

**MANDATORY AUDITOR ROTATION, AUDITOR INDEPENDENCE, AUDIT
FEES AND AUDIT QUALITY: A SURVEY OF SELECTED AUDIT FIRMS IN
LAGOS STATE**

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ABSTRACT

Mandatory auditor rotation, auditor independence and audit fees have been proposed by regulatory authorities around the world. The different cases of failures and global financial crisis which affected the financial world brought about the need for such regulations. It has been proven over time that these crises are in no small way unrelated to audit failures, and the long-term auditor-client relationship often impedes on the ability of the auditor to give an independent opinion on true and fair view of the financial statement of clients. Against this background, the study set out to achieve the following objectives; to examine the effect of audit tenure on the quality of an auditor's opinion; to determine the relationship between auditor independence and audit quality report and to evaluate the effect of audit fees on audit quality.

The study adopted a cross-sectional survey design to a population of 239 auditors from registered complaint audit firms in Lagos. 144 auditors were purposively selected through the use of survey questionnaire administered to the auditors in selected audit firms in Nigeria. The primary data collected through survey questionnaire were analyzed using descriptive statistical tools of mean, standard deviation and percentage frequency while regression analysis was used to measure the impact of mandatory auditor rotation, auditor independence, and audit fees on audit quality.

The finding of the study revealed that audit tenure had a significant ($p=0.001$) positive impact on audit quality; auditor independence had a statistically significant influence ($p=0.000$) on audit quality and audit fees had a significant impact ($p=0.000$) on audit quality.

Based on these findings, the study concludes that there is a significant positive relationship between mandatory auditor rotation and audit quality. The study therefore recommended that policymakers and regulatory bodies should ensure an adequate number of years the audit-client relationship will last and the type of rotation to be done whether its firm rotation or partner rotation; policies that would ensure independence of auditor in appearance and in fact should be promulgated, and the fees to be charged should be regulated and future researchers should look into other variables as an addendum to the variables used in this study to predict audit quality.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The main drive for an audit is to provide users of financial statement with an independent opinion on whether the financial statement presents truly and fairly in all material respect, and in accordance with an applicable financial reporting framework what they purport to represent. The process of expression of an independent opinion aims to enhance the quality and the degree of user's confidence towards the financial statement (Salleh & Jasmani, 2014). This means that auditors are responsible to report honestly and provide reasonable assurance to the shareholders concerning the reliability of financial information and compliance with regulatory framework body through their opinion on the truth and fairness of the client's financial statements.

In recent years however, series of cases of corporate failures and heightened fraud have brought to fore questions surrounding the scope and quality of the external audit and auditors' independence as these failures have impacted negatively on the image of auditor as a corporate watchdog due to their inability to give warning signs before the unfortunate incidence of failures happened. Fraud cases involving Enron, WorldCom, Bernie Madoff, Global Crossing in the US, Northern Rock in the UK, Metageshaft in Germany, Parmalat in Italy, and the audit firm – Arthur Anderson have been largely

attributed to audit failure (Salleh & Jasmani, 2014, Kennedy, 2012 and Onwuchekwa, Erah & Izedonmi, 2012). A third world country like Nigeria is not excluded from this pervasive act as she had her fair share of audit failures with the often cited case of Cadbury Plc with other different scandals in the financial industry especially deposit money banks. Coupled with these corporate failures is the global economic crisis of 2008 which led to stakeholders questioning the credibility of financial reports (Institute of Chartered Accountant of Nigeria (ICAN), 2014 and European Commission (EC), 2010).

The different cases of audit failures and the global financial crisis which affected the financial world brought about the need for regulations that bothers on mandatory auditor rotation, auditor independence and audit fees. It has been proven over time that the crisis in the global financial world is in no small way unrelated to audit failures as the long-term auditor-client relationship often impedes on the ability of the auditor to give an independent opinion on true and fair view of the financial statement of the client.

Auditors failure to carry out their professional duties of care would have an adverse effect on the stakeholders who are users of financial information particularly shareholders who are likely to lose returns on their investment as a result of the bad economic decisions they are likely to make based on the wrong financial information. While, these failures have been largely attributed to poor audit quality and lack of

independence of auditors, ensuring the trust and credibility of financial information for stakeholders benefits is what led to the move by regulatory bodies like the European Commission, Securities and Exchange Commission (SEC), Public Company Accounting Oversight Board (PCAOB), Nigeria Stock Exchange, Central Bank of Nigeria among others to set up rules on mandatory auditor rotation (Oyadonghan & Emmanuel, 2014).

The mandatory auditor rotation rule aims to set a limit on the maximum number of years an audit firm can audit a given company's financial statements. This is a means of ensuring auditors independence and a possible increase in stakeholders' confidence in financial reports (Cameran, Prencipe & Trombetta, 2014). This rotation rule came into being by series of evidence of undue familiarity between the auditor and their client due to the unlimited number of years the auditor have used to serve a single client especially in the aforementioned cases of the failed corporations. The mandatory auditor rotation rule is classified as either firm rotation or partner rotation depending on the country and her financial environment (Zhang, Lennot & Wu, 2014 and Patillo, 2014).

The main goal of mandatory auditor rotation is to ensure audit quality and independence as an independent audit is widely viewed as a means to ensure credible financial reports. Since the role of independent auditors is not only to find material misstatements but ultimately to provide a reasonable assurance that the financial statements are a fair representation of the company's financial position (Kennedy, 2012), therefore, an

independent audit must be encouraged in order to minimize bias involved in an audit engagement. Without an independent audit, the quality of the audit report could be greatly impaired. For this reason, this research investigated the impact of mandatory auditor rotation, auditor independence, and audit fees on audit quality.

1.2 Statement of the Problem

The divergent interest arising from agency relationship that exists between owners and professional managers has made the need for a quality report from external auditors in high demand. The high-quality external audit, therefore, has become an important policy issue following the aforementioned corporate scandals including the Nigerian experience with Lever Brothers, African Petroleum, Cadbury Plc, Savanna Bank, Wema and Intercontinental Bank among others.

These seemingly persistent failures in Nigeria have raised some fundamental issues on the quality of audit and the independence of the external auditor and the fees the auditor charge for their services amidst others. In particular, regulators have often expressed their concern that the length of the auditor-client relationship, familiarity, threat of replacement of an auditor, provision of non-audit services and executive associations with auditors appear to impair auditor's independence and thus audit quality (Adeyemi, Okpala & Dabor, 2012; Daris, Soo & Trompeter, 2003). The quality of an audit depends simultaneously on factors such as auditor independence (fact and appearance), auditor

tenure (rotation), audit firm size, audit fees, audit company type (James & Izien, 2014; Abedalgader, Ibrahim & Baker, 2010).

Auditor independence implied an auditor's quality of being free from influence, persuasion or bias, and hence the unbiased mental attitude in making decisions throughout the audit and financial reporting process. The absence of independence may greatly impair the value of the audit service and the audit report. On the other hand, an excessively long association between the auditor and his client may constitute a threat to independence.

In extant literature, the issue of auditor rotation's effect on audit quality has been constantly debated over the last few decades. Hohenfels (2016) study showed that auditor tenure affects the perception of audit quality, Leung, Srinidhi & Xie (2017) and Gonzalez, Garcia & Lopez (2015) study showed that audit quality decreases as tenure length increases. Salleh & Jasmani (2014) test showed the association between reputable audit firm and rotation of mandatory audit partner seemed significant, while Zhang *et al* (2014) test revealed that a significantly higher frequency of audit adjustments during the departing partner's final year of tenure prior to mandatory rotation and during the incoming partner's first year of tenure following mandatory rotation.

Furthermore, Ikharo (2015), Singer & Zhang (2018) study showed that the impact of auditor tenure on quality of audit report depends on the auditor's ability and level of

independence. In a similar vein, Rahmina & Agoes (2014) study on the state of auditor independence, audit tenure and audit fee on audit quality reveal that auditor independence, audit tenure and audit fees have a positive influence on audit quality. Whereas, Firth, Rui & Wu (2012) tests revealed that firms with mandatory audit partner rotation are associated with a significantly higher likelihood of a modified audit opinion than are no rotation firms. Oyadonghan & Emmanuel (2014) result showed that auditor rotation should be seen by all as a means of guaranteeing corporate survival. On the contrary, Carecello & Nagy (2004) examinations failed to find any evidence that fraudulent financial reporting is more likely given auditor tenure. Although, they found out that fraudulent financial reporting is more likely to occur in the first three years of the auditor-client relationship.

These literature show that there are limited studies that test auditor rotation, auditor independence and audit fees relationship effect on audit quality in Nigeria. Some of these literatures are foreign like Gonzalez, Garcia & Lopez (2015) study in Spanish state-owned owned foundation, Firth *et al* (2012) Study in China, Salleh & Jasmani (2014) study in Malaysia, Zhang *et al* (2014) and Rahmina & Agoes (2014) study in Indonesia among others.

