EFFECT OF AUDITORS' INDEPENDENCE ON FINANCIAL REPORTING QUALITY OF LISTED OIL AND GAS COMPANIES IN NIGERIA

Wilfred Joshua
Department of Accounting
Adamawa State University, Mubi
wilfredjoshua2018@gmail.com

Dr. Danjuma Mohammed
Department of Accounting
Adamawa State University, Mubi
mohammed509@adsu.edu.ng

***Corresponding author:**
Dr. Danjuma Mohammed
Department of Accounting
Adamawa State University, Mubi
mohammed509@adsu.edu.ng

ABSTRACT

This study examined effect of auditors' independence on financial reporting quality of listed oil and gas companies in Nigeria. Eight (8) companies make up the population of this study but only six (6) was sampled due to the availability of data within the study period. Data was extracted from published accounts of these companies for the period 2012-2021. In order to examine the effect of the independent variable (auditors independence) on the dependent variables (discretionary accruals), descriptive statistics, correlation statistics and generalised least square techniques were used. The findings revealed that only audit tenure has a positive impact on financial reporting quality of the sampled oil and gas companies while other variables do not have a significant effect on financial reporting quality of these companies. Thus making this study to have little evidence to agree with the null hypothesis which states that "Auditors independence does not have significant effect on Financial Reporting quality of Listed Oil and Gas Companies in Nigeria. The study recommends that other sectors such as insurance companies and consumer goods can be used to assess the effect of Auditor independence on Financial Reporting Quality; also other variables beside audit switching, audit fee, audit tenure and Big4 should be used in future studies and the study should go beyond 2021 to have a more favourable outcome.

Keywords: *Auditors independence, Financial Reporting Quality, Audit switch, audit tenure, audit fee, Big4.*

1. Introduction

The ability of the auditor to make decisions during the audit assignment and financial reporting process impartially is defined as auditor independence (Okolie, 2014); an auditor's perceived lack of objectivity increases when they lack independence. Financial reports include income statements, statements of financial condition, changes in equity, and other statements issued by management that are legally and professionally necessary for auditors' attestation at the prescribed period. When it's appropriate, these reports are released to the public so that interested parties may utilize them to inform their economic decisions (Ozoanigbo et al, 2016).

The International Accounting Standard Board (IASB) states that the accuracy of the information presented in a company's financial report and the objectives' fidelity are key factors in evaluating the quality of financial reporting.

These qualitative traits raise the financial reports' usefulness and contribute to their excellent quality. Financial reports must be accurately stated, comparable, verifiable, timely, and intelligible in order to reach this level. Because this affects the reporting quality of organizations, the emphasis is on

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having transparent financial reports and avoiding providing consumers with deceptive financial data (Gajevzsky, 2015).

During an audit, financial documents are examined in order to determine the actual financial situation of the firm as reported by the directors. It lowers investors' information risk by improving trust and offering an unbiased validation of the financial data that management presents (Miller et al., 2014).

There are components of high financial reporting, as indicated in the FASB's conceptual framework for financial reporting. There are two categories for the qualitative aspects of financial reporting: Enhancing qualitative features and Fundamental characteristics. The former group includes relevance, faithful representation, understandability, comparability, verifiability, and timeliness. Because it reduces the amount of window dressing the corporations display to stakeholders and serves as a check on managers' unethical behavior when declaring profits or losses, the independence of auditors is a critical aspect in evaluating the integrity of a company's financial reporting; stakeholders will rely on the reported profit when the independent auditor demonstrates a high level of independence. Users of accounting information therefore expect auditors to employ technical expertise, integrity, and objectivity during the audit process in order to stop the release of fraudulent financial reports. Due consideration for financial reporting quality must thus be given to the audit assignment in order for it to meet the realistic expectations of different stakeholders. The perceived linkages between auditor independence and the quality of financial reporting have been the subject of several research, which have found that auditor independence affects the accuracy and transparency of financial data. However, these studies look at a number of variables that could have an impact on independence, such as auditor tenure, auditor switching, Big4 involvement, and auditor fees. The results of these studies have been conflicting, with some indicating a substantial correlation between increased auditor independence and better financial reporting quality, while others have found only weak evidence of one. These conclusions are the result of several circumstances, including the regulatory framework, corporate characteristics, and particular metrics of auditor independence (FASB).

