

IMPACT OF AUDIT QUALITY AND TRANSFER PRICING AGGRESSIVENESS ON FIRM RISK OF LISTED MULTINATIONAL COMPANIES IN NIGERIA

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<http://doi.org/10.35409/IJBMER.2025.3692>

ABSTRACT

This study examined the impact of audit quality and transfer pricing aggressiveness on the firm risk of listed multinational companies in Nigeria. Utilizing data from multinational companies listed on the Nigerian Exchange Group between 2012 and 2023, the research assesses how factors such as audit type, audit fees, audit tenure, related party transactions, effective tax rate, and deferred tax provision influence firm risk. The data were analysed using descriptive statistics such as mean, standard deviation, skewness, kurtosis, Jarque-Bera statistics, and panel regression models. The findings of the study that audit type (ATY) and auditor tenure (AT) have positive and significant impact on firm risk. However, audit fees (AF) has no statistically and significant influence on firm risk. The finding showed that RPTS has a positive and significant contribution to the firm risk. While, DTR, on the other hand, exhibits a negative and no significant relationship between deferred tax rate and firm risk. The finding revealed that ETR demonstrates a positive, indicating that an increase in effective tax rate is associated with higher firm risk. The study concluded that High-quality audits are essential in identifying and mitigating potential risks, enhancing the reliability of financial statements, and fostering investor confidence. Also, choose reputable and well-established audit firms, is preferable those with a strong international presence and recognition need to handle audit work of multinational companies. The study recommends that Investor should critically evaluate the audit quality of multinational companies before making investment decisions and Pay attention to the type and reputation of the audit firms engaged by multinational companies.

Keywords: Audit quality, Transfer pricing aggressiveness, Firm risk, Multinational companies, Nigerian Exchange Group.

1. INTRODUCTION

Multinational companies (MNCs) are large corporations that operate in multiple countries beyond their home nation, characterized by a centralized management structure but with a global reach. These companies engage in various activities, including manufacturing, sales, and research and development, exploiting local markets, labor, and resources in diverse regions. MNCs invest heavily in foreign countries, thereby influencing local economies significantly. They are known for their ability to drive economic growth in host countries through investment, technology transfer, and job creation (Dunning & Lundan, 2008). In the rapidly globalizing world economy, multinational companies (MNCs) play a crucial role in economic development by leveraging international markets to optimize resources, enhance profitability, and maintain competitive advantages (Dunning & Lundan, 2008). However, recent changes in the business environment

have raised awareness concerning the significant changes in the corporate reporting landscape in light of increasing risk exposure, more complex business models, and higher economic uncertainty (Saragih & Ali 2021). Nigeria as a developing country has played host to multinational companies long before independence and till date. The number and activities of these MNCs have grown over time as Nigeria struggles to develop socio-economically as a nation (Onudogo, 2013).

Multinational companies operating across multiple jurisdictions are exposed to various risks, including regulatory scrutiny, financial uncertainty, and reputational damage (Ernst & Young, 2019). In Nigeria, where the regulatory environment is evolving and financial markets are developing, these companies face unique challenges that influence their operational and financial risks (Owolabi & Alu, 2012). Two critical factors that can significantly impact the risk profile of these companies are audit quality and transfer pricing aggressiveness.

Understanding the interplay between audit quality and transfer pricing aggressiveness is crucial for stakeholders, including investors, regulators, and policymakers, to effectively manage firm risk and promote sustainable business practices in Nigeria's dynamic economic landscape (Adeyemi & Fagbemi, 2010). Audit quality refers to the ability of an audit to detect and report any material misstatements in a company's financial statements. High-quality audits are essential for ensuring the accuracy and reliability of financial information, which is critical for decision-making by investors, regulators, and other stakeholders. In the context of listed multinational companies in Nigeria, audit quality has a significant impact on firm risk. High audit quality reduces firm risk by enhancing the credibility of financial statements. When external auditors perform a thorough and independent audit, it assures stakeholders that the company's financial reporting is accurate and transparent. This reduces information asymmetry between management and investors, thereby lowering the perceived risk associated with the company's financial health and operational practices. For multinational companies, which often have complex financial structures and operations across different jurisdictions, high-quality audits are particularly important in mitigating risks related to financial misreporting, regulatory non-compliance, and internal control weaknesses (DeFond & Zhang, 2014). On the other hand, poor audit quality increases firm risk by raising concerns about the reliability of financial information. If stakeholders suspect that a company's financial statements may contain inaccuracies or omissions due to inadequate auditing, it can lead to a loss of investor confidence, increased cost of capital, and heightened scrutiny from regulators. In Nigeria, where regulatory oversight may vary, the role of auditors in maintaining high standards is crucial to managing firm risk (Adeyemi & Fagbemi, 2010).

Transfer pricing refers to the pricing of goods, services, and intangibles transferred between related entities within a multinational corporation. Transfer pricing aggressiveness involves setting transfer prices at levels that minimize the overall tax burden of the multinational group. While such strategies can enhance a firm's profitability by reducing tax liabilities, they also carry significant risks. Aggressive transfer pricing can increase firm risk in several ways. It exposes the company to regulatory and legal risks. Tax authorities in many countries, including Nigeria, scrutinize transfer pricing practices to ensure they comply with the arm's length principle, which requires that transactions between related entities be priced as if they were between unrelated parties. If a multinational company is found to have engaged in aggressive transfer pricing that

does not align with the arm's length standard, it may face significant penalties, back taxes, and interest. This can lead to substantial financial costs and damage the company's reputation (Richardson, Taylor, & Lanis, 2013). Also, aggressive transfer pricing can lead to operational risks. The use of transfer pricing to shift profits from one jurisdiction to another may result in cash flow mismatches and liquidity issues, especially if tax authorities challenge the transfer pricing policies and demand immediate tax adjustments. In Nigeria, where currency exchange controls and repatriation rules may complicate financial operations, these risks are even more pronounced (Blouin, 2014). In addition, transfer pricing aggressiveness can affect firm risk by increasing the volatility of reported earnings. By manipulating transfer prices to manage earnings, companies may present financial results that are not sustainable or reflective of underlying economic performance. This can lead to investor skepticism, increased stock price volatility, and a higher cost of capital as markets adjust to the perceived uncertainty associated with the company's financial health (Hanlon & Heitzman, 2010).

