



Audit Firm Attributes and Independence of Auditors: Evidence from Nigeria's Listed Manufacturing Companies

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Abstract: This study sought to examine audit attributes and independence of auditors: evidence from listed manufacturing companies, Nigeria. A research survey was conducted on 26 listed manufacturing companies with head offices in Lagos, Nigeria. The companies were selected by using the Taro Yamani method while simple random sampling was used to select the respondents and a total number of 78 questionnaires were administered. The data collected from the survey was analyzed with the aid of the Partial Least Square-Structural Equation Model regression technique. Results of the study show that firm tenure and size have a positive and significant relationship with auditor independence. Control variable, provision of non-audit assurance services also has a positive and significant relationship with independence. However, the second control variable, audit fees, showed a positive but insignificant relationship with auditor independence. Based on these findings, the study concludes that audit firm tenure, rendering of non-assurance audit services impairs independence while audit firm size enhances it. The study, therefore, recommends that regulatory provision of rotation of auditors be respected; there should be lifting of the veil of incorporation to ascertain companies that provide non-audit services and sanction of auditors if it is discovered that they are providing non-audit services to their audit client under another name.

Keywords: Auditor independence; Firm size; Audit fees; Firm tenure; Rotation

JEL Classification: M42

1. Introduction

This paper investigates the audit firm characteristics and independence of auditors: evidence from manufacturing listed companies in Nigeria. The rate at which corporations collapse globally and the effect of fraudulent financial reporting after the completion of audit exercises and unmodified audit reports have caught the attention of academic and business researchers in recent times. Corporate financial scandals have been linked with audit failures while the failures have to lead to increased public scrutiny of the exercises of public accounting firms (Eisenberg & Macey, 2004). They raised issues in relation to the quality of audits carried out by the auditing profession (Gendron, Suddaby & Lam, 2006). Fearnley, Beattie, and Brandt (2005) further paid attention to the failure of public corporations which make stakeholders not have an interest in the ethical principles within audit firms.

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Investors have advocated that independence is a critical issue disturbing audit exercises in recent times. To this end, Abedalgader, Ibrahim, and Baker (2010) noted that the independence of the auditor depends majorly on two factors which are auditor tenure (or length of auditor-client relationships) and audit firm size. The auditors have been criticized for carrying out audit exercises for their clients as long as possible and subsequently concentrated more on non-assurance audit exercises rather than mandatory audits (Eyenubo, Mohammed & Ali (2017)) because of the economic profit derivable from non-audit services. It is also observed that big accountancy practices are seen to be more independent than small practices because they possess a better capacity and are also capable of withstanding pressure from the client management in conflict situations.

The regulatory agencies have reacted to this cankerworm distressing the practice of auditing with a number of pronouncements and legislations. In Nigeria, accountancy regulatory agencies like the Institute of Chartered Accountants of Nigeria (ICAN) pronounced rotation of auditors for audit exercise for the companies every three years; a practice which the Financial Reporting Council of Nigeria reinforced by prescribing that companies change their auditors every ten years apart from placing restrictions on some assurance services provided to audit clients by audit firms. These restrictions were intended to safeguard auditors' independence which seems to be under threat from close audit firm attributes. It is, however, not certain whether companies comply with these provisions.

2. Conceptual Review and Theoretical Framework

An audit could be seen as rendering third-party assurance to various stakeholders that the financial statements are free from material misstatement (Huyghe, 2017). This assurance is done by extensively evaluating internal and external evidence of the transactions made available to the auditor. Researchers have put forward various definitions for auditor independence based on individual perceptions of the concept and as such, no generally accepted definition is available in the literature. This fact is adduced to by Scheutze 1994; De Angelo 1981). Regulators like the International Federation of Accountants (IFAC) defined it as 'the ability to act with the independence of mind and appearance, integrity and objectivity, which means that the accountant should execute his investigation in an objective and impartial manner. It also means that while verifying the accounting books and records the auditor must be free from the influence of the client in any given circumstance.

