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EFFECT OF AUDIT FIRM SIZE AND AUDIT TENURE ON AUDIT QUALITY OF SELECTED LISTED FIRMS IN NIGERIA

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ABSTRACT:

The collapse and demise of companies with highly rated market status in both developed and developing countries has made stakeholders to raise questions about factors that affect audit reporting especially in Nigeria. This study examines the effect of audit firm size and audit tenure on audit quality of selected listed non-financial firms in Nigeria. The study anchors on theory of rational expectations because it emphasizes that duties and responsibilities of the auditors are derived from the confidence and trust that the public bestowed on the success of the audit and the assurance given by the auditor. The study adopts ex post facto research design. As at 31st December 2020, ninety - five (95) non-financial firms were listed on the Nigerian Exchange Group floor. The study used purposive sampling technique to select a sample size of 67 listed non-financial firms in Nigeria. Outcome of the analysis conducted in the study showed that audit firm size has a significant and positive effect on audit quality of the sampled firms while auditors' tenure has a positive but insignificant effect on audit quality of the sampled non-financial firms listed on the Nigerian Exchange Group. Since audit firm size has significant positive effect on audit quality, the study recommends that small audit firms should be encouraged to be more diligent in their audit assignment while the big four audit firms should sustain quality of their audit report.

Key words: *Audit firm size, Audit quality, Audit tenure, Nigerian Exchange group, Non financial firms.*
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1. INTRODUCTION

Audit serves as a means of checking books of account or records of account maintained by entrepreneurs to enable a judgment to be made on the true and fairness of financial reports prepared by entrepreneurs or her management. Schilder and Wallage (2005) are of the opinion that carrying on audit exercise lends credibility to financial reports. The audit process is designed to determine whether the numbers and descriptions included in financial reporting represents the firm's true financial position and its operating results in a fair manner. Audit quality describes how well an audit detects and reports material misstatements (including intentional and unintentional errors) in financial statements, reduces information asymmetry between management and stockholders and helps to protect the interests of stockholders (Chen, Kim, Liu & Simmic, 2006). Thus, enhancing audit quality readily gives reasonable assurance about the accuracy of reported financial results even as a low level of audit quality would impair earnings quality and discretionary accruals (Chen & Lin, 2008). The auditor as an umpire between management and dispersed owners, is expected to report about the true position of the audited firm. The continuous discourse on the quality of audit amidst the incidences of financial reporting scandals across the globe which seem to have been a recurring stance may have impaired the perception of third parties and users of accounting information on the quality state of audit services rendered by auditors and the accountant (Mgbame, Eragbhe & Osazuwa, 2012). The collapse and demise of companies like Enron, Cadbury PLC, WorldCom, Africa Petroleum and some Nigerian deposit money banks clearly shows the ugly side and implications of poor audit (Hauwa, Ocheni & Muktar, 2017).

In Nigeria, for instance, during the investigation process of Cadbury corporate fraud, Akintola Willian and Deloitte was indicted for poor audit and involvement in cooking of the financial statement. Poor audit can bring misinformation to stakeholders about the true financial standing of a firm and could lead to conflict of interests among the management and owners of the business. Over the past few years, corporate failures observed in Nigeria have continued to raise burning question on the relevance and reliability of audit reports, especially where shareholders interest is not protected (Egbunike & Abiahu, 2017). Accordingly, audit quality can be traced to quality of audit personnel in audit firms that is commissioned to audit a firm (Zureigat, 2011). Suyono (2012) noted that quality of an audit depends on several audit firm attributes such as auditor independence, auditor experience, and auditor accountability, audit firm size as well as other attributes of audit firms that borders on whether auditors with international affiliation or local can play crucial role on the report of audit quality.

Previous studies such as Wallace (1980); Chinwe and Okafor (2012); Salehi and Kangarlouei, (2010); Rezaei and Shabani, 2014; Aliyu and Ishaq, (2015) proxied audit firm attributes with audit fee, audit firm size, audit delay, auditors independence, auditors' tenure amid proxing audit quality with market value of firm share, auditor's independence, audit fee and audit committee. There are mixed conclusions and this has made the various findings inconsistent on how firm attributes affects audit quality. While some researchers contend that it is only the core attributes of audit quality such as auditor's independence, audit fee and audit committee that have the potentiality of influencing audit quality, others oppose such views. Indeed, lack of consensus among contemporary scholars on the effect of audit firm attributes on audit quality has continued to generate academic debate. However, most of the previous studies cover the period of 1986 to 2017. To this extent, the Researchers of this present study are not aware of any empirical study on audit firm attributes and audit quality of listed firms in Nigeria that covered up to year 2020.
Therefore, this study tends to ascertain the effect of audit firm size and audit tenure on audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX).

