



SCHOOL OF POSTGRADUATE STUDIES (SPGS)

**IMPACT OF ACCOUNTING REGULATORY REFORMS ON AUDIT
QUALITY OF LISTED COMPANIES IN NIGERIA**

A Ph.D. THESIS SUBMITTED

BY

**Ahmad Bukola UTHMAN
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DECLARATION PAGE

I hereby declare that this thesis titled: “Impact of Accounting Regulatory Reforms on Audit Quality of Listed Companies in Nigeria” is a record of my research. It has neither been presented nor accepted in any previous application for higher degree.

PREVIEW

Ahmad Bukola Uthman

Date

APPROVAL PAGE

This is to certify that this thesis by Ahmad Bukola UTHMAN has been read and approved as meeting the requirements of the Department of Accounting and Finance for the award of the degree of Doctor of Philosophy (Ph.D.) in Accounting.

Dr. Mubaraq Sanni
Main Supervisor

Signature and Date

Prof. Moshood Lanre Nassar
Co-Supervisor

Signature and Date

Dr. Mubaraq Sanni
Head of Department

Signature and Date

Internal Examiner

Signature and Date

External Examiner

Signature and Date

Prof. Hamza AbdulRaheem
Dean, School of Postgraduate Studies

Signature and Date

DEDICATION

This thesis is dedicated to my beloved Mom, Mrs Rahmah Bola Uthman

PREVIEW

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Oblivious of His decree and pre-destination, curiosity heightens when man thinks his own time has come. However, God's time is the best. All thanks belongs to Almighty Allah, who elevated me to this status of His prestigious mercy and fabulous grace. He has enabled me put together, this lucubration, that has availed me a lot of benefits and galvanized me into the realm of the academe.

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ABSTRACT

Audit mistakes, causing confidence erosion in accounting numbers and demonstrated by takeover of banks by the Asset Management Corporation of Nigeria (AMCON) and fraud cases have become more worrisome and affected the country's economy. However, the regulatory reform through establishment of Financial Reporting Council of Nigeria (FRCN) appears ineffective, and IFRS Adoption by the FRCN is also perceived by financial reporting stakeholders to have compounded the problems. Therefore, it became imperative to study how audit quality may have been affected by the regulatory reform efforts of the government. The specific objectives of this study are: (i) evaluate the effect of IFRS adoption on audit quality of Nigerian listed companies; (ii) assess the moderating effect of audit fee premium on the relationship between IFRS adoption and audit quality of listed companies Nigerian; (iii) examine whether audit firm size moderate the relationship between IFRS adoption and audit quality of listed companies in Nigeria; (iv) investigate if the effect of IFRS adoption on audit quality of listed companies Nigerian is moderated by auditors' industry specialization; and (v) examine how FRCN rules and pronouncements have affects audit quality of listed companies in Nigeria. The study drew data from primary and secondary sources. Extracted data from financial reports of 52 listed companies in Nigeria covering periods between 2005 and 2019 form the secondary data employed in the study. With 517 observations, secondary data were analysed with the use of longitudinal econometric models. The primary sources involved interview of 11 respondents comprising of auditors, accountants and staff of the FRCN. Schematic analysis was conducted on the primary data and corroborated with document analysis. Evidence from both sources were triangulated to conduct a mixed-method research. The findings of the study are: (i) adoption of IFRS significantly affect audit quality ($t=-1.66$, $p<0.10$ & $t=-1.66$, $p<0.10$) in the non-financials erVICES industry. In the financial services industry, the results indicate that adoption of IFRS does not significantly affect audit quality ($t=-0.78$, $p>0.10$ & $t=-0.16$, $p>0.10$); (ii) audit fee premium after the IFRS adoption led to significant reduction in audit quality for the non-financial firms ($t=4.88$, $p<0.01$ & $t=4.87$, $p<0.01$). For firms in financial services, the relationship of IFRS adoption and audit quality was not significantly affected by audit fee premium as indicated by the results. ($t=4.312$, $p>0.10$ & $t=12.16$, $p>0.10$); (iii) audit firm size after the IFRS adoption led to the reduction in audit quality for the non-financial firms ($t=4.68$, $p<0.01$ & $t=4.68$, $p<0.01$) indicating that Big 4 firms audit quality significantly reduced for the non-financial services sector while there was indifferent moderation of audit firm size on the effect of IFRS adoption on audit quality given the result IFRS ($t=-0.89$, $p>0.10$ & $t=0.02$, $p>0.10$) in the financial services sector; (iv) IFRS adoption led to significant reduction in the audit quality of both financial ($f=6220.57$, $P<0.01$ & $f=6225.71$, $P<0.01$) and non-financial services ($t=1.69$, $p<0.10$ & $t=1.69$, $p<0.10$) industries; and (v) the rules and pronouncements of the FRCN were all found to improve audit quality with the exception of monitoring and review rules which has not been initiated. The study concluded that different aspects of regulatory reform affected audit quality differently. It specifically submits that IFRS adoption improves audit quality but there are aspects of FRCN, such as monitoring and review, which do not improve audit quality. The study recommends, among others, the need for the FRCN regulation to include oversight on audit fee, auditor industry specialization and audit firm size to inform better audit quality.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Nations across the world – developed and developing alike – have reformed the regulation of accounting profession at one time or the other. Reform explains the dynamism required of a system in a dynamic environment. The uses of financial information expand over time and their users increase in response to such expansion. Dynamism in a system usually forces a change and leads to demand for new and more ‘appropriate’ financial accounting regulations (Hassan, 2008). As a result, the accounting literature has documented various reasons for the reform that have been taking place in the regulation of accounting profession.