Therefore, this study tries to dig more into the Nigerian context as a developing country regarding the threats to the auditors as regards the quality of audit in terms of the causes that might be impairing their independence as well as assessing the applicability of the

mandatory rotation rule and the level of audit fees in Nigeria. It is important to note that vital discussions like the mandatory auditor rotation, auditor independence, audit fees and the principles involved are widely discussed in the global accounting profession. The decisions made as a result of this discussion will ultimately impact the Nigerian accounting profession, thus the need for illumination in this area of auditing.

1.3 Research Questions

- i. To what magnitude does audit tenure impact on the quality of auditor opinion in Lagos Nigeria?
- ii. To what extent is the relationship between auditor independence and quality of audit report in Lagos Nigeria?
- iii. What is the effect of audit fees on quality of audit report in Lagos Nigeria?

1.4 Objectives of Study

The main objective of this study is to examine the impact of mandatory auditor rotation, auditor independence and audit fees on audit quality. To achieve this broad objective, the specific objectives are;

- i. To examine the effect of audit tenure on the quality of an auditors opinion in Lagos Nigeria.
- ii. To determine the relationship between auditor independence and audit quality report in Lagos Nigeria.

iii. To evaluate the effect of audit fees on audit quality in Lagos Nigeria.

1.5 Research Hypothesis

H_{0i}: There is no significant relationship between audit tenure and the quality of auditors' opinion in Lagos Nigeria.

H_{0ii}: Auditor independence has no significant relationship with quality of audit report in Lagos Nigeria.

H_{0iii}: Audit fees does not have any significant relationship with quality of audit report in Lagos Nigeria.

1.6 Justification of the Study

In Nigeria, evidence relating to the impact of mandatory audit rotation, auditor independence and audit fees on audit quality are few. Therefore, this study tries to dig more into the Nigerian context as a developing country regarding the threats to the auditing professionals in terms of the causes that might be impairing their independence as well as assessing the applicability of the mandatory rotation rule and the level of audit fees in Nigeria. Thus, the findings of this study will make significant contributions to knowledge, government/policy makers and practice.

As a way of demonstrating the study's contribution to knowledge, it will contribute to the literature on audit quality in Nigeria which would make it serves as a reference and encourage subsequent research in audit quality likewise her theoretical contributions where the observation was drawn from the ignored area of auditor rotation, audit fees

and audit independence. It also fills the gap in the previous literature about how the variables of study affect audit quality in audit firms in Lagos Nigeria while giving a fresh insight into the possible correlation between the dependent and the independent variables by expanding the existing findings in the audit quality literature and by identifying opportunities for further research.

Policy makers and government would appreciate the findings of this research work as a useful guide in understanding policies to be formulated, programmes to embark on and factors that needs consideration in formulating such policies and regulations that would limits the number of years an auditor spend with a particular client, as it enhances the effectiveness of auditors in practice especially on their independence to carry out audit exercise.

In addition, the findings of this study will be relevant to practices as it helps accountants/auditors and audit firms to provide a higher quality audit service and added value to the company and the public as users of financial statements.

Similarly, this study in its entirety caters for the needs of the users of financial statements and stakeholders as the outcome of an audit would affect the economic power for decision making of the stakeholder who is compelled to rely on the reports presented by management of companies and certified by an external audit.

1.7 The scope of the Study

This study observed the relationship between mandatory auditor rotation, auditor independence, audit fees and audit quality in audit firms in Lagos. This study covered the perception of auditors on audit fees, auditor independence, and mandatory auditor rotation as it relates to audit quality.

The focus of the study was on practising accountants/auditors in registered compliant audit firms in Lagos Nigeria as published by the Office of the Auditor General of the Federation in the year 2017. This record was assessed because professional bodies in Nigeria are mandated to submit a list of compliant firms under their purview.

This perception study was however carried out on a population of 239 chartered accountants/auditors in registered compliant firms who are versatile in the field of auditing with numbers of years of experience especially from the grade of assistant managers, managers, senior managers, principal managers and partners in accounting firms in Lagos. This group was considered because of the years of experience in auditing. The selection of chartered accountants for this study is key to our findings as special interest was placed on practising accountants/auditors who have performed audit assignments and have substantial knowledge in this area so that the objective of the study is achieved.

1.8 Organization of the Study

The paper is divided into Chapters and is organized as follows; Chapter one includes the introduction, statement of the problem, research questions, research objectives, research hypothesis, the significance of the study and scope of the study. Chapter two reviews the relevant literature with a focus on auditor rotation with a theoretical framework that shows the theories on which this study was hinged. The methodology adopted and the data sources are described in Chapter three while Chapter four presents and discusses the key findings. The study concludes in Chapter five whilst highlighting the most significant aspects of our findings and providing real-world recommendations useful for future research and policy making.

CHAPTER TWO

LITERATURE REVIEW

This chapter focuses on reviews of extant literature on auditor rotation, audit independence, audit fees and audit quality with a theoretical framework that shows the theories on which this study was hinged.

2.1 Conceptual Review

An overview of auditor rotation was discussed exhaustively with extant literature in this section, alongside the types of rotation that exists. In addition, auditor independence

and threats to auditor independence, audit fees and audit quality which is the crux of this study was discussed at length.

2.2.1 An Overview of Auditor Rotation

Auditor rotation refers to the imposition of a limit on the number of years in which a particular audit firm may be the auditor of a particular corporation (United States Congress, 2002). As seen in Carrera, (2007), auditor rotation is the switching of auditors after a fixed period of tenure. Seidam (1934) also described auditor rotation by saying "a new auditor, like a new broom, will make a clean sweep and pick up things not caught by the predecessors".

Auditor rotation has been a controversial issue that has been debated for decades especially when it comes to the quality of audit report (Okaro, Okafor & Egbunike, 2007). The issue thus resurfaces every time there is a major audit failure of corporations (Barton, 2002). Auditor rotation was first introduced during the McKesson and Robbins hearings in the late 1930s (Question for Changing auditors, 1967 cited in Barton, 2002). McKesson Robbins was involved in a huge scandal in which accounting firm Price Waterhouse failed to detect \$19million in a misstatement of inventory and receivables. McKesson Robbins falsified records and Price Waterhouse did not question or verify the validity of their financial statement. What followed after the discovery of this fraud was the congressional hearings and attempt by lawmakers to reform the accounting

profession. This resulted in the development of the first formal standard for auditing procedures (Ramos, 2002).

The issue of auditor rotation resurfaced as additional scandals occurred which required additional requirements to be placed on auditors throughout the 20th century and the early 21st century with scandals involving the earlier mentioned Enron, WorldCom and others and the subsequent audit failures involving other companies have brought the accounting profession back under scrutiny.

The motivation behind auditor rotation is public concern over high profile corporate collapse (Catarract & Walker, 1999). In this knowledge age, the demand for public protection (i.e users of financial information) must be met by ensuring a reasonable amount of time the auditor-client relationship last. Notwithstanding this, the role of independent auditors is to protect the public (users) by expressing an independent opinion on the true and fair view of financial reports.

Auditor rotation is divided into audit partner rotation which is the rotation of the lead auditor in an audit assignment and audit firm rotation which is the changing of the audit firm. This two divisions can be under a mandatory rotation setting or a voluntary rotation setting (Zhang *et al.*, 2014).

2.2.2 Audit Partner Rotation

The logic behind partner rotation is to bring in a fresh perspective to the audit and encourage a fresh viewpoint which enhances the technical rigour of an audit (ICAEW, 2002, AICPA 2002). The EC (2010) green paper on audit, expressly state that an accounting firm may remain as auditors of the same client company for an unlimited number of years (or until the company decides to change its auditors). However, the lead engagement partner and other key members of the audit team should be rotated regularly (ICAN, 2014)

In most countries, however, audit partners names are not publicly disclosed. Thus, making it difficult for researchers to identify partner rotation events and measure partner tenure. In contrast to this, the jurisdiction of some countries makes them an exception to this non-public disclosure. Countries like Australia, Taiwan, Germany and China have jurisdiction that requires audit reports to publicly disclose partners' names. (Zhang *et al.*, 2014).

Carey & Simnet (2006) examined a sample of Australian companies for the period of 1995 when partner rotation and audit firm rotation were voluntary. Consistent with longer partner tenure leading to lower audit quality, they found out that clients are less likely to receive going concern opinion and are more likely to meet or beat earnings benchmark when partner tenure exceed seven years.

However, in the United States where audits partner's name is not publicly disclosed, Bedard & Johnson (2010) carried out a study using proprietary data from a large US audit firm. They found out that planned engagement effort increases following partner rotation, indicating that new partner invests additional efforts during their first year of tenure in order to acquire client knowledge. In the same vein, Fitzgerald, Thompson & Omar (2012) examine how audit partner rotation and audit firm rotation affect the reporting of internal control effectiveness for a sample of large US not-for-profit making organization. They found out a significant increase in reported deficiencies during the first year of audit firm tenure but no significant association between partner rotation and the reporting of deficiencies. However, Fitzgerald *et al* (2012) fail to distinguish between partner rotations that are voluntary to those that are mandatory.