When considering the combined impact of audit quality and transfer pricing aggressiveness on firm risk, the relationship becomes more complex. High audit quality can mitigate some of the risks associated with aggressive transfer pricing by ensuring that transfer pricing policies are adequately disclosed and compliant with applicable regulations. Auditors with strong expertise in transfer pricing can help multinational companies in Nigeria navigate complex tax laws and avoid potential pitfalls that could lead to financial penalties and reputational damage. Conversely, if a multinational company engages in aggressive transfer pricing and simultaneously has poor audit quality, the risks are compounded. Poor audit quality may fail to detect or report aggressive transfer pricing strategies, leaving the company exposed to regulatory sanctions and financial misstatements. This can lead to a loss of investor confidence, legal challenges, and significant financial repercussions, all of which increase the overall firm risk.

Audit quality can be proxied by several factors, including audit firm size, audit fees, and audit tenure. Larger audit firms, typically categorized as "Big Four" (Deloitte, PwC, EY, and KPMG), are considered to provide higher audit quality due to their extensive resources, expertise, and reputation. Audit fees are another proxy for audit quality, with higher fees often reflecting more thorough and comprehensive audit processes (DeAngelo, 1981). Meanwhile, audit tenure, or the length of the relationship between an audit firm and its client, can have a dual effect: while longer tenure might indicate deeper client knowledge and improved audit quality, it can also lead to complacency and reduced auditor independence, potentially undermining audit quality (Johnson, Khurana, & Reynolds, 2002). The aggressiveness of transfer pricing practices, which can be measured through proxies such as the effective tax rate (ETR) and deferred tax rate, reflects the extent to which firms engage in tax minimization strategies. A lower ETR may indicate aggressive tax planning, which could raise regulatory scrutiny and legal risks (Richardson, Taylor, & Lanis, 2013).

Multinational companies (MNCs) operating in Nigeria face significant challenges related to financial transparency, regulatory compliance, and risk management. These challenges are exacerbated by the complexities of transfer pricing and varying levels of audit quality, which can have profound effects on firm risk. In recent years, concerns have risen over aggressive transfer pricing practices used by MNCs to minimize tax liabilities, which may result in lower effective tax rates and deferred tax payments. Such practices can attract increased scrutiny from tax

authorities and pose substantial legal and reputational risks to firms (Richardson, Taylor, & Lanis, 2013). Furthermore, audit quality, determined by factors such as audit firm size, audit fees, and audit tenure, plays a crucial role in ensuring the integrity of financial statements (DeAngelo, 1981). Poor audit quality can lead to undetected financial misstatements, reduced investor confidence, and increased firm risk (Francis, 2004).

The nexus between audit quality, transfer pricing aggressiveness, and firm risk remains an underexplored area, especially in emerging markets like Nigeria. While global research has established some linkages, the unique economic, regulatory, and market conditions in Nigeria necessitate a localized investigation. The complexity of Nigeria's regulatory environment, coupled with the dominance of a few large audit firms and the increasing focus on transfer pricing regulations, highlights the need for a deeper understanding of how these factors interact and influence firm risk (Otusanya, 2011; Okolie, 2014). Therefore, there is a critical need to examine how audit quality and transfer pricing aggressiveness impact the risk profiles of listed multinational companies in Nigeria.

Audit quality will be assessed using established metrics such as the Audit fee, audit tenure and size of audit firm. Transfer pricing aggressiveness TPAG will be measured using the following proxies: Related party Transaction, Effective tax rate and Deferred tax provision. Firm risk will be evaluated by employing standard deviation of adjusted market return values. The study will draw on existing literature and regulatory guidelines to develop a comprehensive framework for evaluating audit quality specific to the Nigerian context. The primary focus of this study was on multinational companies listed on the Nigerian Exchange Group that engage in cross-border operations. The geographical scope is limited to the Nigerian context, encompassing the unique regulatory, economic, and cultural environment within which these companies operate. The study will encompass a diverse range of industries, including but not limited to telecommunications, banking and finance, energy, and manufacturing. This approach aims to capture variations in the nature of business operations and associated risks across different sectors in the Nigerian economy. The study will consider a time frame between 2012-2023 to analyse the effects of audit quality and transfer pricing aggressiveness on firm risk. Historical financial data, audit reports, and transfer pricing documentation will be examined, with a focus on the last five to ten years to capture relevant trends and changes.

2. LITERATURE REVIEW

2.1.1 Firm Risk

Firm risk refers to the potential for a company to experience financial losses or other adverse effects due to various internal and external factors. It encompasses the uncertainties that can impact a company's profitability, operations, and overall financial health. Firm risk can arise from a variety of sources, including:

Financial Risk: Risks related to the company's financial structure, including leverage, interest rate changes, and liquidity issues.

Operational Risk: Operational risk stems from internal processes, systems, people, and external events that may disrupt business operations. It includes risks associated with technology, human error, and supply chain vulnerabilities (Basel Committee on Banking Supervision, 2011).

Market Risk: Market risk arises from fluctuations in interest rates, foreign exchange rates, commodity prices, and equity prices. It exposes companies to potential losses due to adverse movements in these market variables.

Credit Risk: Credit risk refers to the likelihood of financial loss resulting from the failure of counterparties to fulfil their contractual obligations. This risk is prominent in lending activities, trade receivables, and investment portfolios

Liquidity Risk: Liquidity risk emerges when a company encounters difficulties in meeting its short-term financial obligations. It relates to the availability and cost of funding sources, affecting a company's ability to manage cash flow effectively (Acharya et al., 2017).

Strategic Risk: Strategic risk arises from decisions related to a company's business model, competitive positioning, and long-term objectives. Poor strategic choices or external factors that impact strategy execution contribute to strategic risk (Kaplan & Mikes, 2012).