The variables of auditors independence in this study includes Auditors switch, Auditors tenure, Audit fee and Big 4 while financial reporting quality is proxied by discretionary accruals

Discretionary accruals are accounting adjustments that are left up to the management of the company, as opposed to being based on objective events or transactions that happen during regular business operations. These accruals can significantly affect the financial report of the company and can be used to manipulate earnings, which could have a detrimental effect on the independence of the auditors (Osama, 2023).

This study uses audit fee, big4, audit tenure, and auditors switch as proxies of auditors' independence to investigate the impact of auditors' independence on the quality of financial reporting of listed oil and gas firms in Nigeria, due to their significance in the association with the dependent variable (Financial Reporting Quality), the proxies are appropriate. The study answers the following questions;

i. What is the effect of auditors’ switch on financial reporting quality of listed oil and gas companies in Nigeria?
ii. What is the effect of audit tenure on financial reporting quality of listed oil and gas companies in Nigeria?

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iii. What is the effect of audit fee on financial reporting quality of listed oil and gas companies in Nigeria?
iv. What is the effect of Big-4 audit firm on financial reporting quality of listed oil and gas companies in Nigeria?

This study effect of auditors' independence on financial reporting quality of listed oil and gas companies in Nigeria is structured into section one (Introduction), Section two (Literature review), Section three (Methodology), Section four (Data Analysis and discussion), Section five (Conclusion and recommendations)

2. Literature Review

There are several concepts which were discussed in this study such as concept of auditors independence, audit fee, audit tenure, audit switch, financial reporting quality. Empirical review was also carried out as well as the theoretical framework.

2.1 Concept of Auditors Independence

According to McGrath et al. (2021), auditor independence was defined as the absence of variables that might potentially undermine an auditor's impartiality in making audit judgments, as stated in the Independent Standards Board (ISB) framework on Auditors independence (2012); The concept of independence does not call for the auditor to be totally free from all variables that may compromise their ability to make an unbiased audit conclusion. Rather, it merely refers to those elements that could compromise their capacity.

According to Robert and Peter (2018), the concept of independence does not place restrictions on the kinds of interests that might lead to bias; these interests can be non-financial or financial, as in the instance of a close relative holding a senior management position at the auditee.

The audit fee is the sum of money paid for a certain audit service rendered to a client. A larger audit fee often translates into a greater chance of the auditor losing their independence (Adeyemi & Okpala, 2011). According to the IFAC Standards of Conduct for Professional Accountants, the size of a customer (as determined by the amount of fees) could cast doubt on the independence of the accountant. Even though it does not significantly affect audit independence, the size of audit fees which is calculated as the log of the total audit fee stated in yearly reports is an important consideration when determining audit fees that has caused respondents to express less confidence in the independence of the auditor.

The entire period that the audit firms (auditors) have been representing the client's trust or the number of years in which the auditing firm (auditor) has audited the client in a row (Johnson et al., 2002) is regarded as audit tenure. There are in fact two components to an auditor's tenure: the audit firm's tenure and the tenure of the staff who perform the audit, especially the engagement partner. Both claims are supported by empirical data on the association between auditor tenure and audit quality, demonstrating that as audit firm tenure increases, audit quality both rises and falls (Johnson et al., 2002).

As stated by Jerry and Sani (2018), an audit company is regarded as Big if it is one of the Big4 audit firms, such as Akintola Williams Deloitte & Touche, Ernst and Young, KPMG, and Price Waterhouse Coopers. When an organization is audited by an established reputable audit firm, the conflict of interest is reduced and confidence and reliability are improved. Large audit firms, according to Al-Shammari et

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al. (2007), Jensen & Meckling (1976), and Watts & Zimmerman (1983), act as a check on agency costs and take on a more watchful role by preventing managers from engaging strategically while promoting desirable actions. This confirms DeAngelo's (1981) assertion that by compelling their clients to provide the greatest quantity of information required, they enhanced client adherence.

2.2 Financial Reporting quality

The significance of accounting reporting is measured by and dependent on the standard of financial reporting. The need for a comprehensive and clear definition for financial reporting quality has intensified around the world. To enhance market efficiency and affect users' investment decisions, it is essential to provide high-quality financial reporting because globally there is need for the creation of appropriate methods for assessing the caliber of financial reporting hence auditors' independence.