In furtherance to this, the studies that focus on mandatory audit partner rotation was by Chi, Huang, Liao & Xie (2009), Manry, Mock & Turner (2008) where they found a positive relationship between audit tenure and financial reporting quality/audit quality while Carey & Simnet (2006) found a negative relationship under the conduct of certain audit quality proxies.

2.2.3 Audit Firm Rotation

EC (2010) green paper on audit referred to audit firm rotation as a way in which an accounting firm should remain as auditors of a client company for no longer than a specified maximum number of years, say five years or seven years. This, however, will

require legislative amendment as the law of many countries including Nigeria frequently provide that auditor's appointment is for one year renewable indefinitely (ICAN, 2014 and EC 2010).

There are few countries that require audit firms to be rotated. Therefore, most studies in extant literature examine the relationship between audit firm tenure and audit quality in settings where audit firm switches are purely voluntary (Zhang *et al.*, 2014).

The proponent of mandatory rotation argues that short audit firm tenure can strengthen audit independence due to the avoidance of close personal relationship between the auditors and the client's management. However, the number of evidence available does not support this view (Zhang *et al.*, 2014). On the contrary, literature generally finds shorter audit firm tenure is associated with lower audit quality reporting (Carcello & Nagy, 2004).

While the evidence on audit firm tenure helps to inform the debate about the consequences of extended audit firm tenure, it does not directly examine the consequences of mandatory auditor firm rotation. It is difficult to draw clear inferences from literature about the likely consequences of mandatory audit rotation because the voluntary rotation is endogenous. For example, a company that engages in earnings management or that shop for clean audit opinion are more likely to voluntarily change their audit firms or experience auditor resignation. (DeFond, Raghunandan & Subramanyam 2002 and Lennox, 2000).

However, the General Accounting Office (GAO) conducted a study in 2003 on the potential effects of regulating the mandatory rotation of audit firms where they summarized some arguments that either supported or opposed the regulations. The arguments for and against mandatory audit firm rotation concerned audit quality and auditor independence. Also, the matter of audit costs is an argument in the discussion regarding the subject.

Those who support mandatory audit firm rotation mostly believe that the auditor independence will increase and that an auditor with a “fresh look” will deal with the financial reports more appropriately, while those who are against mandatory audit firm rotation believes that new auditors lack knowledge about the company’s business and that it would instead increase audit risk of audit failure.

Those who oppose mandatory audit firm rotation also believe that it would increase costs. The increased costs together with increased audit risk outweigh the “fresh look” by a new audit firm, while those who support mandatory audit firm rotation believes that the “fresh look” will protect shareholders’ and other stakeholders’ interest so much that it outweighs the increased costs (GAO, 2003).

Arel, Brody, & Pany (2005) further suggest other arguments that either supports or opposes mandatory rotation of audit firms. A supportive argument is that the relationship between the company and the audit firm could become too close and

familiar that it affects the auditor's independence and objectivity if the audit engagement is too long.

An opposing argument is that the auditor's independence would not be affected by a long relationship between the audit firm and the company. Instead, it is a question of the auditor's knowledge, professionalism, and integrity. The auditor's knowledge, professionalism, and integrity maintain the enhanced independence. According to the authors, the outcome of the regulation on mandatory rotation of audit firms is uncertain. Studies show that the rotation could lead to lower audit quality in the first years of the audit, however, the auditor independence might appear to be stronger to external parties (Arel *et al.*, 2005 and Hamilton *et al.*, 2005).

2.2.4 Auditor Independence

Audit independence is an indispensable requirement in providing appropriate quality of financial reports and auditing because the audit of a company follows a structured, documented audit plan in a systematic process that is conducted objectively. In order to conduct an audit objectively, the auditors must be independent, fair and not allow prejudice or bias to override their objectivity (Hayes, Wallage & Görtemaker, 2014 and Velte & Stiglbauer, 2012).

The independence of the auditor is a fundamental principle of good practice because it makes the financial statements more credible (Eilifsen, Messier, Glover & Prawitt,

2013). The auditor obtains and evaluates evidence of economic actions and events and compares the evidence with the assertions made by the management that is evidenced in the financial statement. For example, the actual existence of the debts reported on the balance sheet at the balance sheet date may be one of the assertions of management about economic actions (Hayes *et al.*, 2014).

The auditing standard and ethics code of public accountants also stipulated the need to maintain the independence of auditor meaning that auditor who is independent in carrying out his duties should be neutral and not take side with any party to avoid conflict of interests. Nevertheless, most of the regulators, accounting practitioners, and academics agree that auditor credibility is enhanced by auditor independence.

However, there is no general agreement on how to define auditor independence among these parties as stated in Antle (1984) and Elliott & Jacobson (1992). This notwithstanding, auditor independence has been and is still an important topic of discourse. Though there is no single definition on auditor independence, however, Carrington (2010) states that the purpose for hiring an auditor would be to clearly get an external independent view on the financial statements of the client. If the auditor is not independent of his client, the whole concept of auditing would be meaningless.

Furthermore, Izedonmi (2000) suggests auditors' independence to mean the ability of an auditor to perform his audit work in accordance to his judgement, free from any

undue influence and without being biased. Independence is an important attribute of an auditor and it's an attitude of mind characterized by integrity and objectivity.

Also, Mednick (1997) viewed independence as the cornerstone of the accounting profession and of the professions most precious assets. The auditors and audit firms use its independence as an asset together with its knowledge about accounting and audit techniques when they sell their professional services. At the same time, there is much money to earn when doing services that are not directly related to audit services and the issue is to find a balance that is tolerated and not harming the independence. The audit firms are well aware of this dilemma and are following the changes of rules by regulators. The regulators are involved in the issue of auditor independence and have imposed stricter regulation in order to protect the independence and confidence of the auditor after the corporate failures that rocked the early 21st century and the financial crisis of 2008 (Carrington, 2010). Accordingly, DeAngelo (1981) recognized the importance of auditor independence as it is an important factor that affects audit quality.

However, Rahmina & Agoes (2014), Agoes (2012), Arens, Elder & Beasley (2012) and Dopuch, King & Schwartz (2003) stated that an auditor should maintain his independence, in fact, mind and appearance. Independence in fact (that is real independence) is related to the auditor's ability to express an opinion about the financial statements without his or her professional judgement being affected by factors which

could negatively affect his or her integrity, objectivity or professional scepticism. The auditor with independence, in fact, would make the audit as correct as possible.

The independence in appearance (that is perceived independence) is related to the third party. If the auditor is not perceived as independent by the users, the auditor is not seemingly independent. (Okaro, Okafor & Egbunike, 2013 and Dopuch *et al.*, 2003). These aspects of auditor independence are essential to achieving the goals of auditor independence. Hypothetically, an auditor can be in fact independent without being perceived as independent. In addition, an auditor can also be perceived as independent even though the auditor is in fact not independent. Therefore, it is important that the auditor not only acts independently but also appears to be independent. In the best case scenario, the auditor fulfils both aspects of independence (Cassel, 1996).

2.2.5 Threats to Auditor's Independence

Auditor independence enhances the credibility of the financial statement because of several reasons. If the auditor is independent, the probability that the credibility of the financial statements will be increased and stakeholders are more likely to rely on the statements is certain. If the independence of the auditor is threatened or impaired, it will cause undesirable effects on the client. Thus an understanding of possible threats against auditor independence is of importance (Ikharo, 2015 and Dopuch *et al.*, 2003).

Carrington (2010) posits that the auditor has to be independent of his audit clients both in fact and appearance and to achieve this independence, the EC (2002) gave a recommendation with possible threats against auditor independence and how to avoid such threats. The possible threats consist of self-interest, self-review, advocacy, familiarity or trust, and intimidation threats. It is expected that every auditor should test its own independence against these possible threats. The test has to be done at the beginning of an audit engagement and must be continually updated during the engagement in the light of new information and tasks. The principal rule is that if an auditor's independence is questionable, the auditor must decline or resign from the engagement. However, if special circumstances exist or if the auditor has undertaken actions against the threats of independence, the auditor is allowed to accept or continue the engagement (Ikharo, 2015, Carrington, 2010 and EC, 2002).

When the auditor has a strong personal relationship with anyone of its client, or is too much influenced by the client's personality and qualities or has too long and too close relationship with the client, discussions on auditor rotation suggests that familiarity threats may occur. For example, if the auditor has been auditing the client for a long period there are possibilities that the auditor becomes too close to the client. (Hayes *et al.*, 2014 and Carrington, 2010).