Audit firm tenure is the length at which an audit firm has been executing audit exercises

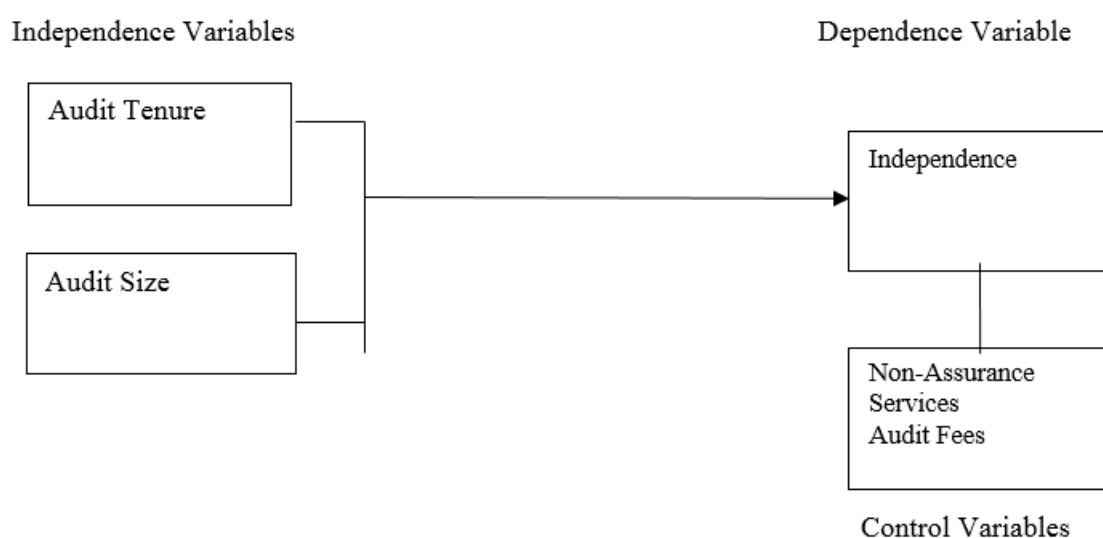
for his client (Huyghe, 2017). Auditor tenure can also be short or long (Carren, 2013). Short audit tenure means a short relationship between the company and its auditor which can be between 1 and 5 years while long tenure denotes a long auditor-client relationship of up to 10 years and above (Barizah Abu Bakar, Rahim Abdul Rahman & Majdi Abdul Rashid, 2005). Non-audit services are those other services that auditors often provide for their clients which are vividly different from statutory audit engagement. Among non-audit services includes; accounting and bookkeeping services, equity valuation, and management consultancy services. It has been noted that these services do create a bond between auditors and clients which raises the question of the preservation of auditors' independence (Huyghe, 2017).

Accountancy firms can be classified as big or small (Big and Non-Big) according to the size of the firm. An earlier study by De Angelo (1981) has affirmed a positive relationship between big-sized audit firms and auditor independence since Big N firms can suffer reputation loss in case of client

misreporting (Krishnan, Ma & Yan 2015; Abid, Shaique & Anwar ul Haq, 2018). Audit fees represent the monetary compensation the auditor receives from the company for which an audit is performed (Mautz & Sharaf, 1961; Huyghe, 2017). Barizah Abu Bakar et al, (2005) maintain that a large audit fee is associated with a high risk of damaging auditor independence.

The study is anchored by the agency and deep pocket theories. Agency theory maintains that the inability of shareholders to fully trust the management due to information asymmetry and the self-interest characteristics of the management make them put mechanisms in place to align the interests and reduce the problem of information asymmetry. The auditor with a deep pocket is the one that has a lot of wealth which is an assurance for him to be independent and thus provide high audit quality.

The diagram below depicts the conceptual framework which shows the linkage between the dependent variable which is auditor independence and independent variables of audit firm attributes proxied by audit firm tenure and audit firm size. Provision of non-audit services and audit fees are control variables because the literature has shown that they also affect auditor independence.



From the empirical studies on tenure, Watts and Zimmerman (1983) opined that the longer the auditor tenure, the more dependent on clients the auditor will be which will result in the independence and objectivity of the auditor been dented. Similar findings by Adeniyi and Mieseigha (2013) in Nigeria show that the significant influence between audit firm tenure and audit quality was inverse (though not significant); meaning that shorter audit tenure promotes auditor independence and longer auditor tenure impaired the audit exercise. Okaro and Okafor (2013) and Okolie (2014) also document the similar finding. Over the years, there are a lot of debates between audit assurance exercises and others provided by auditors such as non-audit assurance services. Specifically, rendering of non-audit assurance exercise has been said to create mutual interests among the audit firm and the client and this has raised issue concerns the going concern of the auditor's independence (Huyghe, 2017). Empirical evidence shows that researchers differed in their views on the provision of non-audit services to audit clients. While some researchers see the provision of non-audit services to audit clients as independence impairing, others are of the view that it enhances auditor independence.