In the Republic of China, accounting regulation reform was triggered by the need to align financial accounting practices with internationally accepted norms (Chalmers, Navissi & Qu, 2010). The reform of the regulation of the United States’ accounting was ignited principally by the global financial crisis and the Eron saga (Gilsinan, Seitz, Fisher, Islam & Millar, 2013) while the Australian accounting reform was a subject of efficiency, effectiveness and economy of the financial management process (Mir & Rahaman, 2006). Other motives of accounting reform noted by prior studies include reduction in prevalent corruption, loss of confidence in accounting information as well as reduced audit quality (Koumbiadis & Pandit, 2014; Hopper & Lassou, 2017).

The Nigerian accounting reform took place as an outcome of a deliberate attempt, through the World Bank’s Observance of Standards and Codes, to strengthen the accountancy institutional framework against the odds of incessant accounting scandals and the plethora of bank failures which gulped about N2 trillion in banks’ deposits and investments within the space of 5 years (World Bank, 2011). Submitting to the policy recommendations of the World Bank’s (2011) report, the Financial Reporting Council (FRC) Bill was promulgated to replace the defunct Nigerian Accounting Standard Board (NASB) while simultaneously adopting the International Financial Reporting Standards (IFRS) in order to toe the line of convergence already in vogue. The essence of the duo was to strengthen the accounting institutional framework and thus improve Audit Quality (World Bank, 2011).

Meanwhile, the reform received reactions for accountants, whose job is practically affected by the reform and hence, affecting the entire audit market. The most pronounced of such reaction was the upward review of the scales of professional fees chargeable by auditors (Institute of Chartered Accountants of Nigeria (ICAN), 2011). Accountants and auditors provide services to their clients beyond the traditional audit and are usually faced with independent threats as documented in extant audit literatures. The independent threats emanate from auditor accruing so much revenue from a single client thereby becoming fee-dependent on such client (Lin & Yen, 2016). Since the enterprise culture inherent in audit firm will usually fuel desire for more profit, perhaps, at the expense of audit independence and thus quality, most auditors would rather hide the proceeds from non-audit services provided to their clients to reshape the perception of financial reporting stakeholders on audit quality (Sikka et al, 2018). Apparently considering the antics of professional auditor, the Financial Reporting Council of Nigeria (FRCN) has been empowered by its Act to provide rules, aside those promulgated in its law to put auditors on check always (FRC Act, 2011). This power has been in use since the reform process came into force.

Following these efforts and reactions thereto, high profile corporate scandals and anomalies are still being reported. This development presupposes a fault in the credibility of audit despite recent reform. Prominent among the cases of audit failure were the Subsidy Scam which named Akintola Williams Deloitte (AWD), a foremost and respected audit firm in Nigeria as well as naming Olusola Adekanola and co. as complicit because subsidies were paid with absolute reliance on their oversight functions as auditors to the Petroleum Product Pricing Regulatory Agency (PPPRA) (House of Representatives, 2012). Klynveld, Peat, Marwick and Goerdeler (KPMG) Professional Services was also found negligent in the audit of the financial statements of Stanbic IBTC Holdings for years 2013 and 2014 respectively (Financial Reporting Council of Nigeria, 2015).