The threats may fall into one or more of the possible threats of independence and if a threat is identified in an audit engagement, suitable safeguards should be applied in

order to reduce the threat of auditor independence to an acceptable level or to eliminate it. If the auditor is not able to eliminate or reduce the threat the audit should decline or resign the engagement. Safeguards could either be created by the profession, legislation, or by safeguards in the work environment. Different type of safeguards may include prohibitions, restrictions, procedures or disclosures and an example of a safeguard could be the rotation of an audit partner or other team personnel in the engagement that has audited the client for a long time (Hayes *et al.*, 2014; Eilifsen *et al.*, 2013).

2.2.6 Audit Fees

The audit fee is any fee established for the performance of any service pursuant to an arrangement (Duska & Duska, 2003). This implies that audit fees are the amount charged by the auditor. Audit fee can be explained to be the amount charged by the auditor for an audit assignment carried out. That is the amount charged by the auditor for any work done in order to express an opinion on the true and fair state of affairs or position of the client's enterprise (Onaolapo, Ajulo & Onifade, 2017).

Suharli & Nurlaelah (2008) described the audit fee as the fee charged by a public accountant to the client for the financial audit services. This is in accordance with the opinion of The Securities and Exchange Commission, Final Rule (in Yuniarti, 2011) that the audit fee is the fees paid for annual audits and reviews of financial statements for the most recent fiscal year. The amount of audit fee can vary depending on the

complexity of services, assignment risk, the cost structure of Public Accountants Firm, the required level of expertise, and other professional considerations.

Moreover, Hoitash, Markelevich & Barragato (2007) opined that the aggregate of audit fees is the amount of all costs covered by the auditor. There is variation in the amount of the fee, depending on auditee size and how complex the auditing process is (Lyon & Maher, 2005). This is further corroborated by Turley & Willekens (2008) who states that there are three composite factors which contribute to the establishment of audit fees, which include complexity, Client size and associated risk. Audit fees are the fees paid to the auditors that reflect the cost of the effort conducted by the public editors and litigation risks (Onaolapo, Ajulo & Onifade, 2017; Choi, 2009).

2.2.7 Audit Quality

Audit quality is a well-researched topic in accounting and auditing. However, there is no standard definition by researchers but some of the definitions are similar. According to DeAngelo (1981), audit quality is a function of the probability that the auditor will discover and report breach, errors or misstatements that exist in the client's finances. The possibility of the auditor discovering errors and/or misstatements depends on the auditor's competence while reporting such errors and/or misstatements depends on auditor independence (Gonzalez, Garcia & Lopez, 2015).

Supporting this view is Cameran & Pettinicchio (2011) who reveals that the traditional definition of audit quality shows that audit quality, auditor's competence and auditor's independence are linked. They defined audit quality as the market-assessed joint probability that a given auditor both (i) detects irregularities (auditor competence) and (ii) reports such an irregularity (auditor independence) (Cameran & Pettinicchio, 2011).

While Frazel (2003) defined audit quality as a way by which auditor conduct audit in generally accepted auditing standards to provide reasonable assurance that the audited financial statements and related disclosures are presented in conformity with relevant international auditing standards and that they are not materially misstated due to errors or fraud. Material misstatement here is considered to reflect poor audit quality.

Li Dang (2004) argued that audit quality describes how an auditor can detect and report misstatement or errors in financial statements which reduces the information asymmetry between management and shareholders, and helps to protect the interests of shareholders. This, thus, requires a high level of competence and independence from auditors. (Suprato & Suwardi, 2013).

The auditors' competence is necessary to guarantee that the audit is professional. Consequently, an audit is able to obtain reasonable assurance about whether the financial statements are free from material misstatement, however, this reasonable assurance is not an absolute level of assurance. This issue is often referred to as the audit expectation gap and results from the fact that users of financial statements have

expectations about the auditors' duties that exceed the current practice (Hayes *et al.*, 2014; Cassel, 1996).

Power (2003) argues that several studies have indicated that the audit quality is difficult to observe because it is a function of how well the auditor is performing. Moreover, he points out that it is difficult to know what a "good audit" actually is and that the auditors themselves are not aware of if they are good auditors or not. In order for auditors to show external parties that they are good auditors they put much effort on work and work long hours (Power, 2003). However, Djamil (2000) pointed out certain factors like audit tenure, auditor independence, client's financial health, level of audit planning, audit fees, fraud and third-party review of the audit report to affect the quality of an audit.

2.3 Theoretical Review

In an effort to provide a sound theoretical background for this study, this study reviewed various theories in auditing in order to find a base on which this study was hinged on.

2.3.1 Agency Theory

The agency theory has its origin in economic theory and it points to two factors that influence the prominence of agency theory. Firstly, the theory is a conceptually simple one that reduces the corporation to two participants, managers and shareholders.

Secondly, the notion of human beings as self- interested is a generally accepted idea.

In its simplest form, agency theory explains the agency and risk sharing problems arising from the separation of ownership and control. It provides a useful way of explaining relationships where the parties' interests are at odds and can be brought more into alignment through proper monitoring and a well-planned compensation system. In other words, agency theory shows that there is a nexus of contracts between the two parties. The first party is the principal, who are considered to be the ones that own the economic resources of the company, while the second party is the agent who is the ones that use the resources provided by the principals to generate profits for the corporation and increase shareholders value. In agency theory, agents are considered to have more information than the principals and as a result, there is information asymmetry between these two parties (Daily, Dalton & Canella 2003 and Jensen & Mecklin, 1976).

Information asymmetry can be informed of moral hazard and adverse selection. The first arises because of the individual motives of the agents which are not always consistent with those of the principals. For example, managers' bonuses can be demonstrated, which arise from the achievement of specific goals. Self-motivated managers can try to deceive principals in order to reach them, and as a result moral hazard problem arises. The latter refers to the inability of the owners of the company (principals) to have the same level of information as managers (agents). As a result,

they are unable to determine if the agents behave in the best interest of the corporation or not (Scapens, 1985).

Nevertheless, agency theory addressed two critical problems in an organization. The first one is agency problem which indicates that the principal has the inability to identify whether the agent has acted accordingly to his desire, due to the fact that there are conflicting goals between the two parties and the costs of specifying if the agents behave appropriately are very high. The second one is the problem of risk sharing. It is developed when there are different aspects between the two parties concerning the risk attitude that has to be considered. In particular, the principal has different views about how risks are mitigated than the agents because of the different actions that these two parties prefer towards them (Eisenhardt, 1989). As a result of the conflicting goals of these two parties and the different risk attitude they have, agency theory is created as a way to resolve them.

2.3.2 Limperg Theory (Theory of Inspired Confidence)

Limperg theory which is known as the theory of inspired confidence was developed in 1920 by Theodore Limperg at the University of Amsterdam. The theory states that the role of auditors is to meet the needs of the users of the Financial Statements. It also considers the fact that the business is a faction that is always in motion and thus it evolves. As a result, auditing techniques should evolve accordingly.

Moreover, the needs of the users of financial information and their trust in the audit profession itself are important to the role of auditors. Limperg's theory is characterized as dynamic and connects the expectations of the public to the reliability of the information provided by the audit profession. Auditor's social responsibility is maintained by the independence of the person performing the audit and the understanding of his role as an agent, not only representing the needs of the shareholders of the company but also the needs of society. Only in that way, the profession of auditors maintains its high level of competence and remains reliable in the eyes of the public (Carmichael, 2004).

2.3.3 Lending Credibility Theory

This theory regards the primary function of auditing to be the addition of credibility to the financial statements. Audited financial statements are used by management (agent) in order to enhance the principal's faith in the agent's stewardship and reduce the information asymmetry. However, Porter (1990) concludes, that "Audited information does not form the primary basis for investors' investment decisions". On the other hand, it is often asserted that financial statements have a function of confirming the message that was previously issued (Hayes *et al.*, 1999).

2.3.4 The Assurance Theory

An assurance service is a service in which a public accountant expresses a conclusion about the reliability of a written assertion that is the responsibility of another party

(Cosserat, 2009). Elder, Beasley & Arens (2010) define an assurance service as an independent professional service that improves the quality of information for decisionmakers.

Individuals responsible for making business decisions seek assurance services to help improve the reliability and relevance of the information used as the basis for their decisions. Following Elder *et al.*, (2010), one category of assurance services provided by auditors is 'attestation services'. Performing attestation services, the auditor issues a report about the reliability of an assertion used by another party. Five categories of attestation services are distinguished as expatiated in the paragraphs below.

An audit of historical financial statements is a form of attestation service in which the auditor issues a written report expressing an opinion about whether the financial statements are fairly stated in accordance with the applicable accounting standards.

Financial statement users value the auditor's assurance because of the auditor's independence from the client and knowledge of financial statement reporting matters.

An audit of internal control over financial reporting is a form of attestation service in which the auditor evaluates management's assertion that internal controls have been developed and implemented following well-established criteria. The auditor's evaluation increases user confidence about future financial reporting because effective internal controls reduce the likelihood of future misstatements in the financial statements.

Performing an audit of historical financial statements, the auditor provides a high level of assurance. For reviews of financial statements, the auditor provides only a moderate level of assurance. Because less evidence will be needed, reviews of financial statements can be performed at a lower fee than an audit.

