Auditors Independence, Auditors' Tenure and Audit Firm Size In Nigeria

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Abstract
This paper has been carried out to empirically examine the relationship between auditor's tenure, audit firm size and auditor's independence. A cross-sectional survey research design was used for the purpose of this paper with a sample size of fifty (50) audit firms in Edo and Lagos States in Nigeria. The statistical technique used for this paper was the binary logistic regression. From our findings, auditor's tenure (TEN) does not compromise the independence of the auditors and audit firm size (AUD) does not also compromise the independence of the auditor. It was therefore recommended that to ensure that the independence of an auditor is not compromised, the length of audit tenure should not exceed 5years .
Keywords: Audit tenure, audit firm size and auditor's independence.

1. INTRODUCTION

Auditor's independence is seen as the back bone of the auditor's profession. It is an important part of the statutory financial reporting process and a necessary condition for adding value to all audited financial report. Izedonmi (2000) opines that independence is of the mind, characterized by objectivity and integrity on the part of the auditor. Auditor's independence is an important ingredient in audit practice. De Angelo (1981) and Simunic (1984) posit that there is an understanding that auditors face substantial economic cost when there is an occurrence of audit failure but in contrast Becker, Defond, Jiambalio and Subramayan (1998). DeFond, Raghumandan and Subramanyam, (2002) say that independence could be influenced because auditors are reluctant to bring up issues pertaining to the preparations of the financial statement at the risk of losing lucrative fees from its clients. Becker et al (1998) and DeFond et al (2002) also say that independence could be influenced because auditors are reluctant to bring up issues pertaining to the preparations of the financial statement at the risk of losing lucrative fees from its clients, thereby making the subject theoretically ambiguous.

Previous studies, empirical evidences have shown that the auditors' tenure, audit firm size, size of the audit fee, client size and the audit committee to mention but a few are factors that pose as a threat to auditors' independence. Works by Simunic (1984), have carefully explained that when a firm is wealthy and has gained significant recognition in the society like the Big 4 (i.e, Akintola Williams Deliotte, KPMG, Ernst & Young and Price Water House (PWC)), it is relatively impossible for such audit firms to be economically dependent on its client. They tend to do their work carefully and are motivated to carry out proper examination of their clients report. Even Shockley (1982), McKinley, Pany and Reckers (1985) are also in agreement.

Consequently, this paper addresses this research question with the aim of contributing to knowledge and ascertaining how auditors' tenure and the audit firm size pose as a threat to the auditors' independence. The remaining part of this paper is divided into four sections. Section two (2) provides a review of prior research examining the relationship between the auditor's independence, auditors' tenure and audit firm size. Section three (3) shows our methodological approach and results presentation. The results are discussed in section four (4) and summary and concluding remarks are presented in section five (5).

2. REVIEW OF RELATED LITERATURE AND HYPOTHESIS DEVELOPMENT

Several variables which could have impact on the independence of auditors have been identified in prior research works, for instance Sucher and Maclullich, (2004), says an auditor's independence can be influenced by conscious inaccuracies or by unconscious inaccuracies in reported information, Watts and Zimmerman (1986) and DeFond, Raghunandan, Subramanyam (2002), has revealed that the fees paid by clients to auditors as incentives to compromise their independence had an economic significance. DeAngelo, (1981) identified audit fee as a possible threat, including Hensen & Watts, (1997) and Reynolds & Francis, (2001) who also identified non-audit fees as one too. This is just to mention a few, but in a bid to investigate those factors that have an impact on the independence of an auditor, this paper would focus on variables such as audits' tenure (TEN) and audit firm size (AUD). To investigate their impact on auditor's independence, this paper focuses on the variable audit firm size (AUD). Literature reviews on each of these variables are as specified below.

2.1 AUDITOR'S TENURE

The prolonged association between an audit firm and company-client could lead to the closeness of the auditing firm with its company-client's management which in turn makes it difficult for the auditor to freely express his professional opinion (Larvin, 1976 & 1977). Previous works done by Barkess and Simnett,(1994); De Ruyter & Wetzels (as cited in Bamber & Iyer, 2007); Defond et al. (2002); Geiger and Ragunandan,(2002); Carcello and Nagy,(2004), have shown that lengthy audit firm tenure leads to a reduced propensity of issuing a qualified audit report. Complacency, lack of innovation, less rigorous audit procedures, and a learned confidence may arise after long association with the company-client (Shockley, 1982). Professional accounting bodies like AICPA (1978 and 1992), ICAA and CPA Australia (2001) and Coordinating Group on Audit and Accountant Issues (2003) also expressed concerns that the length of audit client relationship may impair audit quality which in turn affects the auditors' independence.