1.1.2 Audit Quality

Audit Quality refers to the effectiveness of an audit in fulfilling its objectives of providing reasonable assurance that a company's financial statements are free from material misstatements (The Public Company Accounting Oversight Board [PCAOB], 2011). It encompasses a range of factors, including the auditor's expertise, independence, and professional scepticism (Dechow et al., 2010). A high-quality audit is characterized by the following attributes:

- i. **Thoroughness:** The audit process should be comprehensive and cover all relevant aspects of the company's financial operations.
- ii. **Skill and Competence:** The auditors should possess the necessary skills, knowledge, and experience to effectively assess the company's financial statements.
- iii. **Independence:** The auditors should be free from conflicts of interest and maintain objectivity in their assessment of the company's financial statements.
- iv. **Professional Scepticism:** The auditors should adopt a questioning mindset and critically evaluate the evidence presented by the company.

By providing accurate and reliable financial information, high-quality audits help to reduce the information asymmetry between insiders and outsiders, leading to more efficient capital markets and lower costs of capital (Francis & Jaggi, 1990). When investors have access to more reliable information, they can make more informed investment decisions, reducing the overall risk in the market. Investors place significant trust in the auditor's opinion, and high-quality audits in still confidence in the integrity of a company's financial statements. This confidence can translate into increased investment and improved access to capital (Dechow et al., 2008). Companies with high-quality audits are often perceived as being more trustworthy and transparent, attracting investors who are willing to provide them with capital at lower rates.

High-quality audits are more likely to detect and prevent fraudulent activities, thereby safeguarding the company's assets and protecting its reputation (Arens et al., 2018). Fraudulent activities can have a devastating impact on a company's financial performance and reputation, and high-quality audits can serve as a deterrent against such activities. High-quality audits serve as a signal of strong corporate governance practices, attracting investors and enhancing the company's overall value (Deshpande & Sridhar, 2003). Strong corporate governance practices are associated with lower risk profiles and higher valuations, and high-quality audits can contribute to a company's overall governance framework.

Audit quality is a crucial determinant of a firm's financial health and stability. It affects the

reliability of financial reporting and, consequently, firm risk. Several proxies are commonly used to assess audit quality, including audit firm size, audit tenure, and audit fees. Each of these factors provides insights into the effectiveness and thoroughness of the auditing process.

2.1.2.1 Audit Firm Size

Audit firm size refers to the scale and capacity of the audit firm conducting the audit, typically measured by its market share, revenue, or number of clients. Generally, larger audit firms, such as the Big Four (Deloitte, PwC, EY, and KPMG), are perceived to provide higher audit quality. This is due to their extensive resources, specialized expertise, and rigorous audit methodologies (Francis, 2004). Their larger scale allows for more comprehensive audits, better internal controls, and more robust risk assessment procedures. The use of a larger audit firm is often associated with reduced firm risk. High-quality audits conducted by reputable firms enhance the reliability of financial statements, reduce information asymmetry, and decrease the likelihood of financial misstatements or fraud, thereby lowering firm risk (Chen, Firth, Gao, & Rui, 2006).

2.1.2.2 Audit Tenure

Audit tenure refers to the length of time an audit firm has been engaged to audit a particular company. It is the duration of the audit firm's relationship with the client. Long audit tenures can have mixed implications. On one hand, longer tenures might result in deeper familiarity with the client's operations and a more effective audit (Carcello, Hollingsworth, & Mastrolia, 2011). However, extended relationships might also lead to complacency, reduced skepticism, or diminished audit independence (Knechel & Vanstraelen, 2007). The effect of audit tenure on firm risk can be ambiguous. Longer audit tenures might be associated with lower risk if they reflect stable and effective auditing. Conversely, excessively long tenures might increase firm risk due to potential issues with audit quality and independence (Knechel, 2007).

2.1.2.3. Audit Fees

Audit fees are the payments made by a company to its audit firm for performing the audit services. These fees can vary based on the complexity of the audit, the size of the firm, and the scope of the work. Higher audit fees are often associated with higher audit quality. This is because larger fees may indicate a more comprehensive audit scope, greater auditor effort, and more extensive testing (Simunic, 1980). Higher fees may also reflect the auditor's ability to attract and retain skilled professionals. Increased audit fees can be indicative of better audit quality, which, in turn, can reduce firm risk. A well-compensated audit team is more likely to invest the necessary time and resources to identify and address potential issues, thereby enhancing the reliability of financial statements and reducing the likelihood of financial misstatements (Francis & Yu, 2009).

2.1.3. Transfer Pricing

Transfer pricing refers to the practice of conducting transactions involving products or services between subsidiary firms and their parent company, or between subsidiary companies that are part of multinational corporations (Lin & Chang, 2010). Moreover, Pangaribuan et al. (2021) assert that transfer pricing is closely linked to intercompany transactions involving related parties, resulting in the transfer of goods, services, or intellectual property between the parent company and its subsidiary, or vice versa. The use of business practices may provide advantageous outcomes

for the organization. Organizations have the potential to enhance their commercial competitiveness and enhance their ability to shift funds internally by using certain strategies. On the contrary, transfer pricing may also serve as a means to mitigate the tax burden borne by corporations (Lin & Chang, 2010). This implies that corporations may use transfer pricing as a strategy to evade taxation. The use of transfer pricing as a strategy for tax evasion has the potential to diminish the income generated inside a particular nation, Sebele-Mpofu et al., (2021).

2.1.3.1 Effective Tax Rate

The effective tax rate is a key financial metric that reflects the actual tax burden a company bears relative to its taxable income. It is calculated by dividing the total income tax expense by earnings before taxes, providing a comprehensive measure of a company's tax efficiency and compliance. In the intricate and ever-evolving landscape of corporate finance, the effective tax rate (ETR) stands as a pivotal metric gauging a company's financial performance and overall risk profile. The ETR, representing the percentage of a company's pre-tax income that it remits in taxes, holds significant implications for shareholder value, long-term business sustainability, and overall corporate reputation. However, the pursuit of an overly low ETR through aggressive transfer pricing practices can raise concerns about tax avoidance and expose companies to a spectrum of risks (Wei et al., 2018). Understanding the intricate interplay between ETR, transfer pricing aggressiveness, and firm risk is essential for investors, regulators, and companies alike. The ETR provides a snapshot of a company's tax efficiency, reflecting its ability to strategically manage its tax liabilities. Companies with a lower ETR may appear to be more financially attractive to investors, as they retain a larger portion of their pre-tax income.