Performing attestation services on information technology, the auditor evaluates management's assertions about the reliability and security of electronic information. Other attestation services that may apply to a broad range of subject matter can be performed. In each case, management must provide an assertion before the auditor can provide the attestation.

Eilifsen *et al.*, (2010) provide examples of specific subject matter information, including reporting on sustainability, internal control, the greenhouse gas, and pro forma financial information included in prospectuses.

Corporate social responsibility (CSR) reports (sustainability reports) for example, include information on the environment, the social and economic performance of the reporting entity. The auditor is engaged to add credibility to sustainability reports. As a basis for the sustainability assurance engagement, the auditor uses sustainability reporting guidelines, for example, guidelines of the Global Reporting Initiative (GRI). An external assurance of sustainability reports can contribute to their quality, credibility, and reliability.

2.4 Empirical Review

The issue of mandatory auditor rotation, auditor independence, audit fees and their relationship with audit quality has been widely discussed in the literature and it has been an increasing area of research focus now that regulatory bodies in different countries are advocating for mandatory rotation and auditor independence. However, in this study, extant literatures were reviewed based on their geographical sources as identified below.

Empirical studies in developed countries

Deis & Giroux (1992) analysed the result of quality control reviews of audits of Texas school districts and concluded that audit tenure is positively associated with a quality measure reflecting auditors' failure to comply with professional standards. The first hypothesis suggests that audit quality decreases as audit tenure increases. Their study provides direct empirical evidence that audit tenure is negatively related to audit quality. This negative relation can be attributed to either opportunistic behaviour or complacency.

In their study, audit quality was defined as the probability that the auditor will both discover and report a breach in the client's accounting system, which has been derived from DeAngelo (1981) where it was stated that this quality depends on the auditor's independence.

This definition of audit quality was measured by taking the natural log of the weighted quality metric based on the quality control reviews letters of findings. Audit tenure was measured by the number of years the auditor has audited the independent school district. The variable client, which is measured by the number of independent school district clients audited by the auditor, was also included as an independent variable. The study observed that improved audit quality was expected with increases in the number of audits conducted by the audit firm. However, this study was limited by the fact that the evidence pertains to a single type of client entity, hence the generalization of the result may be limited (Deis & Giroux, 1992).

Meanwhile, Copley & Doucet (1993) tried to provide empirical evidence of the relation between the quality of governmental audit services and auditor tenure. These authors analysed 136 audits of federal financial assistance programs in 1985. Their empirical analysis indicates that the probability of receiving a substandard, low quality, audit increases when the audit tenure increases. To measure the audit quality a dichotomous measure are used, which indicate whether an Office of Regional Inspector General observed the audit to be of acceptable or unacceptable quality. Audit tenure is measured by developing a five-category ordinal level variable indicating the number of previous audits performed by the auditor of the selected financial report. The findings contradict conventional arguments against auditor rotation, which state that there is little evidence supporting the negative association between the quality of audits and audit tenure. This

negative effect can be explained by the fact that incumbent, resting, auditor decreases the quality of audit services supplied, either opportunistically or through an erosion of their objectivity. Nevertheless, this study was limited by the fact that, even though the analysis documents show a significant relationship between substandard audit quality and audit tenure, it does not permit an investigation of the cause of this association (Copley & Doucet, 1993).

Vanstraelen (2000) analysed the impact of renewable long-term audit mandates on audit quality in a European setting. It was questioned whether renewable long-term audit mandates have an impact on the reporting behaviour of the auditor and on his independence. The results of the study suggest that long audit tenure significantly increases the likelihood of an unqualified opinion or significantly reduces the auditor's willingness to qualify audit reports. The study also observed a significant difference between the auditors' reporting behaviour in the first two years of their mandate versus the last years of their mandate.

To measure audit quality this study uses an unclean audit report as a binary variable. The independent variables used are audit tenure, as the length of the auditor-client relationship, and whether or not the auditor is in the last year of his official mandate. The control variables used are fees, the probability of detection of incorrect audit opinion, the fear of loss of the client and the fear of loss of reputation. This study was

however limited by the fact that it is only focused on companies from Belgium with a scope limitation of the results (Vanstraelen, 2000)

While Myers, Myers, & Omer (2003) analysed the relation between audit firm tenure and two measures of accruals, namely discretionary accruals but also current accruals. With a broad cross-sectional study they consider the relation between auditor tenure and earnings quality, by measures of accounting accruals as a proxy. This study finds no evidence that a longer audit firm tenure is associated with lower earnings quality.

Remarkably they find results that suggest that earnings management becomes more limited as the tenure of audits increases. The reasoning behind this is that longer auditor tenure results in auditors placing greater constraints on extreme management decisions in the reporting of financial performance.

Myers *et al.*, stated that earnings quality could be used to draw inferences about audit quality and claimed that a high audit quality constrains auditors in extreme choices that management would like to make in presenting the financial position of the company.

Taking the absolute, signed, and raw values of both discretionary and current accruals measure the earnings quality. As control variables, they used firm age, size, industry growth, cash flow, auditor type, industry and year. This study is limited by the fact that it does not address all instances of earnings management and does not condition on managers' incentives to manage earnings (Myers, Myers, & Omer, 2003)

Ruiz-Barbadillo, Gómez-Aguilar, & Carrera (2009) analysed the impact of Mandatory Auditor Rotation on auditor independence using Spanish archival data. These authors investigated audit firm rotation during a period when audit firm rotation was mandatory in Spain, followed by a period when the requirement to change audit firms was lifted. The study observed no evidence to suggest that mandatory rotation is associated with a higher likelihood of issuing going-concern opinions.

In their study, auditor independence was measured by taking the auditor's tendency to issue a going-concern opinion of a financially stressed company. The independent variables were audit firm rotation, the influence of the audit firm and the reputation. As control variables, the probability of bankruptcy, the existence of loss, leverage and client size are used. The study is limited by the fact that the results may be affected by other potential going-concern determinants and there is a scope limitation (Ruiz-Barbadillo, Gómez-Aguilar, & Carrera, 2009).

Zhang *et al.*, (2014) investigation on the subject "change for change's sake? Does mandatory partner rotation improve audit quality?" tests the impact of mandatory partner rotation on audit quality using a unique dataset, of audit adjustments in China, their study suggests that mandatory rotation of engagement partners results in higher quality audits. And they found out that a significantly higher frequency of audit engagements during the departing partner's final year of tenure prior to mandatory rotation and during the incoming partner's first year of tenure following rotation.

Beside this, Firth *et al.*, (2012) study on "How do various forms of auditor rotation affect Audit quality? Evidence from China" tests on whether the development of the market and legal institutions affect the impact of rotation on audit quality discovered that firms with mandatory audit partner rotation are associated with the significantly higher likelihood of a modified audit opinion than are no rotation firms.

Gonzalez, Garcia & Lopez (2015) analysed the impact of auditor tenure on audit quality for Spanish state-owned foundations. These authors concluded that audit quality, measured as the likelihood that an auditor will submit a qualified opinion, increases over the first five years of the relationship and then decreases. The results indicate that long audit tenure increases the likelihood of the auditor issuing a clean report.

These authors define audit quality as the likelihood that an auditor will submit a qualified opinion. The independent variable is the audit tenure and is measured in two ways: as a continuous or as a dummy variable. As a continuous variable, tenure is calculated as the number of consecutive years a foundation has been audited by the same auditor. For the dummy variable, three measurements for every sample were used, obtained by calculating tenure quartiles. The following control variables were used: type of auditor, size, previous year's opinion if the foundation's revenue exceeds its expenses, the sector and the year. This study is limited by the fact that the research is conducted in an environment where there is no Mandatory Auditor Rotation and in a

sector where further empirical research is very limited (González-Díaz, GarcíaFernández, & López-Díaz, 2015).

Hohenfels (2016) study examines how auditor tenure affects investors' perception of audit quality. The study came about by the ongoing debate on the effect of auditor tenure on audit quality and the recent regulatory approval on mandatory auditor rotation at the EU level, which is justified by the concern that longer auditor tenure impairs auditor independence and thus lowers audit quality. Perceived earnings quality, as measured by the earnings response coefficient from returns-earnings regression, is used as a proxy for investors' perception of audit quality. Using a sample of 2,320 firm-year observations from German listed firms between 2006 and 2013, the study provides evidence of a non-linear relationship between auditor tenure and perceived earnings quality. The results suggest that investors perceive lower earnings quality during the early and later years of an auditor-client relationship. This perception does not change during the investigation period. Furthermore, the results show that earnings quality is perceived as highest when auditor tenure is 8–9 years.