In contrast to the above, the works of Ye, Carson & Simnet (2006), they tried to contribute to the debate on auditor independence by providing evidence as regards the relationship between non-audit services and audit firm tenure, audit partner tenure and alumni affiliation. Their findings showed that the prohibition of lengthy audit firm tenure may not be necessary. They disagree with recent findings of other corporate researchers that a long auditor-client relationship can have a possible negative effect on the independence of an auditor.

H_1: Audit tenure is significantly associated with auditor's independence

2.2 AUDIT FIRM SIZE

In other to safeguard their reputation, large audit firms ensure independent audit services. There are different firms which vary in sizes; therefore, it's only normal to believe that the larger the size of an audit firm, the more the client pays as audit fees. Titard (1971), Hartley and Ross (1972), Shockley (1981), McKinley, Pany and Reckers (1985) and Palmrose (1988) all share the same view that when it comes to smaller companies, larger firms are less dependent on them because the associated fees in most cases makeup a smaller portion of the audit firms total revenue. But when it comes to smaller firms, they have a more personal and close relationship with their clients. Most of these large audit firms are able to undertake large company audits effectively, with the aid of research facilities, superior technologies and better experienced employees (Lys and Watts, 1994). Pearson (1980) discovered that auditor's independence is positively associated with size of audit firm, because they have difficulty in resisting client pressure. The larger client firms have more to lose if an unfavourable judgment is made in a lawsuit.

Furthermore, Feltham, Hughes and Simunic (1991), Dye (1993), Clarkson and Simunic, (1994) posit that firms that are wealthy are not dependent on their client companies. They are therefore more motivated to carry out proper examinations of client companies and are able to avoid being sued for wrong reports and in cases of audit failure they can shoulder their responsibilities.

H_2: Audit firm size is significantly associated with auditor's independence.

3. METHODOLOGY

The method of data analysis used was the regression analysis. A cross-sectional survey research design was used and Binary Logistic regression technique was adopted in this paper due to its cherished properties of unbiasedness, efficiency and consistency. Binary Logistic regression is a technique for making predictions when the dependent variable is a dichotomy, and the independent variables are continuous or discrete.

The source of data used was obtained mainly from primary sources. They were obtained through the distribution of questionnaires to the staff of audit firms in Edo and Lagos States. The sample procedure adopted was random sampling method. The audit firms were used as our unit of analysis. The primary method of data collection used was the questionnaire method. The questionnaire enables the respondents give more truthful responses as a result of its anonymous nature. The questionnaire was constructed in two parts the first part is concerned with the biostatistics of the respondents while the second part consisted of fifteen questions which covered the issues that relate to the topic.

The paper empirically examined Auditors' tenure, audit firm size and auditors' independence. In order to determine the relationship among the variables, a model was specified.

The model in its functional form was specified as follows:

AI = f (AUD, TEN)

The model in its econometric form is presented below:

AI = B_0 + B_1AUD + B_2TEN +Ut

Where:

AI = Auditors Independence

AUD = Audit firm Size

TEN = Auditors' Tenure

U = Error term

B1, B2 > 0

B0 …….. B2 = Coefficient

Table 1: OPERATIONAL DEFINITIONS OF VARIABLES AND EXPECTATED SIGNS

VARIABLES	EXPLANATION	DEFINITION	APRIORI SIGNS
AI	Auditors Independence	Audit fee divided by total fee (where total fee is made up of fees from audit and non-audit services) or Audit fee divided by turnover.	Dependent variable
AUD	Audit Firm Size	If it's any of the Big 4 {Akintola Williams Delloitte; KPMG; Ernst & Young and Price Water House (PWC)} audit firms, it's (1), if not (0).	Positive (+)
TEN	Auditor's Tenure	The length of time an auditor was engaged in a firm.	Positive (+)

Source: Researchers compilation (2012)

3.1 Descriptive Statistics

Following our model specification, it can be deduced that Audit firm Size (AUD) and Auditors' Tenure (TEN) are potential factors that can influence Auditors Independence (AI) in Nigeria. In analyzing the collected data we adopted descriptive statistic as shown on the table below:

Table 2: Descriptive statistics of the variables

Variables	Mean	Standard Deviation	Jarque-Bera (P-Value)
AUD	3.9	1.22	22.53(0.00)
TEN	2.79	1.62	17.27(0.00)
AI	0.82	0.38	80.11(0.00)

Source: E-views Output (2012)

The table 2 above gives the description of variables used in estimation. The average response scores for Audit firm Size (AUD), Auditors' Tenure (TEN) and Auditor's Independence (AI) are 3.9, 2.79 and 0.82 while their standard deviation values are 1.22, 1.62 and 0.38 respectively. The Jarque-Bera (JB) test values of all the variables shows that they are normally distributed since all their p-values are significant at 1% level.

