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# AUDIT FIRM TENURE AND QUALITY OF FINANCIAL REPORT: THE NIGERIAN EXPERIENCE

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***ABSTRACT***

*The purpose of the study is to conceptualizes the effect of audit firm tenure and quality of financial reporting. There have been mixed results on the audit firm tenure and audit quality from scholars. Some of the scholars are on the opinion that the prolonged engagement of an audit firm may likely lead to close relationship amid with the audit firm and the client that will decrease the ingredients in ensuring the trustworthiness of the audit quality. While others scholars are of the thoughts that the shorter the audit firm engagement it reduces the possible occurrence of fraud and enhances the quality of audit. In contrary, other scholars believe that engaging an audit firm for a longer period reduces the financial cost and it improves the quality of audit. The study recommended that standard setters should harmonize the law regulating the rotation of audit firm tenure in line with global practice.*

***Keywords: Audit Quality, Audit Tenure, Financial Reporting Quality***

## INTRODUCTION

The objective of auditing as one of the requirements for the reliability of a company's financial statements, in most cases have been aborted because of the perceived threat of auditor's independence/ audit firms caused by familiarity due to a prolonged audit tenure.

In recent years, the world has experienced a massive turnout of audit failures of high-profile collapse that affected the likes of Xerox, Enron, WorldCom, Adelphia, Tyco, Parmalat, One-Tel, HIH, Waste management, HealthSound, Freddie Mac, American International Group, and Cadbury Nigeria PLC, and this has raised serious concerns as to the quality and reliability of accounting information. Subsequently the global collapse crisis that shocked the accounting body in 2008, gave birthed to continuous debate on the role, purpose and relevance on the value of audit by stakeholders in the way companies and banks went bankrupt after the clean audit (PricewaterhouseCoopers). In response to the corporate scandal, the congress passed the Sarbanes-Oxley (SOX) Act of 2002 was enacted to enhance the quality of financial statements for public companies in the U.S., with requirements that will lead to the fortification of auditor's independence. Similarly, corporate governance codes approved in numerous countries worldwide have included recommendations to guarantee auditor independence (Blandón & Bosch, 2013). Adeniyi and Mieseigha (2013) purported the corporate scandal in the world, specifically in Nigeria had given users concerned on the credibility of the information. The issue has been stressed on the long audit firm tenure and which has also been linked with creative accounting.

Medhat and Mohamed (2018) in GAO, (2003) purported that the global crises emanated the rise for mandatory rotation of auditor and the Sarbanes Oxley Act of 2002 (SOX) mandates that every five years there should be a rotation of audit partner but not necessarily the mandatory rotation of the audit firm. In Nigeria, Section 33 of the Securities and Exchange commission corporate governance code (2014) posited that appointed external audit firms cannot act for a period of ten years consecutively must mandatorily rotate the audit firms that acted as external auditor and the audit firm that was replaced after 10 years cannot be re-engaged until seven years. Although, the auditors independence and auditor(s) rotation have been gravely considered and this has resulted in an increasing demand for voluntary firm rotation to be considered by audit committee as a measures of improving audit quality because it is believed that engaging a new audit firm definitely increases the audit quality (Türel, Tas, Genç & Özden, 2017). In appointing the external audit firm, the firm must be chosen out of sense of judgement, qualified professionals without conflict of interest.

**Literature Review**

Audit tenure is the length of time an audit firm is engaged in auditing a client's financial statements. Audit tenure relates to audit rotation as firms are now required to change audit firms/ partners from time to time. Adeyemi and Okpala (2011) in their work emphasized that an audit firm's tenure can lead to the loss of auditor's independence. An audit firm that service his client in a long-term audit association may lead to loss of the auditors' concentration and that of its client which makes a true and fair independent behavior of the auditor likelihood. Deis and Giroux (1992) revealed that the lengthy the external auditors audit their clients; it invariably leads to closed connection amid the external auditor and clients and consequently decrease audit quality. PwC portray that regulatory bodies are certain that most of the auditing firms have a close bond with their audit client's top management they're by reducing independence, transparency, prime goals, skepticism leading to a decline in the audit quality and value relevance in the financial market. Although, reducing the audit tenure increases the concentration among the big audit firms and the mandatory rotation gives birth to the Nigeria auditing firms the capability to expand and credibility and independence in the quality of audit. Thus, companies are faced with the glaring issue as whether to retain their auditors and build a solid relationship with them or whether to rotate them constantly.

In Nigeria the National Code of Corporate Governance (NCCG) recommended a five-year mandatory rotation of audit firms in overseeing the client's financial statement. The new rule on external auditors disassociate the relationship with their clients.