Leung, Srinidhi, & Xie (2017) study on auditor tenure, information asymmetry and earnings quality showed that auditor tenure improves earnings quality on average. Their findings were extended to show that the improvement in earnings quality resulting from longer auditor tenure is greater for firms with higher information asymmetry, after controlling for auditor's industry specialization. They also argue that audits of client

firms with higher information asymmetry demand more client-specific knowledge that cannot be gleaned from industry or general experience. Longer tenure helps auditors acquire such knowledge and therefore, the benefit of longer audit tenure is greater in firms with greater information asymmetry. Using bid-ask spread, return volatility, intensity of R&D expenditure and a composite distance measure to measure information asymmetry, their results implied that frequent auditor changes are costlier for firms with higher information asymmetry and at the policy level, it implied that mandatory auditor rotation is more (less) costly for firms with high (low) information asymmetry, however, their study failed to examine the quality of an auditor report.

Singer & Zhang (2018) study on auditor tenure and the timeliness of misstatement discovery used the timeliness of misstatement discovery as a proxy for audit quality. They examine the association between audit firm tenure and audit quality in a setting that alleviates the endogeneity problem endemic to this line of research. The study found out that longer audit firm tenure leads to less timely discovery and correction of misstatements, which is consistent with a negative effect of long auditor tenure on audit quality. In addition, using the non-voluntary auditor change following the demise of Arthur Andersen in 2002 as a natural experiment, they show that the misstatements of its former clients were discovered faster than those of comparable companies that retained their auditors throughout the misstatement. This finding speaks to the benefit of a fresh look by a new auditor. In addition, an extended analysis in the study shows

that longer auditor tenure also leads to misstatements of greater magnitudes and that the Sarbanes-Oxley Act has mitigated, but not eliminated, the negative effect of long auditor tenure. The study also showed that the negative association between auditor tenure and timely discovery of misstatements is mainly present in the first ten years of an audit engagement. The study is limited by the fact that timeliness of discovery of misstatement is not a yardstick for the quality of an audit quality as the appropriate measure taken to evaluate the proxy is not clear.

Empirical studies in developing countries

Siregar, Amarullah, Wibowo, & Anggraita (2012) analysed the effect of auditor rotation and audit tenure of the public accountant and the public accounting firm on audit quality, before and after the implementation of mandatory audit firm rotation. The study shows that auditor rotation before regulation increased audit quality, whereas mandatory auditor rotation does not show positive effects on audit quality. However, no strong evidence is observed to support the notion that mandatory audit firm rotation is an effective measure to increase the quality of audits.

To measure audit quality discretionary accruals are used. Audit tenure is used as an independent variable in two components i.e. audit partner and audit firm tenure. As an independent variable audit partner and audit firm rotation are also used and are measured using a dummy variable. This study is limited because it only used discretionary accruals as a proxy to measure the quality of audits. In addition, the study

did not investigate the relation between audit tenure on audit quality for each industry and did not consider corporate governance variables. Another limitation of this study is the fact that quasi-rotation could occur in Indonesia because of the law enforcement regime. Quasi-rotation companies may seem to have changed their audit firms, but this did not occur: audit firms can only change the local name of their audit firms by changing 50% of its audit partners, but their foreign affiliated did not change. (Siregar, Amarullah, Wibowo, & Anggraita, 2012).

Lim & Tan (2010) investigated whether the relation between auditor tenure and audit quality is conditional on auditor specialization and fee dependence. These authors argue that auditor tenure is associated with two related constructs: auditor expertise and economic incentives. Lim and Tan also stated that in assessing the effects of auditor tenure on audit quality, it is important to consider the joint consideration of the two related constructs and not either the effects of expertise or incentives alone. In the study, it is shown that increased auditor tenure is associated with increased expertise factors to protect reputational capital, which increases audit quality. Also concluded is the fact that increased auditor tenure is associated with increased incentives to please the client, which reduces audit quality. The authors show that extended auditor tenure does not necessarily decrease audit quality. In fact, the authors believe that audit quality can be improved with extended tenure when two conditions are met: the auditor is a specialist and has low fee dependence (Lim & Tan, 2010).

Nasser, Wahid, Nazri, & Hudaib (2006) investigated audit tenure and switching behaviour in the Malaysian audit environment. Malaysian listed companies were examined using logistic regression. Results show that retention of audit firms depends on the size of clients based on total assets, level of financial risk and type of audit firm but not by changes in operating income and market value. The study also indicates that auditors with distressed large clients fear losing their tenure and being switched, hence their independence and objectivity may be impaired (Nasser, Wahid, Nazri, & Hudaib, 2006).

In the same vein, Suprato & Suwardi (2013) in their study on the effect of audit partner rotation and audit firm fees on audit quality reveal that public accountants' compliance on audit rotation regulation and audit tenure provide no effect on audit quality. Their study thus posits that the audit firm's annual fees and initial balance testing are the two determinant factors which provide a positive effect on audit quality.

Rahmina & Agoes (2014) examined the influence of auditor independence, audit tenure, and audit fee on audit quality of members of capital market accountant forum in Indonesia. The aim of the research was to determine the effect of auditor independence, audit tenure and audit fee both partially and simultaneously on audit quality. Using primary data collected through the distribution of questionnaires in audit firms listed in capital Market Accountant forum, they found out that auditor independence, audit tenure and audit fees have a positive influence on audit quality.

Ahmet, Nihat, Mustafa, & Burcu (2017) study on audit firm tenure and audit quality implied by discretionary accruals and modified opinions: evidence from turkey where they examined the association between audit firm tenure and audit quality in Turkey. They used three measures to proxy audit quality such as propensity to issue modified audit reports and discretionary accruals determined by two models. Their study found some evidence that audit quality does not increase with limited audit firm tenure. Given the additional costs associated with audit switch, they concluded that there are minimal benefits of mandatory firm rotation. However, their study was limited in scope as the study occurred at a period where mandatory rotation was not practised.

Empirical studies in Nigeria

Olowookere & Adebisi (2013) study on mandatory audit firm rotation and audit quality in Nigerian Deposit Money Banks investigated how mandatory audit firm rotation rule could affect the audit quality in Nigerian Deposit Money Banks (DMBs). The data for this study were collected through primary and secondary sources. The Binary Logit Model estimation technique was used to analyze the relationship between the mandatory audit firm rotation and audit quality. The study's results show that mandatory audit firm rotation rule does not affect the audit quality. In addition, most banks have complied with the directives of the Central Bank of Nigeria with respect to the mandatory rotation of audit firm after ten years. We, therefore, recommended that the rotation of external auditors should be made voluntary.

Amake & Okafor (2012) auditors independence, auditors' tenure and audit firm size In Nigeria 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.

Adeyemi, Okpala & Dabor (2012) study on factors affecting audit quality in Nigeria investigated the factors affecting audit quality in Nigeria. The primary data were supplied by 430 respondents from several stakeholders in the fields of financial reporting and auditing. The secondary data were generated from the financial statements of forty annual reports of companies quoted on the Nigerian Stock Exchange. The test of hypotheses and other analysis of data were done using SPSS, version 17. The tests revealed that among others, multiple directorships is the most significant in affecting audit quality in Nigeria. In addition, it is found that provision of non-audit service would likely have a significant effect on the audit quality in Nigeria. However, the study did not find audit firm rotation to be a significant factor in

enhancing audit quality in Nigeria. The study recommends efforts should be made to strengthen audit quality if the quality of financial reporting was to be improved. Also, regulatory authorities should ensure that the same firm does not render audit services and offer management advisory services in the same company simultaneously.

Imeokparia (2014) study on audit firm rotation and the quality of audit work: an empirical study of Nigeria sought to determine if the rotation of audit firms would increase auditor's independence and audit quality; whether long audit tenure has any effect on auditor's independence and audit quality as well as if the start-up cost and risk of audit failure would increase provided that there is rotation of audit firms. In this research, three (3) hypotheses were formulated and tested. The primary data was obtained through the administration of questionnaires to a simple randomly selected set of 120 auditors from the Big 4 audit firms (Price Waterhouse and Coopers, KPMG, Deloitte, and Ernst & Young). In testing the hypotheses the regression analysis was used. The findings from this research indicated that mandatory rotation of audit firms has a positive relationship with auditor's independence and audit quality so likewise does long audit tenure. It also shows that audit firm rotation significantly affects audit start-up cost and the risk of audit failure. This study highly recommends that accounting and auditing bodies in Nigeria should incorporate mandatory rotation of audit firms as this would enhance the independence of auditors. It further recommends that the rotation period is determined with great care given the delicate trade-off between

clientspecific knowledge on the one hand and independence-related issues on the other hand.

Okolie (2014) study on auditor tenure, auditor independence and accrual-based earnings management of quoted companies in Nigeria examined the relationship and effects of auditor tenure and auditor independence on the earnings management (measured by the number of discretionary accruals) of companies in Nigeria. The study relied on secondary data derived from various companies' financial statements and the Nigerian Stock Exchange fact book to determine and measure the level of earnings manipulations in corporate financial statements, applying an all-inclusive multivariate analysis. The empirical analysis using a total of 342 company year observations, shows that Audit tenure and auditor independence exert significant effects and exhibit a significant relationship with the number of discretionary accruals of quoted companies in Nigeria. The descriptive statistics result reveals a minimal presence of discretionary accrual management by the companies in the sample and on the average; about 94% of the companies engage their audit firms for over three years, with a considerable experience of a substantial number of audit firms in this distribution. However, this study was limited as it failed to do justice to the variable used to measure earnings management.