Financial reporting quality is referred to as financial statements that give accurate and fair information about the underlying financial position and economic performance of an entity, as defined by the Financial Accounting Standards Board (FASB), the International Standards Board for Accounting (IASB), the Accounting Standard Board in the United Kingdom (ASB) [UK], the Nigerian Accounting Standard Board (FRC), and the Australia Accounting Standard Board (AASB).

2.3 Empirical review

Several authors and scholars have carried out studies on effect of auditors independence on financial reporting quality in Nigeria; while few uses similar proxies, others used other sectors such as banking and consumer goods companies to assess the effect of auditors independence on quality of financial report.

Carp and Istrate (2021) used discretionary accruals as a proxy for measuring the financial reporting quality using the Jones (1991) model and the accruals quality, estimated using the Dechow and Dichey (2002) model, to estimate the impact of auditors' characteristics on audit quality for the Romanian listed firms (943 observations for the 2007–2019 period). The variables that are dependent The Big 4 membership of the auditor was shown to have a negative impact on the audit's quality by increasing discretionary accruals. The quality of the audit was not significantly impacted by the switch to IFRS.

Nurita (2019) examined the impact of auditor experience, independence, and professional ethics on the caliber of auditors employed by public accounting companies in DKI Jakarta. Primers were the data utilized, and they were gathered from a survey that 127 respondents completed. The hypothesis examined the relationship between the independent and dependent variables. Nonetheless, the outcome demonstrates that audit quality is influenced by the independence, integrity, and expertise of the auditors.

An empirical investigation of the impact of audit fee and auditor independence on audit quality was conducted by Novie (2013). Questionnaires and interviews were used as main data in this explanatory research study. The number of capital market accountants in Indonesia, or 73 public accounting offices, comprised the sample. The outcome demonstrates that the independence of the auditors has a major impact on both the audit fee and audit quality. Size of the auditee, complexity, and risk are used to gauge the auditing charge. The auditing quality is broken down into the following categories: skills, experience, ethical value, dependability, and auditing technique.

Gamal (2012) studied the factors influencing audit fee determination for external auditors and client representatives (accountants, financial controllers, and internal auditors) and provided evidence regarding whether these factors are related to the characteristics of the audit firm or the client firm. The empirical data for this study came from a sample of eighty respondents who completed a self-administered questionnaire. Descriptive statistics, means, standard deviation, and the Mann-Whitney U test were used to analyze the data. The study's conclusion offers important new information on what influences audit fees in emerging nations like Lebanon. It was discovered that each of the previously proposed factors for determining audit fees is either very significant or important. Groups of client representatives and external auditors concur that the Whether or not the audit company is one of the Big Four is the most significant factor influencing the amount of audit fees; the size of the audit firm based on staff count is the least significant factor. The findings also demonstrate that there is uniformity in the significance of each factor influencing audit fees between the two respondent groups.

Olagunju (2011) assessed the impact of auditor independence on the reliability of financial statements. A combination of primary and secondary sources provided the data. Simple percentage analysis and chi-square table testing were used to examine the data. The findings indicate that the independence of the auditors has an impact on the financial statements' credibility, and that financial statement manipulation may be minimized by raising the credibility of the financial statements. According to the report, businesses should let auditors do non-audit activities and rotate them after a predetermined amount of time.

Agus (2019) investigates how management intervention and audit fees affect the independence of the auditor in the province of Bali's office of public accountant. Multiple linear regressions were used as the data analysis method. The findings indicate that while audit fee has a positive effect on auditor independence that is, the higher the audit fee, the greater the auditor independence management intervention has a negative effect on auditor independence. This suggests that the more management intervention there is, the weaker the auditors' independence.

Oziegbe (2022) conducted research to ascertain the impact of corporate characteristics, audit tenures, and auditor independence on audit quality in Nigeria. Ten pharmaceutical businesses that were listed in the Nigerian Exchange group between 2013 and 2019 make up the population. The dependent variable, audit quality, was proxied by big 4 companies and non-big 4 businesses, while the study employs two control variables, firm size and firm age, and two explanatory factors, audit independence and audit tenure. Secondary data were used, and panel regression analysis was employed to examine the information. The outcome demonstrates that every explanatory and control variable significantly and favorably affects audit quality. In order to prevent the possibility of familiarity, the research also suggests that the audit tenure not exceed three years. It is also recommended that enterprises use the services of the Big Four accounting firms, and smaller firms should shadow larger firms in order to gain knowledge.