2.1.3.2 Deferred tax Rate

Deferred tax provision is an accounting concept that represents the recognition of future tax consequences resulting from temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases (Schroeder et al., 2019). These temporary differences give rise to deferred tax assets or liabilities. DTPs can serve as a red flag for potential transfer pricing aggressiveness. Companies with unusually high DTPs relative to their industry peers may be engaging in aggressive transfer pricing practices to reduce their current tax burden. Investors, regulators, and other stakeholders should carefully scrutinize a company's DTPs as part of their overall risk assessment.

Transfer pricing aggressiveness can impact the recognition and measurement of deferred tax assets and liabilities. Shifting profits to low-tax jurisdictions may affect the timing and amount of future tax benefits or obligations, influencing the deferred tax provision (Hanlon & Heitzman, 2010). Aggressive transfer pricing strategies can introduce earnings volatility due to changes in deferred tax assets and liabilities. This volatility may lead to fluctuations in reported earnings, potentially affecting investor perceptions and confidence (Wei et al., 2018). Companies engaging in transfer pricing aggressiveness may face increased audit and regulatory scrutiny. Tax authorities globally are vigilant in monitoring transfer pricing practices, and deviations from arm's length principles may lead to challenges, potentially impacting deferred tax positions (Hanlon & Heitzman, 2010). Transfer pricing aggressiveness can directly influence the measurement of deferred tax assets and liabilities. The allocation of profits to low-tax jurisdictions may result in lower future taxable income in those jurisdictions, impacting the recognition of deferred tax liabilities (Wei et al.,

2018).

2.2. Theoretical Review

Agency Theory

The principle of the agency motivates the manager to administer the organisation with the objective of enhancing its overall worth. The manager strategically allocates the company's resources in order to optimise benefits for the owner. Within this particular circumstance, there exists a notable disagreement between often referred to as agency conflict. According to Lee et al. (2015), the principle thereafter directs the agent to continue doing business in accordance with his instructions, offering much more remuneration than the norm. Hence, managers actively seek strategies to enhance the company's performance and worth, with the aim of attaining the remuneration pledged by the owner. In this particular instance, one of the variables that requires careful examination is the net profit. The perception of a company's strong performance is often associated with the upward trend in profits, as seen by both owners and investors. Conversely, the decline in net profit might be attributed to the impact of operational expenditures. The imposition of taxes is a financial obligation can lead to a reduction in corporate earnings. Hence, managers contemplate strategies aimed at reducing the tax liability, one of which is the practise of tax evasion. This circumstance gives rise to a conflict of interest between management and owners of a corporation. The owner may face a disadvantage if the rise in earnings is derived by engaging in tax avoidance practises, since profits generated from the firm's core operational operations contribute to the overall development of the company. The pursuit of profit maximisation via tax evasion strategies by management may potentially impede the development trajectory of the organisation.

2.3. Empirical Review

2.3.1. Audit quality and firm risk

Sari et al. (2020) conducted an investigation into the correlation between audit quality and transfer pricing aggressiveness (TPAG). They also explored the influence of TPAG on company risk, as well as the indirect impact of audit quality on firm risk via TPAG. The study gathered data from publicly listed non-financial firms in three Southeast Asian nations, namely Indonesia, Malaysia, and Singapore, spanning the years 2014 to 2018. The dataset consisted of 1,470 firm-year observations and was analysed using panel data regression techniques. The findings suggest that multinational corporations that undergo audits conducted by reputable audit firms, often referred to as Big-N firms, have elevated levels of TPAG. Furthermore, it may be argued that organisations who implement a greater number of TPAG (Transfer Pricing and Advance Pricing Agreement) practises are more likely to have reduced firm risk. This is mostly due to the enhanced efficiency of their transfer pricing transactions. This study also emphasises that enhanced audit quality has an indirect effect on reducing business risk via its influence on TPAG.

The study conducted by Kenny and Yola (2022) aims to investigate the impact of corporate governance structures, political ties, and transfer pricing on tax aggression, specifically focusing on the measures of current effective tax rate (CETR) and book-tax differences (BTD). The theoretical framework used in this research is agency theory. The study's sample consists of manufacturing businesses that are publicly listed on the Indonesia Stock Exchange over the period of 2014-2019. The research used a purposive sampling technique and utilised multiple linear

regression as the method of data analysis. The findings of the study utilising the cash effective tax rates (CETR) proxy indicate that the presence of an independent board positively influences tax aggressiveness, while the audit committee has a negative impact on tax aggressiveness. Furthermore, the study reveals that political connections do not exert any significant influence on tax aggressiveness, and transfer pricing also does not have a discernible effect on tax aggressiveness. The findings of the study utilising a book-tax difference (BTD) proxy indicate that the presence of independent commissioners does not exert an influence on tax aggressiveness. However, audit committees demonstrate a positive association with tax aggressiveness.

Moreover, the study reveals that political connections do not have a significant impact on tax aggressiveness, and similarly, transfer pricing does not exhibit a notable effect on tax aggressiveness. The findings of this research suggest that it is advisable for corporations to adhere to government-established tax rules in order to engage in tax planning within the framework of relevant legislation.

Ilham et al. (2022) conducted an empirical investigation to examine the influence of transfer pricing on tax evasion. The researchers used the variable of audit quality as a moderating factor in order to evaluate its impact on the association between transfer pricing and tax evasion. The research was centred on a cohort of manufacturing companies that are publicly traded on the Indonesia Stock Exchange. The selection of these companies was done using a purposive sampling approach. In order to examine the impact of transfer pricing factors on the occurrence of tax evasion, as well as the potential moderating role of audit quality, the researchers used multiple linear regression analyses. The study's results demonstrate a correlation that is favourable between transfer pricing and the practise of tax avoidance. This study offers significant insights on the use of transfer pricing practises by firms as a means of tax avoidance, with the objective of reducing their corporate tax liabilities. Nevertheless, the research conducted does not provide empirical support for the proposition that the competence of auditors may effectively alleviate the practise of transfer pricing carried out with the intention of evading taxes.

