypothesis reveal how audit report affects share prices of manufacturing industries. The hypothesis reveals that audit reports significantly affect manufacturing companies' share price. The findings reveal audit content is the most significant driver of the share price. The result further indicates that when unqualified audit report increases, the share prices fall. However, the results indicate that audit content does not have an impact on share prices. The implication is that to improve their share prices, manufacturing firms should make sure their audit reports express qualified auditors' opinions and the content of their report reflects the generally accepted accounting standards. The findings of the study support the Hoti et al. (2012) and Ajwardetal. (2015) that there exists a significant relationship between auditor's independence, auditor's opinion, level of compliance, quality of financial report and material misstatement, and the quality of financial report of quoted cement manufacturing companies.

5.0 SUMMARY, CONCLUSION, AND RECOMMENDATIONS

5.1 Summary

The study determines the effect of auditors' reports on share prices of manufacturing firms in Ogun State, Nigeria. The study identified a lacuna in the research on why there is a need to investigate the interaction between auditors' reports measured by audit report contents and audit quality and manufacturing companies' share prices, price to earnings ratio, and earnings per share. The study identified that the failure of audit to alert and inform investors has made them helpless and unable to undertake rational financial decisions; this is why the quality of audit reports has been poor and has not made them fully confident of the statements. Issues were raised on determining the effect of audit reports on the share prices of a manufacturing industries in Ogun State. The study revealed extant literature on the fact that the audit report should instill higher confidence in the auditing profession among public members (users) And hinged the study on the behavioral financing theory. Utilizing the expo facto research design and data from selected firms in Ogun State, Nigeria. The result reveals that audit reports do not significantly affect the price to earnings ratio and earnings per share. However, the result reveals that audit report significantly affects share prices.

5.2 Conclusion

In conclusion, the findings reveal of the study that audit reports do not significantly affect the price to earnings ratio and earnings per share. However, the findings reveal that audit report is a significant driver of share prices. The findings are consistent with the behavioral finance theory, which connects finance theory and human behavior. It shows the influence of psychology on the behavior of investors or financial analysts. Behavioral finance has two building blocks; cognitive psychology and the limit to arbitrage. Cognitive refers to how people think; they tend to be overconfident, make decisions based on recent experiences, and are not rational when making investing decisions. Limit to arbitrage refers to predicting in what circumstances arbitrage forces will be influential. When they are not because auditors have a reputation to defend, it may be difficult to persuade them to go against the established rules of auditing processes.

Furthermore, the findings imply that the environment could be a valid reason for the variation in the results. The environment in which the firm exists is a critical part of the information that flows from it and its level of performance. A plausible reason for the variation in this result could be hinged on the fact that there is information asymmetry from the manufacturing firms to the market.

5.3 Recommendations

Given the findings mentioned above on the impact of audit reports on share prices of manufacturing companies, the following were suggested:

i. Manufacturing companies should pay attention to their audit report in driving their share prices. An audit report should instill higher confidence in the auditing profession among public members (users).

ii. To improve the share prices of manufacturing firms, there is a need to pay attention to audit content since the report is a recommendation between the entity and the external parties. A good audit report contributes to prudent management of available resources, greater accountability, and control.

5.4 Contributions to Knowledge

The study investigated the impact of audit reports on manufacturing companies' share prices. The findings contributed to knowledge by revealing how manufacturing firms can drive up their share prices by leveraging audit reports and audit report content that are in line with the generally accepted accounting principles. The study also contributed to knowledge by looking at how behavioral finance could drive a manufacturing company's performance in terms of share prices.

5.5 Limitation of Study

The study on the impact of audit reports on manufacturing companies' shares prices is limited to Ogun state Nigeria. There is a need for a longitudinal study looking at other sectors in all the states of the federation of Nigeria. Also, further studies should be done using other measures of audit reports such as adverse report

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