This study, therefore, is designed to contribute to the understanding of the nexus between audit firm attributes and auditor independence since the independence of the auditor is at the heart of the auditing profession, and anything that affects it is always of interest to the stakeholders.

Based on the foregoing, the study hypotheses that:

Ho1 Auditor tenure has no significant influence on the independence of auditors of listed manufacturing companies in Nigeria;

Ho2 Audit firm size does not have any significant effect on the independence of auditors of listed manufacturing companies in Nigeria.

3. Methodology

This study adopts a cross-sectional descriptive research design using a survey method with the aid of a self-administered questionnaire. 28 listed manufacturing companies with an operational base in Lagos constitute the population of the study. The sample size for this study is determined through a two-stage procedure. In the first stage, the sample size is computed by using the Taro Yamani method. This produced 26 manufacturing companies. Thereafter, three managers were randomly selected in each manufacturing company and as a result of this, a total of seventy-eight (78) research instruments were distributed in the selected companies. The analysis of the data was done by using both descriptive and inferential statistical techniques. Descriptive statistics used include tables, percentages, charts, ratios. The inferential statistics used is the Partial Least Square (PLS) analytical method which is a variant of the structural equation model (SEM).

4. Model Specification

Variables for the study include one dependent, two independent, and two control variables. The model for the study was adopted from the work of Omondi (2017) and thereafter amended to suit the purpose of this study. The model is presented thus:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon + \beta_4 X_4 + \epsilon \quad (1)$$

5. Data Analyses and Discussion of Finding

The study administered seventy-eight (78) questionnaires to the respondents of listed manufacturing companies with headquarters in Lagos State. Out of this number, 74 questionnaires representing 94.9% were returned while 69 copies (88.5%) were found useable for analysis. The remaining 5 questionnaires (6.4%) could not be used and as a result, were excluded.

6. Demographic Profile of the Respondents

The people sampled are represented by 43 men (62.3%) and 26 women (37.7%). This means that majority of the respondents are predominantly men that are spread in various departments. However, 49% of these people are in the accounting/finance department and since these are the people that the auditor interacts with the most, it is expected that they are in a vantage position to understand those relationships that can affect auditor independence. The respondents are matured men and women over 40 years of age. This suggests that they are matured enough to interpret the questions in the survey instrument and respond to them accordingly. In addition, most of the respondents (80%) are professionally qualified accountants while the remaining (20%) have post-graduate certificates. The

implication of this is that the respondents have a better understanding of the constructs in the questionnaire. Regarding the length of service of the respondents with the company, over 60% of the respondents have spent more than 7 years in the company, meaning that they have substantial knowledge of company operations and are better positioned to understand those factors that affect independence either positively or negatively.

7. Convergent Validity

To establish convergent validity, factor loadings and cross-loadings of the variables as well as average variance extracted were used. The rule is that both loadings and AVE should be 0.5 and above (Ahmad, et.al, 2016). The table below shows that the cross-loadings and AVE values of all the latent variables have shown more than the prescribed value of 0.5 and therefore establish convergent validity.

Table 1. Cross Loadings and Factor Loadings

	NAS	Audit fees	Size	Tenure	Independence	AVE
NAS1	0.925	0.914	0.962	0.805	0.943	0.796
NAS2	0.854	0.651	0.754	0.629	0.763	
NAS3	0.907	0.819	0.831	0.870	0.855	
NAS4	0.852	0.662	0.737	0.663	0.744	
NAS5	0.919	0.888	0.915	0.825	0.938	
Fees1	0.804	0.909	0.813	0.889	0.854	0.680
Fees2	0.575	0.764	0.679	0.573	0.656	
Fees3	0.890	0.911	0.866	0.814	0.916	
Fees4	0.625	0.693	0.644	0.629	0.638	
Size1	0.696	0.835	0.797	0.845	0.790	0.701
Size2	0.857	0.841	0.946	0.780	0.908	
Size3	0.770	0.659	0.805	0.531	0.729	
Size4	0.850	0.727	0.791	0.641	0.787	
Tenure1	0.727	0.820	0.737	0.945	0.787	0.693
Tenure2	0.538	0.642	0.532	0.712	0.548	
Tenure3	0.883	0.903	0.867	0.904	0.933	
Tenure4	0.722	0.557	0.598	0.745	0.677	
Independence1	0.759	0.847	0.769	0.871	0.831	0.690
Independence2	0.807	0.662	0.775	0.607	0.767	
Independence3	0.893	0.891	0.906	0.822	0.926	
Independence4	0.724	0.605	0.683	0.674	0.691	
Independence5	0.762	0.854	0.866	0.822	0.880	
Independence6	0.715	0.859	0.754	0.878	0.813	
Independence7	0.863	0.703	0.812	0.578	0.828	
Independence8	0.855	0.827	0.876	0.847	0.860	
Independence9	0.850	0.791	0.813	0.688	0.882	
Independence10	0.717	0.740	0.717	0.707	0.802	