The study conducted by Santosa et al (2023) investigates the impact of related party transactions (RPTs) on the pre-tax profit margin (PPM). This study examines the moderating influence of audit quality and business size within a comprehensive panel dataset of Indonesian-listed enterprises. The study examines a subset of three prominent corporate organisations over the period from 2010 to 2021. The analysis uses the Generalised Method of Moments (GMM) estimator to account for the presence of Profit per Member (PPM) as a surrogate measure for taxable income. The authors of this research provide evidence that the variables PPM(t-1) and RPT Sales have a substantial negative influence on businesses' PPM, which aligns with the incentive alignment theory. However, it may be seen that RPTs (Related Party Transactions), RPT Loan, and RPT Receivables have a beneficial impact. Additionally, our analysis reveals that the quality of audits has a substantial effect on the relationship between RPT Loan and RPT Receivables with the PPM, both adversely and favourably. However, it diminishes the associations between RPTs, RPT Sales, and RPT Expenses. Additionally, the impact of related party transactions (RPTs) on private placement memorandums (PPMs) is diminished by the size of the business. The phenomena of RPTs and tax evasion in corporate finance are intricate and multidimensional. The potential influence of supplementary business groups and factors on the relationship between taxable income and the business group may be characterised by moderating and mediating effects. It is essential for

stakeholders, particularly the government, to exercise complete oversight and regulation over RPTs operations, with a specific focus on the various forms of RPT Sales and RPT Expenses transactions.

The research conducted by Lungu et al. (2023) examines the relationship between the implementation of a quality audit and the practise of corporate tax evasion. The research technique consisted of two fundamental parts. The first phase included doing a bibliometric study to examine the relevant scholarly literature. During the subsequent phase, the researchers conducted an exploratory examination of the Key Audit Matters (KAMs) that were declared by European Union companies listed between the years 2016 and 2021. The investigation was conducted using data obtained from the Web of Science and Audit Analytics databases. Based on the findings, it is recommended that more emphasis be placed on examining the relationship between Key Audit Matters (KAMs) communicated by auditors in extended audit reports and the indication of corporate tax evasion using various tax planning criteria. Simultaneously, the research emphasises the significance of amassing data pertaining to Key Audit Matters (KAMs) disclosures, as it may facilitate the development of a shared knowledge base about KAMs and their effective utilisation as communication instruments among auditors, management, stakeholders, and governmental entities.

2.3.2. Effective tax rate and firm risk

The study conducted by Kenny and Yola (2022) investigated the impact of corporate governance structures, political ties, and transfer pricing on tax aggression, specifically focusing on the measures of current effective tax rate (CETR) and book-tax differences (BTD). The theoretical framework used in this research is agency theory. The study's sample consists of manufacturing businesses that are publicly listed on the Indonesia Stock Exchange over the period of 2014-2019. The research used a purposive sampling technique and utilised multiple linear regression as the method of data analysis. The findings of the study utilising the cash effective tax rates (CETR) proxy indicate that the presence of an independent board positively influences tax aggressiveness, while the audit committee has a negative impact on tax aggressiveness. Furthermore, the study reveals that political connections do not exert any significant influence on tax aggressiveness, and transfer pricing also does not have a discernible effect on tax aggressiveness. The findings of the study utilising a book-tax difference (BTD) proxy indicate that the presence of independent commissioners does not exert an influence on tax aggressiveness. However, audit committees demonstrate a positive association with tax aggressiveness. Moreover, the study reveals that political connections do not have a significant impact on tax aggressiveness, and similarly, transfer pricing does not exhibit a notable effect on tax aggressiveness. The findings of this research suggest that it is advisable for corporations to adhere to government-established tax rules in order to engage in tax planning within the framework of relevant legislation.

2.3.3. Deferred tax rate and firm risk

In their study, Supriyati et al. (2021) investigate the impact of many factors, including tax evasion, bonus system, debt covenant, tunnelling incentive, audit quality, multinationality, foreign ownership, and firm size, on transfer pricing. The research population for this study comprises some listed multinational companies in Nigeria, during the year of 2012-2023. However, the gathered data spans a broader timeframe. This study employs a methodology that encompasses descriptive statistical analysis, classical assumption testing, and hypothesis testing. The use of a regression test is employed to evaluate and validate the hypotheses. The findings of the study

indicate that transfer pricing decisions are significantly influenced by tax evasion, debt covenant, and firm size. Multinationality, foreign ownership, and audit quality are identified as key elements in the determination of transfer pricing choices. In contrast, the impact of bonus system and tunnelling incentive on transfer pricing choices is shown to be insignificant. The findings of this study indicate that the transfer price choice is influenced by several variables. One individual employed inside the organisation and the remaining individuals contracted from an external organisation. Transfer pricing is a strategic mechanism used to effectively attain certain objectives. Given the dynamic nature of the business landscape and the persistent endeavours of multinational enterprises (MNEs) to reduce their tax liabilities by means of income shifting, Favourate, et al (2021) undertake an evaluation of the determinants influencing the efficacy of transfer pricing (TP) audits and dispute resolutions as mechanisms to bolster compliance and enforcement in developing nations, with particular emphasis on the case of Zimbabwe. The findings of this study indicate many factors that contribute to the challenges in the field of transfer pricing. These include the absence of clear and unambiguous regulations pertaining to transfer pricing, limitations imposed by resource restrictions and the intricate nature of transactions, insufficient competence in handling transfer pricing matters, and a scarcity of comparable data for reference purposes. It is advisable for developing nations to establish well-defined transfer pricing legislation and allocate resources towards enhancing the capabilities of tax agencies.