Onyabe, Okpanachi, Nyor, Yahaya, & Ahmed (2018) study on the effect of audit committee tenure on financial reporting quality of listed deposit money banks in Nigeria. Using panel data obtained from the Nigerian Stock Exchange factbooks and

the financial statements of 14 listed deposit money banks over a period of 10 years (2007-2016) with a cross-sectional and time series research design, the study measured financial reporting quality using the modified Jones (1991) model and changes in working capital model, while audit committee tenure was measured as the mean tenure of audit committee members. The data was analyzed using descriptive (mean, standard deviation, minimum and maximum) and inferential statistics (correlation and regression analysis). The study revealed that audit committee tenure has a negative and insignificant effect on financial reporting quality under the two models. The implication of these results is that the tenure of audit committee members is not important when considering the financial reporting quality of deposit money banks in Nigeria. The study concluded that the effect of audit committee tenure on financial reporting quality of deposit money banks in Nigeria is negative and insignificant.

The gap discovered in these literature shows that there are limited studies that test auditor rotation relationship effect on audit quality in Nigeria. Some of these literatures are foreign like Singer & Zhang (2018) study on auditor tenure and the timeliness of misstatement discovery, Leung, Srinidhi, & Xie (2017) study on auditor tenure, information asymmetry and earnings quality, Gonzalez, Garcia and Lopez (2015) study in Spanish state-owned owned foundation, Firth *et al* (2012) Study in China, Salleh & Jasmani (2014) study in Malaysia, Zhang *et al* (2014) and Rahmina & Agoes (2014) study in Indonesia among others. Therefore, this study aims to provide empirical

evidence in Nigeria as it examines the impact of auditor rotation on audit quality. This analysis is particularly relevant at this time seeing the current wave on the issue of mandatory auditor rotation and auditor independence by regulatory bodies with regard to its likely impact on developing economies like Nigeria.

2.5 Theoretical Framework

Having reviewed the relevant theories to the study, agency and Limperg theories were used as base theories for this study. In an attempt to justify the use of Agency and Limperg theories in this study, auditors are also considered agents of the principals because they are hired by the audit committee of the company. As a result, trust needs to be placed between these two parties and this can be achieved if auditors maintain their objectivity and independence.

Moreover, the importance of regulations and mechanisms to enforce the fulfilment of expectations of all the stakeholders of the company related to the audit profession must be well spelt out. In other words, the audit provides an independent check on the work of agents and of the information provided by an agent, which helps to maintain confidence and trust. It is obvious that auditors are hired as agents by the directors of the company in order to monitor the work of managers who are also considered as agents.

In its simplest model, the agency theory states that no agent is trustworthy. Therefore, auditors must be independent of the company and its executives in order to maintain their trustworthiness and objectivity. Auditors provide credibility for the financial information presented which impacts on information value and the value of the entity concerned. (Carmichael, 2004; Daily, Dalton & Canella 2003)

The concepts of agency theory and Limperg theory have been expatiated to be the base for this study where agency theory was defined along with the two parties of owners of economic resources, the principals and the agents and Limperg theory supporting.

2.6 Conceptual model of the impact of mandatory auditor rotation on audit quality in selected firms in Nigeria.

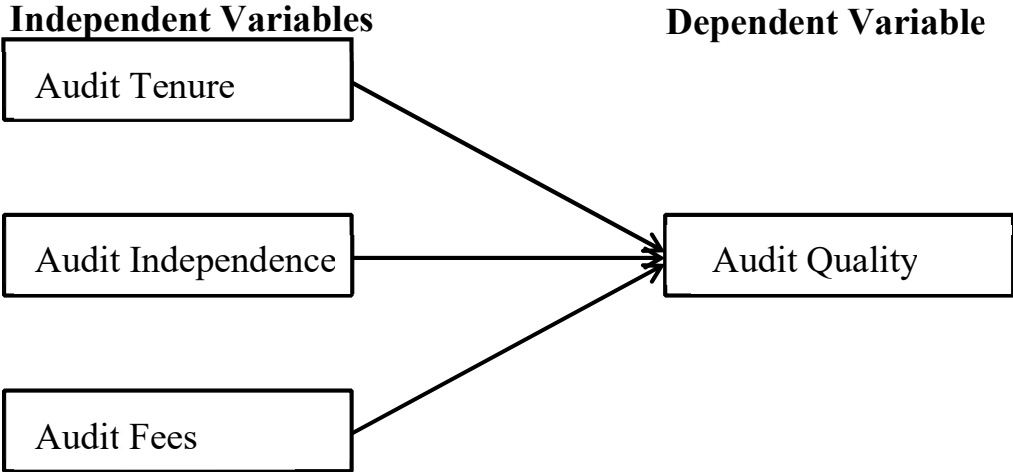


Fig 1: Research Model of mandatory auditor rotation, auditor independence, audit fees and audit quality

The conceptual model above demonstrates the link between mandatory auditor rotation and audit quality. Mandatory auditor rotation is measured by audit tenure (audit tenure,

going concern of auditee and auditors report), audit independence (integrity and objectivity) and audit fees (size of auditee, risk and complexity) that leads to audit quality (skill, ethical value mind-set, reliability of audit methods, the effectiveness of the tools utilized, the availability of technical support).

CHAPTER THREE

METHODOLOGY

3.1 Research Design

The research design is a detailed plan or research work that shows the links or processes of the operationalized variables which were measured and analysed. It contains the adopted sample of interest and data collection was based on the tested hypothesis of a research study (Otokiti, 2009). A cross-sectional survey design was used in this study. Survey strategy is a popular and common strategy for research in business and management research because it allows the collection of a large amount of data from a sizeable population in a highly economical way. This research is also quantitative. The quantitative nature of the research is designed for auditors' so as to appropriately measure their perceptions of the identified variables in the study.

This study was therefore designed to ascertain the effects of mandatory auditor rotation on audit quality. To attain the above measurement objective, explanatory and descriptive measures were adopted. In order to establish causal relationships between identified variables, an explanatory study was used. The research is cross-sectional because the phenomenon of our investigation was studied at one particular time and not over several years.

3.2 Population of Study

There are 88 registered complaint auditing firms in Lagos Nigeria (Office of Auditor General of the Federation, 2017). These compliant firms have headquartered in Lagos due to a high level of economic activities, the concentration of corporations and registered business in the State. Thus, the total number of practising auditors these 88 firms are 239 consisting of (112 assistant managers, 56 managers, 38 senior managers, and 33 Partners) (Office of Auditor General of the Federation, 2017). Hence the target population of auditors for the study is 239.

3.3 Sample Size and Sampling Technique

The sample of this research was determined by using Taro Yamane (Yamane, 1967) formula with a 95% confidence level. The calculation formula of Taro Yamane is presented as follows;

$$n = \frac{N}{1 + N(e)^2}$$

Where;

n = Sample size

N = Population e =

Margin of error (%)

Substitute numbers in

formula:

$$n = \frac{239}{1 + 239(0.05)^2}$$

$$n = \frac{239}{1.5975}$$

$$n = 149.6 \approx 150 \text{ (rounded)}$$

Hence the sample size is 150 respondents.

The respondents for this study were selected using purposive sampling technique on assistant managers, managers, senior managers and partners from the population of study. The respondents were selected with particular interest on auditors in Lagos metropolis. Meanwhile, the respondent analysis shows a 96% response rate.

3.4 Method of Data Collection

In research methodology, data collections are either through a primary source of data or secondary source of data. However, for the purpose of this research which requires the perception of auditors, primary data was used in this study and was collected through a carefully designed survey questionnaire administered by the researcher to the targeted group of practising auditors and accountants. The questionnaire was divided

into two sections. The first section was designed to capture the biodata of the respondents such as age, gender, years of experience, educational and professional qualification while the second section addressed questions relating to relevant variables used in the study on a five-point Likert scale ranging from strongly agree (5) to strongly disagree (1).

3.5 Method of Data Analysis

Descriptive and inferential statistics were used to analyse the data and necessary interpretations were made based on the outcome of these tools. The descriptive method described the variables using frequency tables, mean and standard deviation. While the hypothesis formulated was tested using multiple regression technique after the assumptions required for the usage of this technique have been met. These tests answered the research questions and the objective of the study was achieved.

In addition, a validity test was conducted to ascertain the stability of the measurement instruments. The researcher adopted the use of content and face validity to measure the instrument of this study. Content validity in this study was attained by allowing the supervisor, Lecturers and senior colleagues' (PhD Students) to review and evaluate the instrument before the data collection.