1.1 Objectives of the Study

The study seeks to ascertain the extent to which audit firm size and auditors' tenure affect audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX). Specifically, it intends to:

1. To ascertain whether Audit firm size has any significant effect on audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX);
2. To determine the extent to which Auditor's tenure affects audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX).

1.2 Hypotheses

This study will be guided by the following null hypotheses:

H_o: Audit firm size has no significant effect on audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX);

H_o: Auditor's tenure has no significant effect on audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX).

2. LITERATURE REVIEW

2.1 Theoreticall Review

2.1.1 Theory of Inspired Confidence/Rational Expectations

Theodore Limperg of the University of Amsterdam in 1926 propounded a theory known as the theory of Inspired Confidence that was later ultimately transformed into theory of rational expectations. Limperg (1926) in Millichamp and Taylor (2012) supposed that the work performed by the auditor ought to be guided by the realistic expectation of the users of audit reports and the expectations should not be dashed by the auditor. Limperg stresses on the social usefulness of auditors report in meeting societal expectations for reliable financial information. The auditor must meet the expectations of the rationally well knowledgeable layman but should not create unrealistic expectations that cannot be justified by the work carried out. The auditor thus has a broader duty to the society than a mere a watchdog for the shareholders (Millichamp & Taylor, 2012).

According to Carmichael (2004), the confidence that the society has in audited financial statements is misplaced when the audit process fails to address the societal expectations giving rise to a loss in the value relevance of the audit. The study anchored on this theory because it emphasize that duties and responsibilities of the auditors are derived from the confidence and trust that the public bestowed on the success of the audit and the assurance given by the auditor.

2.2 Empirical Review

Daniela and Reiner (2020) examined how non audit services provided by auditors affect audit quality of their client..The study focused on German listed firms between 2006 and 2013. The study found that fees collected by auditors for non audit services is higher than the audit fees and it have negative significant on audit quality.

Enekwe, Udeh and Okwo (2020) investigated the influence of attributes of audit quality on return on assets of selected quoted manufacturing firms in Nigeria from 2006 to 2016. The study found that audit firm size had a positive and significant effect on return on assets.

Okolie; Izedonmi and Enofe (2013) studied audit tenure and earnings management of quoted non-financial companies in Nigeria for the period of 2007 to 2017. The study found a positive significant relationship between audit tenure and earning management.

Morteza (2014) investigated the joint effect of audit firm tenure, auditor reputation, auditor independence and auditor professional competence and due care on quality audit of firms listed in the Nairobi Securities Exchange in Kenya. A descriptive research design was used. The researcher

used primary and secondary data for a period of five years between 2011 and 2015. The study found a significant positive relation between auditor independence, auditor professional competence and audit quality but significant negative relationship between audit tenure and audit quality.

Odia (2015) examined the effect of auditor tenure, auditor rotation on audit quality. This study was done based on theoretical review. From researches reviewed, long term auditors tend to be better than new auditors and thereby provide no support of audit rotation. It also found that short audit tenure associates with low quality of audit while long tenure audit results in high audit quality.

Listya and Sukrisno (2014) investigated the influence of auditor's independence, audit tenure and audit fee on audit quality of members of capital market accountant forum in Indonesia. The study used primary data collected through questionnaire from 143 respondents. Linear regression model was employed for the study. The results indicate that auditor's independence and audit fee have positive significant effect on audit quality while audit tenure has no significant effect on audit quality.

3. MATERIAL AND METHOD

The study adopted the ex post facto research design. The population of the study was made up of non-financial firms listed on the Nigerian Exchange Group (NGX). As at 31st December 2020, ninety - five (95) non-financial firms were listed on the Nigerian Exchange Group floor. The study used purposive sampling technique to select the sample population. This sampling technique will be used to enable researcher to select firms that he can conveniently assess their data. Non-financial firms that have not operated on the floor of Nigeria Exchange Group for the period of ten years (2011 to 2020) were excluded from the sample population. Hence, the sample size was 67 listed Non-financial firms in Nigeria (See Appendix I for list of sampled firms). The Ordinary Least Square (OLS) multiple regression was adopted to examine the effect of audit firm attributes on audit quality of selected manufacturing firms listed on Nigerian Stock Exchange.

3.1 Decision Rule

As a rule of thumb, the null hypothesis (H_0) is rejected if the calculated value of any of the statistical tools adopted in this study is greater that the critical/table value, at 5% level of significance, otherwise H0 is accepted. Alternatively, if P-value is equal to or less than the chosen significance level (5%), we reject the null hypothesis (H_0) and accept the alternative hypothesis (H_1), otherwise the H_0 is accepted.