Source: Author's compilation, 2019

8. Discriminant Validity

The criterion and cross-loading scores of Fornell & Larcker (1981) were used to establish discriminant validity for this study. As a rule of thumb, Fornell and Larcker (1981) suggested the use of AVE with a score of 0.50 or more. From the table below, it can be deduced that all the cross-loadings and AVE are greater than 0.5.

Table 2. Fornell-Larcker Criterion

	Audit Fees	Audit Tenure	Auditor's Independence	Firm Size	NAS
Audit Fees	0.825 (0.825)				
Audit Tenure	0.894	0.832(0.833)			
Auditor's Independence	0.942	0.907	0.830(0.831)		
Firm Size	0.918	0.841	0.963	0.837(0.8372)	
NAS	0.892	0.856	0.958	0.948	0.892(0.8922)

Source: PLS-SEM output, 2019

9. Internal Consistency Reliability

Composite reliability was used to measure internal consistency reliability because of the limitations of Cronbach alpha as a measure of reliability. The composite reliability coefficient ranges between 0 and 1, where a higher value indicates a higher level of reliability. It is suggested that composite reliability values should be 0.70 or higher (Hair, *et al.*, 2012). Since the composite reliability values are higher than 0.70 as shown in Table 3, the condition of internal consistency is met.

Table 3. Construct Reliability

Latent Variable	Code	Loading	Cronbach's Alpha	Composite Reliability	AVE	Discriminant and Convergent Validity
Audit Fees	fees 1	0.909	0.838	0.894	0.680	Yes
	fees 2	0.764				
	fees 3	0.911				
	fees 4	0.697				
Audit Firm Tenure	tenure1	0.945	0.847	0.899	0.693	Yes
	tenure 2	0.712				
	tenure 3	0.904				
	tenure 4	0.745				
Non-Audit Services	NAS 1	0.925	0.936	0.951	0.796	Yes
	NAS 2	0.854				
	NAS 3	0.907				
	NAS 4	0.852				
	NAS 5	0.919				
Audit Firm Size	size 1	0.797	0.855	0.903	0.701	Yes
	size 2	0.946				
	size 3	0.805				
	size 4	0.791				

Source: Author's compilation, 2019

10. Assessment of R-square (R^2)

The predictive accuracy of the model was categorized as substantial, moderate, or weak if the R^2 values are 0.75, 0.50, or 0.25 (Hair, et al. 2012; Henseler, et al. 2009). In this study, the endogenous variable has an R^2 value of 0.97 which means that 97% of the independent variables explained the dependent variable Auditors Independence (Table 4). This evidenced the fact that the structural model developed in this study has strong predictive relevance.

Table 4. (R^2)

	R Square	R Square Adjusted
Auditor's Independence	0.970	0.968

Source: PLS-SEM output, 2019

11. Effect Size (F^2) Assessment

F^2 Size effect shows the impact of a specific predictor latent variable on the construct variables. According to Cohen (1988), the impact is small, medium, or large if the f^2 values are 0.02, 0.15, or 0.35 accordingly. The f^2 for this study is shown in the table below. Size effect shows the impact of a specific predictor latent variable on the construct variables. According to Cohen (1988), the impact is small, medium or large if the f^2 values are 0.02, 0.15 or 0.35 accordingly. The f^2 for this study is shown in the table below.