In 2019, after close to two decades of periodic audit of OANDO Plc. by the Big 4 firms and the consistent issuance of clean bill of health on the numbers in the financial statements of the companies, the Securities and Exchange Commission (SEC) ordered some board members to resign as a result of investigations indicted them of alleged false disclosures, misstatement of financial statements, market abuses, internal control failures, poor board oversight among other offences (Admin, 2019). Although, the auditor (Ernst & Young) flagged its concern about the going concern of the company in 2018 due to huge losses and negative assets (Hassan, 2018),

the auditors' communications to the management were silent on the possibility of existence of infractions later discovered. SEC also directed that, the affected directors and individuals pay monetary penalties. However, the issue is still a subject of legal quandary with substance of the matter pending judicial decisions (Admin, 2019). In another corporate fraud, a former Managing Director of Fin Bank was jailed for involvement in the diversion of N18bn bank's money for personal benefit (Odunsi, 2020). This was revealed by the CBN and NDIC examination on the bank which led to a bail-out loan of ₦50 bn. After the loan, the board were noted to have begun to approve special packages for the executives to the tune of ₦200m to the interim chairman among others (Odunsi, 2020). These infractions went on for years of compulsory audit by the Big 4 without a mention to neither the shareholder nor putting the public on notice.

Several other cases in the public sector have named auditors as indirect accomplices thereby questioning audit quality. Such cases include the revelations made in the Report of the Federal Ministry of Finance (2018) administrative panel of inquiry on violation of financial regulation, Skye Bank Takeover by the Federal Government in 2017. A KPMG forensic review commissioned by the Federal Ministry of Finance in 2010 identified sharp financial practices that led to "significant underpayment of domestic crude cost to the Federation Account" (KPMG, 2010, p.19) as well as deliberate deprivation of the federation, the timely utilization of funds accruable to it.

Other untoward financial practices led to "under-remittance of domestic crude sales proceeds into the Federation Account, which according to KPMG's (2010) analysis, "subsidy over-deduction for 2007, 2008 and 2009 was estimated at ₦2.0bn, ₦10.3bn and ₦16.2 bn respectively" (p.33). Similarly, the report of the ad-hoc committee of the House of Representatives (2012), spanning the period between 2009 and 2011 revealed how the subsidy regime was manipulated to unlawfully deprive the federation of colossal sums. The committee concluded that a sum of about ₦1.7 tr was lost to non-remittance and under remittances within the period covered by the investigation. While these malpractices occurred during the pre-reform era, they, perhaps among the factors led to recommendation for and implementation of the reform processes.

The widely reported case of non-remittance of oil revenue to the federal government came to fore through the allegation of the Ex- CBN Governor, Sanusi Lamido Sanusi in a letter to the president, leaked to the press. The letter reported under-remittance of \$49.8 billion (₦ 22

trillion) initially and later agreed to \$20 billion (~~₦~~9 trillion) after reconciliation efforts were made with the NNPC Pricewaterhousecoopers (PWC, 2015). On the recommendation of the Finance Minister, PricewaterhouseCoopers (PWC) Limited was commissioned in 2014 to conduct an independent forensic audit on the allegation (CBN, 2014). The scope of the audit was to analyse the remittance shortfall, submissions were made with respect to the analysis likewise reports were produced on the findings thereafter (PWC, 2015). The audit exercise traverse seven distinct issues including revenue generated, revenue remitted, other third-party financing arrangements, Premium Motor Spirit (PMS) and Dual-Purpose Kerosene (DPK) Subsidy, NPDC lifting, pipeline maintenance and management costs as well as crude oil and product losses (PWC, 2015).