2.4. Gap in the Literature

The literature reviewed provides valuable insights into various aspects of transfer pricing, tax evasion, and audit quality in different contexts, including Indonesia, Southeast Asian nations, and Zimbabwe. However, a noticeable gap exists in the literature concerning the specific context of Nigeria, particularly in investigating the effects of audit quality and transfer pricing aggressiveness on firm risk for listed multinational companies.

While the studies above shed light on the relationships between related party transactions, audit quality, transfer pricing, and tax risk, the absence of research focused on Nigeria limits the general application of these findings to the Nigerian business environment. Nigeria, as a significant player in the African economy with a diverse multinational business landscape, presents a unique context that warrants specific attention.

3. METHODOLOGY

This study adopted an ex-post facto research design. This is a kind of research strategy in which the researcher makes use of the data that has already been supplied from previous events. The population of the study comprises thirty-two (32) multinational corporations that were listed on the stock market in Nigeria as of the 31st of December 2022. Convenience sampling was utilized to pick a sample from the whole population due to availability of data, which then serve as the study's sample. The study selected 10 listed multinational companies as sample for this research. This study concentrated on 10 listed Multinational Companies listed on Nigeria Exchange Group whose information was easily obtainable and published up to date in the annual reports. The companies' annual reports and financial statements from 2013-2022 were utilised as secondary data. The goal is to rule out any possibility of the study's data becoming inaccessible. The data were analysed using descriptive statistics such mean, standard deviation, skewness, kurtosis, jaqubera statistics, and panel regression model.

Model Specification

To examine the effect of audit quality on firm risk of listed multinational companies in Nigeria, the following model is estimated:

Model 1

$$FR = \alpha_0 + \beta_1 ATY + \beta_2 AF + \beta_3 AT + \varepsilon_1$$

Where:

FR= Firm Risk

ATY=Audit type

AF= Audit fee

AT= Audit tenure

α_0 = Constant

Σ = Stochastic Error Term

$\beta_1, \beta_2, \beta_3$ = The Coefficients of the Independent variable

The *a-priori* expectation= $\beta_1, \beta_2, \beta_3 > 0$, the implication of this is that there is a positive relationship expected between the explanatory variables and explained variables.

Model 2

To examine the effect of transfer pricing aggressiveness on firm risk of listed multinational companies in Nigeria, the following model is estimated below:

$$FR = \alpha_0 + \beta_1 RPT + \beta_2 ETR + \beta_3 DTR + \varepsilon_{it}$$

Where:

FR = Firm Risk

RPT= Related Party Transaction

ETR= Effective tax rate

DTR= Deferred tax rate

α_0 = Constant

Σ = Stochastic Error Term

β_1, β_2 = Coefficients of the Independent Variable

The *a-priori* expectation= $\beta_1, \beta_2 > 0$, the implication of this is that there is a positive relationship expected between the explanatory variables and explained variables.

4. RESULTS AND INTERPRETATION

The results presented in Table 1 provide a detailed descriptive analysis of the data used in this study, highlighting the characteristics of both independent and dependent variables. The independent variables such as audit type (ATY), auditor tenure (AUD_T), audit fees (AF), related parties' transaction (RPTS), deferred tax rate (DTR), and effective tax rate (ETR) display varying degrees of central tendency and dispersion. The mean values range from 0.0026 (ETR) to 4.4443 (AF), and the standard deviations indicate differing levels of variability, with DTR showing the highest variability (0.7939) and ETR the lowest (0.0086). Skewness and kurtosis values reveal that most variables are negatively skewed, except for ETR, which is positively skewed, and exhibit varying kurtosis levels, with FR showing an extremely peaked distribution (57.290). The Jarque-Bera test results indicate significant deviations from normality for most variables, except AF, which appears closer to a normal distribution. The dependent variable, firm risk (FR), has a mean of 3.2435 and a median of 0.0997, with high variability (standard deviation of 18.7335) and

significant positive skewness and kurtosis, suggesting a highly skewed and peaked distribution, further confirmed by the significant Jarque-Bera test result. Each variable has 100 observations, which indicate that there is consistency in the dataset.

4.1.1 Descriptive Analysis

Table 1: Showing the descriptive analysis

	Mean	Median	Std. Dev.	Skewness	Kurtosis	Jarque-Bera	Probability	Obs
ATY	0.670000	1.000000	0.472582	-0.72308	1.522840	17.80568	0.000136	100
AUD_T	0.740000	1.000000	0.440844	-1.09431	2.197505	22.64174	0.000012	100
AF	4.444342	4.482716	0.477944	-0.04902	2.135846	3.151563	0.206846	100
RPTS	0.490300	0.529000	0.273261	-0.78372	2.604536	10.88862	0.004321	100
DTR	0.301617	0.212308	0.793893	-1.16736	10.37881	249.5739	0.000000	100
ETR	0.002646	0.002096	0.008553	2.016765	34.72959	4262.652	0.000000	100
FR	3.243474	0.099721	18.73348	7.109168	57.28956	13122.99	0.000000	100

Source: Researcher's Computation 2024

The Variance Inflation Factor (VIF) results in Table 2 assess multicollinearity among the variables. The uncentered VIF values indicate moderate multicollinearity for all variables, with values ranging from 1.319351 (DTR) to 9.022177 (constant term C). However, the centered VIF values, which provide a more accurate measure by accounting for the overall model structure, are all below 2, suggesting no severe multicollinearity issues. Specifically, ATY (1.409691), AT (1.062323), AF (1.346812), RPTS (1.145023), DTR (1.151469), and ETR (1.259930) all exhibit centered VIFs well below the commonly accepted threshold of 10, indicating that multicollinearity is not a significant problem in this dataset.

Variance Inflation Factor

Table 2: Showing Variance Inflation Factor for multicollinearity among the Variable

	Uncentered	Centered
Variable	VIF	VIF
ATY	4.271791	1.409691
AT	4.085858	1.062323
AF	7.900807	1.346812
RPTS	4.868501	1.145023
DTR	1.319351	1.151469
ETR	1.381736	1.259930
C	9.022177	NA

Source: Researcher's Computation 2024

The correlation matrix in Table 3 illustrates the relationships among the variables FR, ATY, AT, AF, RPTS, DTR, and ETR. Firm Risk (FR) has weak and insignificant correlations with all other variables, with the highest correlation being with AT (-0.172458, $p=0.0862$). Audit Type (ATY) shows a significant positive correlation with Audit Fees (AF) (0.437517, $p=0.0000$) and a significant negative correlation with Related Parties Transaction (RPTS) (-0.239670, $p=0.0163$).