3.2 Discussion of Probit Regression Results

The table below shows Binary probit regression results:

Table 3: Probit Regression Result

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	-1.439014	0.816627	-1.762144	0.0780
AUD	0.163173	0.198214	0.823217	0.4104
TEN	0.181883	0.173689	1.047182	0.2950

McFadden R-squared	0.166694	Mean dependent var	0.822785
S.D. dependent var	0.383065	S.E. of regression	0.358827
Akaike info criterion	0.829181	Sum squared resid	19.82851
Schwarz criterion	0.906715	Log likelihood	-61.50530
Hannan-Quinn criter.	0.860669	Deviance	123.0106
Restr. Deviance	147.6176	Restr. log likelihood	-73.80881
LR statistic	24.60701	Avg. log likelihood	-0.389274
Prob(LR statistic)	0.000019		
Obs with Dep=0	28	Total obs	158
Obs with Dep=1	130		

Source: E-views Output (2012)

3.3 Regression Equation

$$AI = -1.43 + 0.16AUD + 0.18TEN$$
$$(-1.762) \quad (0.823) \quad (1.047)$$

NOTE: The Z-values are reported in parentheses below each of the co-efficient estimates.

The table 3 above shows the Binary probit regression results of the independent variables (audit firm size and auditor's tenure) and auditor's independence as the dependent variable.

A close examination of the Pseudo (R^2) which is also called the McFadden's (R^2) which serves as an analog to the squared contingency coefficient, with an interpretation like R-square. The Pseudo R^2 with a value of 0.17 indicates that Audit firm Size (AUD) and Auditors' Tenure (TEN) can explain only about 17% of the total systematic variation of audit independence in Nigeria. This implies that about 83% of the total systematic variation in the dependent variable has been left unaccounted for by the model hence captured by the stochastic error term. This implies that other factors not included in the model accounts for audit independence in Nigeria. On the basis of the overall statistical significance of the model, it was observed that the LR ratio statistics value of 24.6 is significant at 5% level of significance.

The Z-statistic is an alternative test which is commonly used to test the significance of individual probit regression coefficients for each independent variable. The probit regression result shows that AUD and TEN with a calculated Z-value of 0.82 and 1.04 respectively are less than 1.96 at 5% level of significance. Thus the audit firm size and the tenure of an auditor has no significant influence on the independence of auditors in Nigeria.

4. *Discussion of Results*:

Audit firm size has been found to be positive but not significantly associated with auditor's independence. This goes to show that audit firm size has no significant influence on auditors' independence in Nigeria. This could be that certain characteristics inherent in one audit firm practiced in Nigeria may increase the danger of impairment of independence, with the tendency of a more personalized mode of service and close relationship with the client. The larger the audit firm size the more independent the audit is. An increase in the size of audit firm by 1unit would lead to about 0.16 increase in auditors independence although audit firm size has no significant influence on auditors' independence in Nigeria. This findings is consistent with Feltham, Hughes and Simunic (1991), Dye (1993), Clarkson and Simunic,(1994).

Auditors' tenure has a positive relationship but it's not significantly association with auditors' independence in Nigeria. This agrees with the findings of Ye, Carson & Simnet (2006). Their findings showed that preventing a prolonged audit firm tenure may not be necessary because it may not have a negative effect on the independence of an auditor even though we know that the attachments between directors and auditors is as a result of a continued business relationship. They found that trust and pleasant business partnerships increase the commitment of clients to the relationship and their intention to continue it. The attachments between directors and auditors have the choice of continuing business relationships depends on the trust that emerges between organisations due to repeated personal attachments and ties.

5. SUMMARY AND CONCLUDING REMARKS

The main objective of this paper was to examine the relationship between audit firm size, auditor's tenure and auditor's independence in Nigeria. To address the issue, relevant data where collected and analyzed and from these analyses results were therefore obtained and discussed. From the outcome of our findings, TEN and AUD are not statistically significant in determining auditors' independence in Nigeria. This could be that certain characteristics inherent in l audit practices in Nigeria may increase the danger of impairment of independence; the tendency is towards a more personalized mode of service and close relationship with the client. We conclude that both audit firm size and auditors' tenure are positive but not significantly associated with auditors' independence.

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