There have been numerous debates regarding audit tenure length and the quality of financial reporting. There have been foregoing scholarly debate on audit firm/ partner rotation that it improves audit quality due to skepticism on the part of engaging the same auditor for a prolonged period of time will result in self-interest and familiarity threats, thus hindering independence (Eilifsen, Messier, Glover & Prawit, 2010). Similarly, Ernst and Young (2015) disagree with the compulsory rotation of audit firms as it is not an actual measure in enhancing auditor independence, and it has not been established as a yardstick to improve audit quality. PricewaterhouseCoopers (2012) concurs with the view that the costs of mandatory audit firm rotation would outweigh the perceived benefits of a required "fresh look" at the financial statements by a new audit firm. Inclusively, Krauß and Zülch, (2013) believes a prolonged auditor client relationship is perceived as a probable threat to auditor independence or a probable benefit. Similarly, Isenmila and Elijah (2012) asserted how Nigerian corporate companies engaged in earnings management (fraudulent financial reporting) through the negligence of audit tenure that is posing threats and adverse effect on investors' confidence and credibility of public financials to the society at large.

**Theoretical Framework**

The study is based on the credibility theory where the essential aspect of auditing is the introduction of credibility to the financial report. The audited financial report is used by the agents (management) to increase the confidence level of the stakeholders, government, investor, creditors and reducing the information asymmetry in the financial statement. The credibility of the information allows the various users to make an independent judgement on the quality of information presented by the management for investment decision.

**Audit Tenure and Audit Quality**

Mandatory audit firm rotation likely not the most efficient way to strengthen the independence of the auditor in improving the quality of audit but the financial implication (Goa, 2003). PCAOB (2011) viewed that rotation of audit firm increases professional skepticism. The rotation of audit firm is quite expensive but there is a long run benefit and it would improve the quality of the audit. Scholars have explored the empirical relationship with audit tenure and quality of financial reporting and from the analytical output, there had been inconsistency and conflicting findings on the audit tenure mandatory rotation. Some of these studies underpinned a positive or a negative relationship between audit tenure and quality of financial reporting, such as (AICPA, 1992; Copley & Doucet 1993; O'Keefe, Simunic & Stein, 1994; Raghunandan, Lewis & Evans, 1994; Deis & Giroux 1996; Arrunada & Paz-Ares, 1998; Barbadillo & Aguilar, 2000; Vanstraelen, 2000; Dopuch, King & Schwartz, 2001; Ebrahim, 2001; Geiger & Raghunandan, 2002; Healy & Kim, 2003; Sinnett, 2004; Raiborn, Schorg & Massoud, 2006; Appah & Oyadonghan, 2011; Adeniyi & Mieseigha, 2013; Babatolu & Oyewo, 2015) have all argued and the longer the duration of engagement with external auditor firm has an adverse effect on the quality of audit report. The association with the client has an effect of higher risk and reducing the audit quality. Although other scholars disagreed that external auditor rotation may likely not improve or decrease the audit quality such as (Walker, Lewis & Casterella, 2001; Nashwa, 2004; Carcello, & Nagy, 2004; Knechel & Vanstraelen, 2007; El-Guindy & Basuony, 2018; Inas, Iman, Agus, Eka, & Dyah, 2019).

In the light of the scholarly juxtapose reviewed on the above topic, effect of audit tenure firm on the quality of financial reporting. There exists controversial argument from different scholars. Moreover, some of the studies are carried out in the developed countries and scanty work in Nigeria and limited access to evidence. Although, the study will contribute to the foregoing debate on the effect of audit tenure firm and quality of financial reporting in Nigeria.

**Regulation Rule Around the world**

In line with the Financial Accounting Standard Board (FASB, 2011) defined financial reporting as the activities which purport to relay the informational needs of external users who are unable to demand the financial information they want from an organization and therefore must rely on the information provided by management.

In several countries, regulations have been made as to the length of relationship between an audit firm tenure/ rotation rules on the audited client. The ministry of Finance/China Institute of Certified Public Accountants (CICPA) in 2016 announced a compulsory 5 (five) years rotation for auditors of financial institutions, Hungary, Austria, brazil, France etc. also proposed an audit rotation of 5years. The Securities and Exchange Commission Nigerian (SECN) regulator of the capital market, Company and Allied Matter Decree 2004 (CAMA) are responsible for financial reporting, Financial Reporting Council of Nigeria (FRCN) responsible for the compliance of the standard in the financial report. The SECN secured an alignment with FRCN stipulated a ten-year mandatory audit firm rotation with a period of (7) seven year cooling off (Samuel, Mudzamir, & Mohamad, 2017).

## CONCLUSION AND RECOMMENDATION

The study examined the extent of audit firm tenure and quality of financial reporting objective of in Nigeria. There have been inconsistency and continuous debate on audit firm tenure, scholars underpinned that short audit tenure improves the quality of audit while longer audit firm tenure reduces the quality of financial reporting. The mutual relationship amid the client and the external auditor reduces the viewpoints, consistency, accountability in the early stage of engagement. The study recommended that standard setters should harmonize the law regulating the rotation of audit firm tenure in line with global practice.

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