Auditor Tenure (AT) has insignificant correlations with other variables. Audit Fees (AF) shows a negative but insignificant correlation with AT (-0.146225, $p=0.1466$) and positive but insignificant correlation with Deferred Tax Rate (DTR) (0.132133, $p=0.1900$). RPTS is positively correlated with Effective Tax Rate (ETR) (0.211599, $p=0.0346$) and shows weak correlations with other variables. DTR has a significant positive correlation with ETR (0.320232, $p=0.0012$). Overall, the correlations are weak to moderate, indicating no severe multicollinearity among the variables, which is essential for reliable linear regression analysis.

4.1.3 Correlation matrix

Table 3: showing Correlation among the variables

Variables	FR	ATY	AT	AF	RPTS	DTR	ETR
FR	1.000000						

ATY	-0.055224	1.000000					
	0.5853	----					
AT	-0.172458	0.068848	1.000000				
	0.0862	0.4961	----				
AF	0.018632	0.437517	-0.146225	1.000000			
	0.8540	0.0000	0.1466	----			
RPTS	0.000231	-0.239670	-0.060640	-0.118001	1.000000		
	0.9982	0.0163	0.5490	0.2423	----		
DTR	-0.147962	0.107334	0.082403	0.132133	0.054916	1.000000	
	0.1418	0.2878	0.4150	0.1900	0.5874	----	
ETR	-0.156318	0.160438	0.109248	-0.065179	0.211599	0.320232	1.000000
	0.1204	0.1108	0.2793	0.5194	0.0346	0.0012	----

Source: Researcher's Computation 2024

Table 4 presents the results of the Breusch-Godfrey Serial Correlation LM Test, which assesses the presence of serial correlation in the residuals of a regression model. The F-statistic value is 0.593958 with a corresponding p-value of 0.7253, indicating that the null hypothesis of no serial correlation cannot be rejected at conventional significance levels. Similarly, the Obs*R-squared statistic is 1.128493 with a p-value of 0.5902, further supporting the absence of serial correlation. These results suggest that there is no significant evidence of serial correlation in the residuals, implying that the regression model's error terms are independent and the model is appropriately specified for further analysis.

Table 4: Breusch-Godfrey Serial Correlation LM Test

F-statistic	0.593958	Prob. F(3,18)	0.7253
Obs*R-squared	1.128493	Prob. Chi-Square(2)	0.5902

Source: Researcher's Computation 2024

Table 5 presents the results of the Breusch-Pagan-Godfrey heteroskedasticity test, which assesses whether the variance of the errors in a regression model is constant (homoskedastic) or varies (heteroskedastic). The F-statistic is 2.342634 with a corresponding p-value of 0.2954, and the Obs*R-squared statistic is 3.857590 with a p-value of 0.2187. Both p-values are above the conventional significance level of 0.05, indicating that we cannot reject the null hypothesis of homoskedasticity. Therefore, the test results suggest that there is no significant evidence of

heteroskedasticity in the model, implying that the variance of the residuals is constant and the model assumptions are valid for reliable inference.

Table 5: Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	2.342634	Prob. F(2,38)	0.2954
Obs*R-squared	3.857590	Prob. Chi-Square(2)	0.2187

Source: Researcher's Computation 2024

In line with the pre-estimation tests, the study interprets the output of the fixed effect model examining the relationship between audit quality and firm risk for listed multinational companies in Nigeria. Table 6 shows that audit type (ATY) and auditor tenure (AT) have positive and significant coefficients (9.247329, $p=0.0464$ and 6.698724, $p=0.0208$, respectively), indicating a significant impact on firm risk. However, audit fees (AF) and the constant term (C) are not statistically significant, with p -values of 0.1562 and 0.0658, respectively. The Hausman test show that Fixed effect model is better to be interpreted. The model explains about 51.78% of the variability in firm risk, as indicated by the R-square value, and 48.40% when adjusted for the number of predictors. The overall model is significant (F-statistic = 1.627871, $p=0.005909$), and the Durbin-Watson statistic of 1.513575 suggests no severe autocorrelation in the residuals. These results suggest that certain aspects of audit quality such as audit type and audit tenure significantly influence firm risk. Therefore, the study rejected hypothesis 1 and 2, however reject hypothesis 3.

Table 6: Fixed Regression model for the effect of audit quality on firm risk of listed multinational companies in Nigeria

Variables	Coefficient	t-statistics	P.value
ATY	9.247329	0.715707	0.0464
AT	6.698724	1.416106	0.0208
AF	34.87092	1.939182	0.1562
C	152.2750	1.867041	0.0658
R-square	0.517804		
Adjusted R-Square	0.484007		
F-statistics	1.627871		
P.value	0.005909		
Durbin-Watson Sta.	1.513575		
Hausman Test	0.0392		

Source: Researcher's Computation 2024

Table 7 presents the results of the Breusch-Godfrey Serial Correlation LM Test, a diagnostic tool used to assess whether there is serial correlation in the residuals of a regression model. The F-statistic, which measures the overall significance of the test, is 0.290494, with a corresponding p -value of 0.4896. Additionally, the Obs*R-squared statistic is 1.643085, with a p -value of 0.3851. Both p -values exceed the conventional significance level of 0.05, suggesting that we fail to reject the null hypothesis of no serial correlation. These results indicate that there is no significant evidence of serial correlation in the residuals of the model, implying that the model's error terms are independent and the regression analysis is reliable.