4. RESULT AND DISCUSSIONS

4.1Data Analysis

Normality Test

The normality test was carried out using Jarque-Bera Test at 5% level of significance. The test result is shown below.

Table 1: Normality Test for the Variables

	Audit firm size	Auditor tenure
Jarque-Bera	185.4479	234.9116
Probability	0.000000	0.000000
Observations	1110	1110

Source: Analysis Output (2021)

To establish whether the residuals are normally distributed the study adopted the Jarque-Bera test which is a more conclusive test than the graphical inspection approach of testing for normality. The results in Table1 indicate the results of the Jarque-Bera test for the six variables. The null hypothesis under this test is that the residuals are significantly from a normal distribution. Given that the p-values are all less than 5% for the residual, the null hypothesis is rejected and thus the conclusion that the residuals are not normally distributed. Satisfying this assumption of normality allows statistical hypothesis testing that generates reliable confidence intervals and prediction intervals. However, it is not compulsory that the error term or residuals must follow a normal distribution for Least Squares Regression to produce unbiased estimates with the minimum variance.

4.2 Test of Hypothesis

The Unit Root Test Results was obtained with the use of Augmented Dickey-Fuller (ADF). The test results are presented in Table 2 below.

Table 2: Summary of Unit Root Test Results Using Augmented Dickey-Fuller

Variables	T-ADF	Lag Length	Test critical values:@ 5% Level	Prob.	Remark
Audit Firm Size	-9.401177	1(0)	-2.863936	0.0000	Stationary
Auditor Tenure	-25.87608	1(0)	-2.863939	0.0000	Stationary

Source: Author's Computations (2021)

The decision rule is to reject the null hypothesis and accept the alternate hypothesis if T-ADF is more than the critical using absolute values. Unit root test result shows that all of the variables (audit firm size and auditors' tenure) are stationary at levels, justifying the uniformity of the data. Hence, since all the variables are stationary, the null hypothesis is rejected while the alternate hypothesis was accepted, which indicates that the variables are stationary or got no unit root. That means we can go on with using the data for further analysis.

H_0: Audit firm size has no significant effect on audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX).

Audit Firm Size has a positive coefficient of 23377.01. This implies that an increase in Audit Firm Size by 1 unit will increase the Audit Quality of non – financial listed firms by 23377.01.This agrees with the expectation that engaging one of the Big4's will result in increased audit fees, and consequently enhanced audit quality. Since the prob(z) = 0.000 for Audit Firm Size is less than 0.05, the alternate hypothesis was accepted. In conclusion, *Audit firm size has a positive and significant effect on audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX).*

H_0: Auditors' tenure has no significant effect on audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX).

Auditors' tenure has a positive coefficient of 126.6864. This implies that an increase in Auditors' tenure by 1 unit will increase the Audit Quality of non – financial listed firms by 126.6864. This agrees with the expectation that increased audit tenure enables the auditors get familiarized with the audit engagement in a way that makes the audit task more effective. Since the prob(z) = 0.9619for Auditors' tenure is greater than 0.05, the null hypothesis was accepted. In conclusion, *Auditors' tenure has a positive but insignificant effect on audit quality of non-financial firms listed on the Nigerian Exchange Group (NGX).*

CONCLUSION AND RECOMMENDATIONS

This paper examined the effect of audit firm attribute on audit quality by specifically examining the effect of audit firm size and auditors' tenure on audit quality of non-financial firms listed on the

Nigerian Exchange Group from 2010 to 2020. The findings of the study revealed that audit firm size has a significant positive effect on audit quality of non-financial firms listed on the Nigerian Exchange Group. While auditors' tenure has no significant positive effect on audit quality of non-financial firms listed on the Nigerian Exchange Group.
Since audit firm size has significant positive effect on audit quality, small audit firms should be encouraged to be more diligent in their audit assignment while the big four audit firms should sustain quality of their audit report.
The study found that audit tenure does not have positive significant effect on audit quality; therefore number of years does not matter when considering audit quality. The study recommends that number of years that audit firm audit her clients does not guarantee quality audit report.