A potential relationship between audit independence and audit quality in Nigeria was investigated by Bassey (2020). From 2010 to 2019, the study employed an ex post facto research design. The houseman test was equally used in the optimal model that was chosen for the study, which applied the panel least squares approach based on a fixed and random effect framework. According to the report, audit tenure

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has a detrimental impact on audit quality in banks with operations in Nigeria. It also demonstrates that, in order to ensure their independence and improve quality, audit costs have to be set based on professionally specified benchmarks. It also demonstrates the need for audit staff rotation to avoid over-familiarity, which poses a risk to independence and improves the caliber of financial reporting.

According to empirical research by Albagali & Kukreja, 2017, the least important element influencing auditor independence in Bahrain is auditor rotation; research on the relationship between non-audit service providing an auditor independence yields contradictory findings. According to Frankel et al. (2020), a sizable non-audit services charge in relation to overall audit fees is linked to the possibility to slant the auditors' assessment of the financial papers they saw. Because of this, the authors came to the conclusion that an auditor's independence is threatened when they provide a sizable number of non-audit services.

Otuwa (2019) conducted research on the objectivity of auditors and the standard of financial reporting in Nigerian listed manufacturing firms. The study used a context analysis research approach, and descriptive correlation statistics were used to gather data from secondary sources between 2013 and 2017. According to the data, audit reporting lag has a positive but negligible association with financial reporting quality (FRQ), audit incentives, audit tenure, and audit client size have a substantial positive link with FRQ, and the Big 4 have a significant negative relationship with FRQ. This research cannot be trusted since it did not include the oil and gas industry and other factors like audit switches that might affect the integrity of financial reports.

2.4 Theoretical Framework

Several theories can be lined to this study due to their relevance to principal (Directors) and agents (auditors) relationship. However, the most relevant which is the agency theory is used in this study.

Agency theory is appropriate because of the relationship that exists between the auditor and the directors of companies which is why the audit assignment is initiated in the first instance, the auditor who serves as the agents and the directors who serves as the principal engage the auditor to ascertain the arithmetical accuracy of the transaction of the company and to state whether in his view, the books follow the International Financial Reporting Standard of reporting. The agency also has a link with policeman theory and lending credibility which are both theory of similar nature. Since the auditor is expected to ascertain the arithmetical accuracy of the books, in turn leads to detection and prevention of fraud; it is also linked to lending credibility theory in the sense that the audited financial report lends credence to management for the stakeholders to feel the managers are steering the company to the right direction.

Jensen and Meckling are credited with developing agency theory in 1976. According to this hypothesis, information asymmetry can arise when ownership and control are separated. Therefore, the company's directors and managers have the potential to take advantage of the shareholders and postpone financial reporting that is necessary for shareholders to evaluate the managerial performance of the company. They may also choose to delay the report for their own financial gain. The audit report should be released on schedule or without any delays. According to Scott (1997), an agency relationship is one that results from a contract between the principle and agents, whereby the principal uses the agents' services to carry out tasks that the principal finds valuable in the event that ownership and control of the

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business are separated (Jensen & Meckling, 1976). A system including relationship management (agents) and owners (principal) was created by the model agency. The timeliness of audited financial reports and the significance of timely financial reporting to the public and consumers of financial statements are supported by the assumptions of Agency Theory (Akinleye 2019).

3.0 Methodology

The study adopts ex post facto research design and secondary data was used because the data used has already existed; the population was eight (8) listed oil and gas companies where six (6) was sampled due to the availability of the data at the time of carrying out the study. The model used was The Dechow, Sloan, and Sweeney (1995) model's Jones model, which subtracts the expected amount of non-discretionary accruals from total accruals, was used to estimate discretionary accruals.