Table 7: Breusch-Godfrey Serial Correlation LM Test

F-statistic	0.290494	Prob. F(4,20)	0.4896
Obs*R-squared	1.643085	Prob. Chi-Square(4)	0.3851

Source: Researcher's Computation 2024

Table 8 presents the results of the Breusch-Pagan-Godfrey heteroskedasticity test, evaluating whether the variance of the errors in a regression model is constant (homoskedastic) or varies (heteroskedastic). The F-statistic is 4.879952 with a corresponding p-value of 0.4951, and the Obs*R-squared statistic is 6.231057 with a p-value of 0.3859. Both p-values exceed the typical significance threshold of 0.05, indicating that the null hypothesis of homoskedasticity cannot be rejected. Therefore, the results suggest no significant evidence of heteroskedasticity in the model, implying that the variance of the residuals is constant across the range of predicted values. This implies that the model's assumptions are satisfied, and the inference drawn from the model is reliable.

Table 8: Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	4.879952	Prob. F(3,24)	0.4951
Obs*R-squared	6.231057	Prob. Chi-Square(3)	0.3859

Source: Researcher's Computation 2024

The regression results in Table 9 show the impact of related parties transactions (RPTS), deferred tax rate (DTR), and effective tax rate (ETR) on firm risk (FR). RPTS has a positive coefficient of 3.152775 with a t-statistic of 0.395675 and a significant p-value of 0.0393, indicating that an increase in related parties' transactions leads to a corresponding increase in firm risk. DTR, on the other hand, exhibits a negative coefficient of -3.989857 with a t-statistic of -1.551807 and a non-significant p-value of 0.2944, suggesting an insignificant negative relationship between deferred tax rate and firm risk. ETR demonstrates a positive coefficient of 3.128259 with a t-statistic of 1.305387 and a significant p-value of 0.0153, indicating that an increase in effective tax rate is associated with higher firm risk. Overall, the model explains approximately 69.51% of the variability in firm risk, with an adjusted R-square of 55.25%. The F-statistic of 2.232330 is significant at the 0.05 level, indicating that the overall model is useful in explaining the variation in firm risk. The Durbin-Watson statistic of 1.875566 suggests no significant autocorrelation in the residuals, and the Hausman test with a p-value of 0.0812 indicates that the random effects model may be appropriate.

Table 9: Random Effects Model for the effect of transfer pricing aggressiveness on firm risk of listed multinational companies in Nigeria

Variables	Coefficient	t-statistics	P.value
RPT	3.152775	0.395675	0.0393
DTR	-3.989857	-1.551807	0.2944
ETR	3.128259	1.305387	0.0153
C	4.706366	1.049275	0.2970
R-square	0.695064		
Adjusted R-Square	0.552479		
F-statistics	2.232330		
P.value	0.032228		

Durbin-Watson Sta.	1.875566
Hausman Test	0.0812

Source: author's Computation 2024

5. DISCUSSION OF FINDINGS

The findings of the study revealed that audit quality, audit type, and audit tenure statistically and significantly influence firm risk. This result could be attributed to several factors. High audit quality, often associated with certain audit types (e.g., Big Four auditors) and longer audit tenure, likely enhances the accuracy and reliability of financial reporting. This, in turn, reduces information asymmetry and potential misstatements, thereby lowering firm risk. Furthermore, consistent and high-quality audits can strengthen investor confidence, improve internal controls, and ensure compliance with regulatory standards, all of which contribute to mitigating firm risk. Additionally, longer auditor tenure may lead to a better understanding of the firm's operations and financial intricacies, enhancing the auditor's ability to detect and address potential risks effectively. The study supports the findings of Santosa et al. (2023), who reveal that the quality of audits has a substantial effect on the relationship between RPT Loan and RPT Receivables with the PPM, both adversely and favorably. The study by Sari, Siregar, Martani, and Wondabio (2020) reveals that audit quality has an indirect effect on reducing business risk via its influence on TPAG.

The findings of the study show that there is a significant impact of transfer pricing aggressiveness (related party transactions (RPTS) and effective tax rate (ETR)) on firm risk (FR). The result indicating that transfer pricing aggressiveness, as indicated by related party transactions (RPTS) and effective tax rate (ETR), significantly impacts firm risk (FR) could be due to several factors. Aggressive transfer pricing strategies often involve manipulating prices of intra-company transactions to shift profits to low-tax jurisdictions, which can lead to increased scrutiny and potential penalties from tax authorities. This scrutiny and the associated legal and financial risks can elevate firm risk. Additionally, firms engaging in aggressive transfer pricing may face reputational damage if perceived as evading taxes, which can further contribute to overall risk. The effective tax rate (ETR) reflects the tax burden of a firm, and a lower ETR through aggressive tax planning can indicate higher risk-taking behavior, leading to potential financial instability and increased firm risk. The findings support the research outcome of Supriyati, Dewi, and Kadek (2021), who indicate that transfer pricing decisions are significantly influenced by tax evasion, debt covenants, and firm size.

6. CONCLUSION

These factors collectively contribute to a more stable and trustworthy financial environment, thereby reducing firm risk. The study concluded that High-quality audits are essential in identifying and mitigating potential risks, enhancing the reliability of financial statements, and fostering investor confidence. Also, choose reputable and well-established audit firms, is preferable those with a strong international presence and recognition need to handle audit work of multinational companies. Additionally, it is concluded that Multinational companies need to establish a rotation policy that retains the benefits of experienced auditors while periodically introducing new auditors to provide fresh insights and challenge existing practices.

7. RECOMMENDATIONS

The following recommendations are made based on the finding of the study

1. Multinational companies should conduct a comprehensive evaluation of potential audit firms, ensuring that they thoroughly vet each candidate based on several critical factors. This evaluation process should prioritize the reputation of the audit firm within the industry, as a strong reputation is often indicative of high standards of professionalism and reliability. Additionally, the track record of the audit firm should be scrutinized in detail, with particular attention paid to their past performance, the quality of their audits, and any instances of regulatory or compliance issues.
2. Investor should critically evaluate the audit quality of multinational companies before making investment decisions and Pay attention to the type and reputation of the audit firms engaged by multinational companies.
3. Stakeholders should analyze the audit tenure policies of multinational companies to understand their impact on financial reporting. By evaluating these policies, stakeholders can assess the likelihood of audits being conducted with the necessary rigor and independence, which is crucial for reliable financial reporting and effective risk management.

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