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APPENDIX I

Table 3.2: Sample population of the study

s/n	Company	Sector	Date listed
1	ALUMINIUM EXTRUSION IND. PLC	Natural Resources	December 29, 1987
2	BERGER PAINTS	Industrial Goods	
3	BETA GLASS PLC.	Industrial Goods	July 2, 1986
4	TOTALENERGIES MARKETING NIGERIA PLC	Oil and Gas	
5	CADBURY NIGERIA PLC.	Consumer goods	
6	CAP PLC	Industrial Goods	May 24, 1978
7	CHAMPION BREW. PLC	Consumer goods	September 1, 1983
8	CUTIX PLC.	Industrial Goods	August 12, 1987
9	DANGOTE CEMENT PLC	Industrial Goods	October 26, 2010
10	DANGOTE SUGAR REFINERY PLC	Consumer goods	March 8, 2007
11	FIDSON HEALTHCARE PLC	Health care	April 6, 2008
12	FLOUR MILLS NIG.	Consumer goods	
13	GLAXO SMITHKLINE CONSUMER NIG. PLC	Health care	
14	GOLDEN GUINEA BREW. PLC	Consumer goods	
15	GUINNESS NIG PLC	Consumer goods	January 2, 1965
16	HONEYWELL FLOUR MILL PLC	Consumer goods	October 20, 2009
17	INTERN. BREWERIES PLC.	Consumer goods	
18	LAFARGE AFRICA PLC	Industrial Goods	February 17, 1979
19	MAY & BAKER NIGERIA PLC.	Health care	November 10, 1994
20	MCNICHOLS PLC	Consumer goods	December 18, 2009
21	MEYER PLC	Industrial Goods	
22	MORISON INDUSTRIES PLC	Health care	
23	MULTI-TREX INTEGRATED FOODS PLC	Consumer goods	November 1, 2010
24	N NIG. FLOUR MILLS PLC.	Consumer goods	
S/n	Company	Sector	Date listed
25	NASCON ALLIED INDUSTRIES PLC	Consumer goods	
26	NEIMETH INTERNATIONAL PHARMACEUTICALS PLC	Health care	
27	NESTLE NIGERIA PLC	Consumer goods	
28	NIGERIAN BREW. PLC.	Consumer goods	

29	NIGERIAN ENAMELWARE PLC	Consumer goods	
30	P Z CUSSONS NIGERIA PLC	Consumer goods	
31	PHARMA-DEKO PLC.	Health care	
32	PREMIER PAINTS PLC.	Industrial Goods	March 7, 1995
33	TRIPPLE GEE AND COMPANY PLC.	Industrial Goods	
34	UNILEVER NIGERIA PLC.	Consumer goods	
35	UNION DICON SALT PLC.	Consumer goods	
36	VITAFOAM NIG PLC.	Consumer goods	
37	C & I LEASING PLC.	Services	December 1, 1997
38	FTN COCOA PROCESSORS PLC	Agriculture	
39	GREIF NIGERIA PLC	Industrial Goods	
40	LIVESTOCK FEEDS PLC	Agriculture	April 1, 1978
41	THOMAS WYATT NIG. PLC.	Natural Resources	October 26, 1978
42	OKOMU OIL PALM PLC	Agriculture	September 9, 1997
43	PRESCO PLC	Agriculture	October 10, 2002
S/n	Company	Sector	Date listed
44	AUSTIN LAZ & COMPANY PLC	Industrial goods	
45	CHELLARAMS PLC	Conglomerate	April 1, 1977
46	JOHN HOLT PLC	Conglomerate	
47	S C O A NIG. PLC	Conglomerate	
48	TRANSNATIONAL CORP. OF NIG PLC	Conglomerate	
49	U A C N PLC	Conglomerate	
50	ACADEMY PRESS PLC.	Service	June 15, 1965
51	AFROMEDIA PLC	Service	May 18, 2009
52	ARBICO PLC	Real estate	
53	ASSOCIATED BUS COMP. PLC	Services	December 20, 2006
54	CAPITAL HOTEL PLC	Services	August 15, 1990
55	CAPITAL OIL PLC	Oil and Gas	
56	CHAMS PLC	ICT	
57	CONOIL PLC	Oil and Gas	
58	DAAR COMMUNICATIONS PLC	Services	
59	E-TRANZACT INT. PLC	ICT	August 7, 2009
60	ETERNA PLC	Oil and Gas	

61	IKEJA HOTEL PLC	Services	September 6, 2007
62	JAPAUL GOLD & VENT. PLC	Oil and Gas	August 10, 2005
63	JULIUS BERGER NIG. PLC	Construction/Real estate	
64	LEARN AFRICA PLC	Services	
65	MRS OIL NIGERIA PLC	Oil and Gas	
66	NCR (NIGERIA) PLC	ICT	
67	NIGERIAN AVIATION HANDLING COMPANY PLC	Services	November 27, 2006

Source: NGX, 2021