The revenue generated were underreported by \$2.34 billion (~~₦~~1.05trillion) within the period understudied (PWC, 2014). This represent the sum of \$29 million (~~₦~~13 billion) on export equity crude, \$22 million (~~₦~~ 9 billion) on domestic crude revenue, \$1 billion on FIRS tax oil, DPR royalty crude oil of \$42 million (~~₦~~18.9 billion), NPDC crude oil of \$82 million (~~₦~~ 36.9 billion) as well as other third-party financing of \$43 million (~~₦~~ 19.35 billion). As a result, instead of the \$67 (~~₦~~ 30.15 billion) reported to have been generated by the NNPC, \$69 billion (~~₦~~ 31.05 trillion) was discovered as their revenue for the period under consideration (PWC, 2015). The review unveiled taxes and royalties of a sum of \$1.7 billion (~~₦~~765 billion) paid by the NPDC, a subsidiary of the NNPC, on estimates as actual tax and royalty payments were not assessed for the underlying revenues. This clearly contravenes financial prudence and ethical corporate practices. Certain sales of Oil Mining Leases (OML) assigned by the Department of Petroleum Resources (DPR) at a consideration of \$1.85 billion (~~₦~~ 832.5 billion) were remitted to the federation as \$ 100 million (~~₦~~ 450 billion) (PWC, 2015). Summarily, the estimated withheld amount by the NPDC on the transaction of the outright sale of the OML stood at \$5.11 billion (~~₦~~2.2 trillion).

These incidences and a host of several others question the quality of audit purported to have been enhanced by accounting regulation reform. While many studies have documented audit quality determinants (Sarwoko & Agoes, 2014; Miko & Kamardin, 2015; Furidy & Kurnia, 2015; Wang & Dou, 2015; Gonzalez-Diaz, Garcia-Fernandez & Lopez-Diaz, 2015), research outputs have hardly addressed the implications of accounting regulatory reform on audit quality. More so, research efforts on accounting reform and audit quality considering the whole reform

process through the triangulation of evidence across methodological approaches in Nigeria is rare. Extant works (Abdul-Baki, Uthman & Sanni, 2014; Uthman & Abdul-Baki, 2014; Ozili & Outa, 2019; Otiya, 2019) in Nigeria on accounting reforms have isolated IFRS adoption with limited approach to its effects on audit quality in Nigeria as quite a number of other studies (Adeniyi, 2013; Zubairu, 2018; Aggreh, 2019) have always isolated some industries to the exclusion of others thereby affecting the generalization of their results. These identified problem and research lacuna provides the motivation for this study. Thus, this study examines the impact of accounting regulatory reform on audit quality of listed Nigerian companies.

1.2 Statement of the Problem

The sensitivity of accounting regulatory reform to the audit market amidst unfolding financial scandals, blamed on accounting malpractices, signals a fault line in the audit process. Accounting regulatory reform in Nigeria came as the duo of FRC enactment and the adoption of IFRS with similar motive but differing methods. That is, improvement of audit quality and financial reporting practices.

The nature and extent of audit failure publicly reported just after the reform suggests that a lot might be needed to really substantiate the purported accounting regulatory reform. Just as the reform measures took shape in 2011, The Institute of Chartered Accountants of Nigeria (ICAN) did an upward review of professional services fees warning practitioners that “charging below the [new] minimum rates is not permissible as it amounts to professional misconduct” (ICAN, 2011, p.iii). Osayande (2012) observed that the reform in accounting regulation has led to the upward review of audit fee occasioned by increased rigour and professional requirements. Such increase led to audit fee premium and impair auditors’ independence. Fees anomaly formed one of the bases of the regulatory decision of the FRCN to suspend KPMG from its engagement with Stanbic IBTC Bank (FRCN, 2015). The FRCN alleged that the fees earned by KPMG could possibly impair audit independence and objectivity which, in turn, is the bedrock of audit quality. The occurrence of such anomaly with a high-profile audit firm presupposes several other unreported cases in the audit market. Whether or not the reform’s effect on audit fees has affected audit quality is still a research quandary.