Non-discretionary accruals are measured using equation as follows;

$$NDACCit = \frac{1}{TA\mathrm{it} - 1} + REVit - \frac{RECit}{TAit - 1} + \frac{PPEit}{TAit - 1}$$

Discretionary accruals are the difference between total accruals and the non-discretionary components of accruals, as indicated by the following equation:

$$DACCit = TACCit - NDACCit$$

TA_{it} – Total accruals in year t
A_{it-1} – Total asset in year t-1 $_{it-1}$
$\triangle REV_{it}$ – Annual change in revenues in year t
$\triangle REC_{it}$ – Annual change in receivables accounts in year t
PPE_{it} – Gross property, plants and equipment in year t
ϵ_{it} - The error term

In order to achieve the objective of this study, the following multivariate regression model was developed;

$_{FRQ} = \beta o + \beta_1 AUFEE_{it}, + \beta_2 AUTEN_{it} + \beta_3 BIG4_{it} + \beta_4 AUSWTCH\ \varepsilon_{it}$ - i

i = cross sectional variable from 1, 2,3,4
ε = error term
Where:
AUDTEN = Audit Tenure; AUDFEE = Audit Fee; BIG4A = Big4a; AUSWCH = Audit Switch

The study was panel because the reports were drawn from 6 companies for a period of ten (10) years 2012-2021 hence Generalised least square method of data analysis was also used because the Hausman test favors Random effect regression model.

4. Results and Discussions

Under this, results from the descriptive statistics, correlation, test of normality, regression result and discussion of findings was presented and discussed.

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Table 1: Descriptive statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
FRQ	60	-0.0167017	0.3170788	-0.7076006	1.962329
AS	60	0.1166667	0.3237318	0	1
BIG4a	60	0.6	0.4940322	0	1
AT	60	0.8166667	0.3902049	0	1
AF	60	4.4245	0.2910963	3.74	5.29
Profitability (ROA)	60	1.584333	26.54511	-71.36	176.3
Leverage (DTA)	60	76.312	29.96806	53.68	247.9
Firm Size (FZ)	60	7.757333	0.2750523	7.12	8.5

Source: Authors Computation 2024

The table 4.1 of the study depict the mean, max and standard deviation between variables. From the table 4.1 "frq" has a mean of approximately -0.017, which means that on the average, the financial reporting quality of the oil and gas companies in Nigeria is negative while a standard deviation of about 0.317 is indication of wide dispersion in quality financial reporting of the sample companies. A minimum of -0.708 means that 0.71 is minimum quality recorded while 1.96 is the maximum quality recorded. Where "AS" has a mean of approximately 0.117, a standard deviation of about 0.324, a minimum of 0, and a maximum of 1; Big4 has a mean of 0.6, a standard deviation of about 0.494, a minimum of 0, and a maximum of 1; AT has a mean of approximately 0.817, a standard deviation of about 0.39, a minimum of 0, and a maximum of 1; AF has a mean of approximately 4.425, a standard deviation of about 0.291, a minimum of 3.74, and a maximum of 5.29; Profitability has a mean of approximately 1.584, a standard deviation of about 26.545, a minimum of -71.36, and a maximum of 176.27; Leverage has a mean of approximately 76.312, a standard deviation of about 29.968, a minimum of 53.68, and a maximum of 247.85; Firm Size has a mean of approximately 7.757, a standard deviation of about 0.275, a minimum of 7.12, and a maximum of 8.32.

Table 2: Correlation statistics

	FRQ	Audit Switch	Big4	Audit Tenure	Audit Fee	Profitability	Leverage	Firm Size
FRQ	1.0000							
AS	-0.0626	1.0000						
B4	-0.0620	0.0848	1.0000					
AT	0.0961	-0.6329	-0.0352	1.0000				
AF	-0.0524	-0.1370	0.2897	0.1312	1.0000			
ROA	0.8808	-0.0321	0.0495	-0.0108	-0.0004	1.0000		
DTA	-0.1100	-0.1500	-0.1972	0.1306	-0.2633	-0.2278	1.0000	
FS	-0.0026	-0.1468	0.1417	0.0759	0.6817	0.0606	-0.1484	1.0000

Source: Authors Computation 2024

The Table 4.2 depicts the coefficient of observations (60) used in this study. The correlation coefficient between "frq" and "as" is approximately -0.06. This indicates a weak negative linear relationship between these two variables. The coefficient between "B4a" and "FRQ" is approximately -0.0620 this suggests a weak negative linear correlation between these variables. The coefficient between "FRQ" and

"AT" is approximately 0.0961. This implies a weak positive linear correlation between these variables. The coefficient between "AF" and "FRQ" is approximately -0.0524, this indicates a negative weak linear relationship between the variables. The coefficient between Profitability (ROA) and FRQ is 0.8808 this indicates a relatively strong positive linear relationship between these variables which is a possible indication of the presence of multicollinearity.