Table 5. Effect Size (F^2)

I	Variable	f^2	Decision
1	ees	0.106	Small
2	auditor tenure	0.242	Medium
3	firm size	0.323	Medium
4	provision of audit and non-audit services	0.247	Medium

Source: PLS-SEM output 2019

12. Predictive Relevance (Q^2)

Table 6. Q^2

	Audit Fees	Audit Tenure	Auditor's Independence	Firm Size	NAS	Q^2
Audit Fees			0.106			0.234
Audit Tenure			0.242			0.342
Auditor's Independence						
Firm Size			0.323			0.432
NAS			0.247			0.238

Source: PLS-SEM output, 2019

13. Structural Model

Assessment of the structural model was designed to estimate and test the relationship that exists between latent independent variables. The result of the structural model in table 7 below reported the estimation parameters that were used to test the hypotheses.

Table 7. Total Effects and Decision table

Hypothesis	Path	Path Coefficient	Standard Error	t-Statistic	P-value	Decision
H ₀₄	Audit Fees AH ►	0.173	0.065	0.139	0.232	Accepted
H ₀₁	Audit tenure AH►	0.200	0.067	3.7456*	0.001	Rejected
H ₀₂	Firm size AH►	0.362	0.034	4.672*	0.002	Rejected
H ₀₃	NAS AH ►	0.289	0.013	2.814*	0.000	Rejected

$\alpha = 0.05$

14. Discussion of Findings

From the empirical analysis conducted, audit firm tenure has a positive and significant impact on the independence of auditors of listed manufacturing companies in Lagos. The PLS result showed that $\beta = 0.200$; $t = 3.7456$; $p = 0.001 < 0.05$. This result indicates that listed manufacturing companies with headquarters in Lagos, Nigeria perceive the long-term relationships with their auditors as an impairment of auditor independence. As a result of this, the alternative hypothesis is accepted. This finding is in line with that of Moré and Berg (2016); Yip and Pang (2017) and Hamuda (2018). It is also supported by the agency theory. The second objective deals with how to audit firm size could significantly influence the independence of auditors of listed manufacturing companies in Nigeria. Results of the empirical study revealed that audit firm size has a positive and significant effect on the independence of auditors of listed manufacturing companies with head offices in Lagos, Nigeria. The PLS result showed that $\beta = 0.289$; $t = 2.814$ and $p = 0.000 < 0.05$ which means that the respondents see the size of audit firm as significantly affecting the independence of their auditors positively. Therefore, the alternative hypothesis is accepted. The finding, which is in line with those of Krishnan, Ma, and Yan (2015) and Choi, Lim, and Mali (2017) is supported by the deep pocket theory which sees large audit firms as having enormous wealth which makes it easy for them to resist client pressure in conflict situations.

Results of the first control variable showed that the joint provision of audit and non-audit services has a positive and significant effect on the independence of auditors of listed manufacturing companies with head offices in Lagos, Nigeria. The PLS result showed that $\beta = 0.289$; $t = 2.814$; $p = 0.000 < 0.05$. This result is significant at a 5% level of significance means that the provision of non-audit services also has implications on auditor independence. For the second control variable, result show a positive but insignificant relationship between audit fee and independence ($\beta = 0.173$; $t = 0.139$; $p = 0.232 > 0.05$). However, the fact that the result is statistically insignificant means that the effect of this variable on auditor independence cannot be confirmed. It also means that the result is inconclusive meaning that it cannot be predicted whether audit fees affect auditor independence or not.

15. Conclusion

The study found that auditor tenure exhibited a significantly strong impact on independence and as a result, the study concluded that an unduly long relationship between the auditor and client management that is not maintained at arm's length could create familiarity threat which can impair auditor independence. The study, based on the empirical finding also concludes that listed manufacturing companies should continue to engage international audit firms like the Big 4 audit firms and/or big national firms (either as a sole auditor or as joint auditors) that are known to possess

deep pockets and at the same time have the capability to withstand unnecessary pressures from client management.

16. Recommendations

The following recommendations were made with the aim of ensuring that audit firm attributes strengthen auditor independence manufacturing listed companies in Nigeria.

(i) The rules of professional bodies and relevant government regulations on auditor tenure should be respected by auditing firms. Appropriate penalties should be stipulated for non-compliance and this should be strictly enforced.

(ii) In accordance with the finding, audit firm size enhances auditor independence, the study recommends that professional accountants that are given license to practice be encouraged to come together and register their practice as partnerships rather than going into practice as sole practitioners.

Unique Contribution

The study provides further evidence through a more robust analytical procedure (PLS-SEM regression technique) that audit firm attributes of tenure and rendering of non-audit assurances services impair independence while size enhances it in Nigeria's listed manufacturing companies.

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