The widely reported cases of professional misconduct after the reform featured only the ‘big’ firms. Meanwhile, the World Bank (2011) blamed the reduced quality of audit on the monopolization of the audit market by the ‘big firms’ as well as the inaccessibility of small audit

firms to current information and developments in applicable accounting standards. Big firms with international network perform audit for most listed companies (World Bank, 2011) and as a result, employ their monopoly in colonizing the audit market for financial gains at the expense of audit quality (Otusanya & Lauwo, 2012). To buttress this, all the banks named for scandalous practices that led to the loss of N2 trillion were audited by the 'big four' audit firms (Otusanya & Lauwo, 2012). Otusanya and Lauwo, (2012) also indicated that, the major accounting malpractices reported after the 2011 regulatory reform featured both Akintola Williams Deloitte (now Deloitte) and KPMG which are both among the 'big four' audit firms in Nigeria. Although, the reform paved way for mergers among small audit firms, the impact of such mergers on audit quality is yet illusionary in the wake of recent accounting scandals. Studies on audit size and audit quality (Kumar & Lim, 2014; Aggreh, 2019; Oyuya 2019) also neglected the impact of accounting reform which form the crux of this research.

Furthermore, the report of the World Bank (2011) report was premised on the accounting malpractice revelations in the banking sector. it specifically drew its examples from the sector, making it seem as if all is not well with the banking sector to the exclusion of other sectors. To establish the veracity of any claim that all may not be entirely well with companies reporting financial performance in other sectors of the economy, a research effort is required. Meanwhile, prior studies (Scott & Gist, 2013; Hoelscher & Seavey, 2014; Dao & Pham, 2014; Nagy, 2014; Fuentes & Sierra 2015) have examined specialization of auditors in specific industries based on the possibility that, industry expertise attained by auditors through experience could cultivate inordinate beliefs of 'perfection' in the auditors and cultivate complacency in the auditee firms due to subconscious belief that transfer of audit service may be practically difficult. Therefore, sectoral disparity of auditee companies may also contribute to the dynamics of audit quality in Nigerian listed companies particularly, as World Bank (2011) study cited the banking industry as the rationale behind its observance of standards and codes in financial reporting.

With the financial reporting reform in Nigeria, stakeholders' awareness on the need for auditors to improve compliance with financial reporting practices has increased, thereby putting the audit quality in the spotlight (World Bank, 2011). The FRC enactment empowers the Financial Reporting Council of Nigeria (FRCN) to issue and enforce rules required to complement the pronouncements made FRC Act (2011) in ensuring improvement in audit quality. The rules have been made but the effectiveness of such rules have hardly been tested through research efforts while the potency of the rules has been with the PWC forensic report (2015) on the

allegations of unremitted \$2.33 billion (₦1.04 trillion) NNPC 's funds to the coffers of the federal government despite its annual audit requirement by the Nigeria law.

Seemingly thus, the potency of FRCN rules and enactments in enhancing audit quality is a question and requires an empirical study. Similarly, how IFRS adoption, through the reform process, has moderated the relationships between audit quality and such variables as Audit Fee Premiums, auditor size and auditor industry specialization is largely vague, as it rarely exists in the contemporary accounting and audit quality literatures.

1.3 Research Questions

Based on the statement of research problems, the following questions were drawn:

- i. Has the audit quality of listed companies in Nigerian been affected by IFRS adoption?
- ii. What moderating effect does audit fee premium have on relationship between IFRS adoption and audit quality of the listed companies in Nigeria?
- iii. Does audit firm size moderate the impact of IFRS adoption on the audit quality of listed companies in Nigeria?
- iv. Has the relationship between IFRS adoption and audit quality of listed companies in Nigeria been moderated by auditors' industry specialization?
- v. How have FRCN's rules and regulatory pronouncements affected the audit quality of the listed companies in Nigeria?

1.4 Objectives of the study

The aim of the study is to examine the effect of accounting regulatory reform on audit quality of listed companies in Nigeria. To achieve this, the following specific objectives were pursued:

- i. Evaluate the effect of IFRS adoption on audit quality of Nigerian listed companies.
- ii. Assess the moderating effect of audit fee premium on the relationship between IFRS adoption and audit quality of listed companies Nigerian.
- iii. Examine whether audit firm size moderate the relationship between IFRS adoption and audit quality of listed companies in Nigeria.
- iv. Investigate if the effect of IFRS adoption on audit quality of listed companies Nigerian is moderated by auditors' industry specialization.

- v. Examine how FRCN rules and pronouncements have affects audit quality of listed companies in Nigeria.