Table 4: Result of Random effect regression

FRQ	Coef	Std.err	t	P >/t/
as	.0657027	.0789468	0.83	0.405
b4a	-.0591437	.0417119	-1.42	0.156
at	.1120283	.0646399	1.73	0.083
af	.0152573	.0980288	0.16	0.876
roa	.0108359	.0007577	14.30	0.000
dta	.0007156	.0007108	1.01	0.314
fs	-.051452	.0975887	-0.53	0.598
_cons	.1794805	.5829231	0.31	0.758

R-Sq	Wald chi2 (7) = 215.73
Within = 0.8071	Prob > chi2 = 0.0000
Between = 0.7068	
Overall = 0.8058	

Source: Authors Computation 2024

The output from a Random Effects Generalized Least Squares (GLS) regression analysis provides information about the model's performance, coefficient estimates, statistical significance, and goodness of fit. Number of Observations and Groups as indicated in the analysis is conducted on a dataset with 60 observations and 6 groups defined by the variables.

As can be seen the R-squared values indicate the proportion of variability in the dependent variable that is explained by the model. The "Overall" R-squared 81% is a weighted average of the within-group and between-group R-squared values indicating that 81% of the variability is been explained by the independent variables captured in this research while 19% is been explained by variables not captured in the research. At least one coefficient is statistically significant, according to the Wald chi-squared statistic of 215.73 and the corresponding p-value of 0.0000.

The results reveal that AS has a coefficient of 0.0657027 meaning that a unit increase will result to about 6.6% increase in FRQ. The AS p-value of 0.405 exceed the 5% level of significance. Audit tenure (AT) has a coefficient of 0.112 meaning that a unit increase will result to about 11.2% increase in FRQ. The AT P-value of 0.083 is below the 5% level of significance. Audit fee (AF) has a coefficient of 0.015 meaning that a unit increase will result to 1.5% increase in Financial Reporting quality. The Audit Fee P-value of approximately 0.88 exceed the 5% level of significance.

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5. Conclusion and Recommendations

The hypothesis 1 stating the positive relationship between Audit Switch and the Financial Reporting Quality is unsupported based on the above result hence, null hypothesis which states that Auditor Switch has no significant effect on FRQ of Oil and Gas companies in Nigeria is accepted. The hypothesis 2 stating the positive relationship between AT and FRQ is supported as can be seen from the regression result. hence, the null hypothesis which states that Audit Tenure has no significant effect on FRQ of Oil and Gas Companies in Nigeria is not accepted.

The hypothesis 3 and 4 stating the positive relationship between Audit Fee/Big4 and Financial Reporting Quality is unsupported. Hence, the null hypothesis which states that Audit Fee and Big 4 has no significant effect on Financial Reporting Quality of Oil and Gas Companies in Nigeria is thus agreed with.

The study found out that Audit tenure among the other proxies has a positive and significant effect on financial reporting quality of listed oil and gas companies in Nigeria; the research established that there is negative relationship between audit fee and financial reporting quality; this means the fee received by auditors in carrying out their duty is not a threat to financial reporting quality of these oil and gas companies. It was also found out that there is a positive but insignificant relationship between Big4 and financial reporting quality of the listed oil and gas companies' sampled in this study. Lastly, hypothesis stating the positive relationship between Audit Switch and the Financial Reporting Quality is unsupported. Hence, Auditor Switch has no significant effect on FRQ of Oil and Gas companies in Nigeria. Based on the findings and conclusions, this study recommends that other variables should be used to assess effect of financial reporting quality besides the ones used for this study (Audit switching, audit fee, audit tenure and Big4), other sectors (e.g insurance companies) can be jointly analysed together with Oil and Gas sector this is because only few (6) oil and gas companies has complete annual report from the period 2012-2021 based on the study period.

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