1.5 Statement of Hypotheses

To achieve the stated objectives, the following null hypotheses were tested:

- i. H₀₁: IFRS Adoption does not significantly affect audit quality of listed companies in Nigeria.
- ii. H₀₂: The effect of IFRS adoption on the audit quality of listed firms in Nigeria is not significantly moderated by audit fee premium.
- iii. H₀₃: The relationship between IFRS adoption and the audit quality of listed companies in Nigeria is not significantly moderated by audit firm size.
- iv. H₀₄: Auditor industry specialization does not significantly moderate the relationship between IFRS adoption and audit quality of listed companies in Nigeria.

1.6 Justification for the Study

Audit quality though enjoys replete research outputs, lacks specific attention from accounting regulatory reform. Research agenda on accounting reform are either biased towards the efficiency and economy in accounting for public sector finances (Okoroafor, 2016; Enofe, Afiangbe & Agha, 2017; Bakre, Lauwo & McCartney 2017; Zubairu, 2018; Salihu, 2019) or focused on the private sector, considering the nexus between accounting reform and value relevance of accounting information, behavioral aspects of reform as well as the long run implication of accounting reform on other regulatory issues (Mgbame, Eragbhe & Osawuwa, 2012; Adeniyi & Mieseigha, 2013; Miko & Kamardin, 2014; Ozili, & Outa, 2018; Egbunike & Odum 2018). As a result, there is an apparent gap in literature and research output alike with regards to the new developments on accounting reform as it impacts audit quality considering audit market features such as fee premium, auditor size and auditor industry specialization .

This study therefore contributes to fill the identified gap apparent in the problem stated. It contributes to enrich the sparse literature while at the same time expanded the base of academic research on accounting reform beyond its currents sphere through intertwining of theories across social science fields, triangulation of evidence across methodology as well as extension of the extant discourse on accounting regulation, political involvement in accounting standards and internalization of accounting profession.

The output of the time, human and financial resources expended by government to establish the reform mechanisms were established with verifiable evidence. The output of this research also provides recommendation as to whether to re-visit the reform, pursue other possibilities or expand the current reform process. It offers policy guidance to government and policy makers and serve as information source to regulators on the next line of action beyond the establishment of FRCN and the adoption of IFRS. While the aftermath of the reform could present some reactions from some quarters, this research also suggests possible frameworks for managing such reactions and allow for continuous attainment of the rationale behind the reform.

The incidence of audit failure is usually succeeded by public outcry and loss of huge sums to scams and fraudulent financial practices. The research also serves as a means of unveiling to practitioners and user, the events and happenings in the background of audited figures reported in financial statements. Hence, auditors, accountants as well as financial analyst are kept abreast of the interaction between the figures and policy events that underlie those figures. The research guides professional bodies as to the implication of audit fees, audit sizes and other quality determinants for audit quality.

1.7 Scope of the Study

This study examines the impact of accounting regulatory inform on the audit quality of listed companies in Nigeria. The study is motivated by reported audit mishaps and continuous corporate financial infractions that trail the establishment of FRC Act (2011). This study examined the behaviour of audit quality after the enactment of FRC Act (2011) and the adoption of IFRS in Nigeria in 2012. Specifically, it provides evidence on how audit fee premium, audit firm size and audit industry specialization moderate the effect of IFRS adoption on audit quality. These variables are known in literature as determinants of audit quality irrespective of any reforms. It therefore becomes important to investigate how they affect audit quality within the context of IFRS adoption and other regulatory rules and pronouncements.

The study collects data from listed companies in Nigeria from 2005 to 2018 to capture equal periods of seven years each for pre-reform and post reform periods. This period is considered appropriate for this study as it captures two halves of pre-reform and post reforms periods of 2005-2011 and 2012-2018 respectively. Hence, the data analysis will not be biased towards any of the two sides at the expense of the order. This research approach is expected to prevent the outcome of the study from sampling bias and enrich its output. Data were hand-extracted from

financial reports due to unavailability of database for financial report numbers in Nigeria. The extracted data therefore provides appropriate grounds to run econometric models in testing hypotheses 1 through 4. The study also collected primary data through telephone interview in order to answer abstract questions on the effect of the regulatory rules and pronouncements of financial reporting council of Nigeria. In order to capture opinions across relevant stakeholders and professionals, the interview covered accountants, auditors and technical staff of the financial reporting council of Nigeria, thereby ensuring the quality of data collected. The study adopted a mixed-method approach and was able to triangulate data across different data sourced to enhance the quality of evidence provided by the results.

PREVIEW