For face validity, the researcher seek for the opinion of others to know whether or not the instrument used was appropriate enough to measure what was supposed to be

measured. This instrument was also subjected to modifications by the supervisor to ensure that the study is confirmed for face validity.

3.6 Reliability test

Table 3.1: Reliability Statistics

Variables	Cronbach's Alpha	N of Items
Audit Tenure	0.77	10
Audit Independence	0.76	7
Audit Fees	0.73	6
Audit Quality	0.81	12
Overall	0.77	33

Source: Survey Result, 2017

The internal consistency of the questionnaire reliability was measured by using Cronbach's coefficient alpha statistical test as shown in Table 3.1 above. The analysis provides an indication of the average correlation among all the items that made up the scale. The study demonstrates that all indices obtained were considered high at 0.77, 0.76, 0.73 and 0.81 for audit tenure, audit independence, audit fees and audit quality respectively. The overall Cronbach's alpha coefficient is 0.77. A sample scale that shows an alpha value above 0.70 is considered reliable (Md Nor, 2009). Therefore, the indices for the questionnaire reliability are generally considered adequate for this study.

3.7 Model Specification

The model for this study adapted with modifications is consistent with the model used in other studies like Rahmina & Agoes (2014). However, this study wishes to test the acceptability and applicability of the model in Nigeria.

The model is specified as

$$\text{AudQua} = f(\text{AudTen}, \text{AudInd}, \text{AudFees})$$

Where;

AudQua = Audit Quality

AudTen = Audit Tenure

AudInd = Auditor Independence

AudFee = Audit Fees

The econometrics equation for this model is

$$\text{AudQua} = \beta_0 + \beta_1 \text{AudTen} + \beta_2 \text{AudInd} + \beta_3 \text{Audfees} + \epsilon$$

Where;

β_0 = Constant

$\beta_1 - \beta_2$ = Coefficient of independent variables

ϵ = Error term

3.8 Operational Definition of variables

Operationalizing research variables is a process of translating or defining a concept to make them measurable. The concept of mandatory auditor rotation used in this study adopts a concept developed by Hartadi (2009) where Mandatory auditor rotation consists of audit tenure, going concern and auditor reports. Similarly, the concept of auditor independence used in this study adopts the concept developed by Rittenberg *et al.*, (2008) (cited in Novie, 2013) in which auditor independence consists of integrity and objectivity. The definition of audit fees is adapted from Duska & Duska (2003). Furthermore, referring to Turley (2005) (cited in Novie, 2013), audit fees are divided into three indicators, i.e. size of an auditee, complexity, and risks. The concept of audit quality is adapted from Turley & Willekens (2008). In addition, the operationalization of audit quality adopts the seven indicators proposed by Schilder (2011), i.e. skill, experience, ethical value, mindset, the reliability audit methods, the effectiveness of the tools used, and the availability of technical support.

The following table further expatiates the operational definition of the variables used in this study

Table 3.2: Operational definition of Variables

Concept	Indicator	Operational Definition
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Audit Tenure	Audit Tenure	The time an auditor conducts the financial statements examination of a company. (Hartadi, 2009)
	Going Concern of Auditee	The continuity of an audit client indefinitely. (Arens <i>et al.</i> , 2012).
	Auditors report	The type of report auditor produces at the end of the audit exercise. (Kegel, 2006).
Auditor Independence	Integrity	A person's attitude acting in accordance with conscience, honesty, looking at and presenting facts as they are (Arens <i>et al.</i> , 2012).
	Objectivity	Objectivity is an attitude that does not take sides and is free of conflict of interests (Messier, 2008)
Audit Fees	Size of Auditee	It is by far the most important determinant of audit fees. It is the total assets and turnover the most commonly utilized measures of the size of an auditee. (Turley <i>et al.</i> , 2005)
	Complexity	The level of business complexity of the auditee also influences audit fees. Complexity reflects the nature and diversity of the business of the auditee locations,

		the quality of internal control, the existence of unusual transaction. (Turley <i>et al.</i> , 2005)
	Risk	Auditee risk and thus the auditor might perform additional work, which means higher fees (Turley <i>et al.</i> , 2005)
Audit Quality	Skill	The ability in accounting, auditing, taxation, management consulting and financial management services that the auditor needs to possess in order to perform professional services (Hayes <i>et al.</i> , 2005).
	Ethical Value	The principles of public accountant ethics as regulated in ICAN Professional code of ethics
	Mindset	The paradigm which is solidly ingrained in a community (Enrico, 2001).
	Reliability of Audit Methods	The reliability of audit procedures, the adherence to regulation, the ability to interpret an evidence conducted by an auditor (Kegel, 2006).
	The Effectiveness of the tools utilized	Conducting information technology-based auditing in which such a tool will aid the auditor in

		performing professional services in terms of speed and accuracy (Russel, 2005).
	The availability of Technical Support	Auditing staff with up to par competence is readily available.

Source: Authors compilations, 2017

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND DISCUSSION OF RESULTS

4.1 Introduction

To empirically verify our hypothesis, we employed various statistical techniques. This chapter presents the empirical results on the impact of mandatory auditor rotation, auditor independence and audit fees on audit quality. We present the descriptive statistics, Pearson correlation and multiple regression analysis results.

4.2 Presentation and Interpretation of Findings

Table 4.1: Demographic Characteristics of Respondents

		Number	% Frequency
EDUCATIONAL QUALIFICATION	HND	16	11.1
	B.Sc	64	44.4
	M.Sc	52	36.1
	PhD	12	8.3
	Total	144	100
PROFESSIONAL QUALIFICATION	ACA	104	72.2
	FCA	24	16.7
	ACCA	4	2.8
	ANAN	12	8.3
	Total	144	100
AGE	18-30	48	33.3
	31-45	64	44.4
	46-60	28	19.4
	ABOVE 60	4	2.8
	Total	144	100

GENDER	MALE	108	75
	FEMALE	36	25
	Total	144	100
CADRE	Partners	21	14.6
	Senior Managers	23	16
	Managers	34	23.6
	Asst. Managers	66	45.8
	Total	144	100
YEARS OF EXPERIENCE	LESS THAN 5YRS	36	25
	6-10 YRS	40	27.8
	11-20 YRS	48	33.3
	21-30YRS	16	11.1
	GREATER THAN 30YRS	4	2.8
	Total	144	100

Source: Survey result, 2017

As a way of demonstrating that the respondents have substantial knowledge in the study area, the frequency distribution shown in Table 4.1 revealed the educational qualification of the respondents. Where 71 respondents (44.4%) are B.Sc holders, 57 respondents (36.1%) are M.Sc holders, 18 respondents (11.1%) are HND holders while 13 respondents (8.3%) are PhD holders, these results indicate the highest academic level that respondents have, and this may be positively reflected upon the importance of the information given by the respondents. Professionally, 115 respondents (72.2%) are ACA, 27 respondents (16.7%) are FCA, 4 respondents (2.8%) have ACCA and 13 respondents (8.3%) have other professional qualifications. This demonstrated the importance of the respondent's group as technocrats in the area being studied. The

distribution of the respondents by age showed that 71 (44.4%) respondents are with age range of 31-45years, while the lowest age bracket is above 60 where we have 4 respondents. The distribution of respondents by gender revealed that male respondents accounted for 75% of the respondent's group while the remaining 25% are female giving a total of 144 respondents. The representation of the respondents according to their cadre/rank showed that 14% of the respondents are Partners, 16% senior managers, 23.6% managers and 44.5% are assistant managers. Apart from demonstrating substantial knowledge by the respondents, years of experience in auditing are also essential in this analysis. The field survey revealed that 53 respondents (33.3%) have experience of between 11-20 years in auditing while the smallest groups in terms of experience are those respondents who have experience greater than 30 years. This result indicates that the extent of experience and maturity may be reflected positively in the work.

Table 4.2: Presentation of Distributed Questionnaire

	No	Percentage
Returned Usable	144	96%
Returned Unusable	5	3.33
Unreturned	1	0.67%
Total	150	100

Source: Author’s Survey, 2017

Table 4.2 above shows that out of the 150 copies of questionnaires distributed to the respondents, 144 (96%) were completely filled and returned while 1 (0.67%) was not

returned and 5 (3.33%) were returned but unusable due to errors of respondents in completing them.

4.3. Normality Test

A normality test was conducted using Kolmogorov-Smirnoff and Shapiro-Wilk test to test if the variable did not deviate from a normal distribution. The result of the test is shown below.

Table 4.3: Normality test

	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	Df	Sig.
Audit Quality	.158	144	.100	.953	144	.310

a. Lilliefors Significance Correction

Level of significance: 0.05

The normality test conducted as shown in Table 4.3 above to determine whether the dependent variable did normal distribution characteristics. Analysis of the data revealed that the values of the variable under study were indeed normally distributed. The Kolmogorov-Smirnoff test for normality produced a small K-S statistic of 0.158, which was not significant at 0.05 ($p = 0.10$) while the Shapiro-Wilk test of normality too obtained a relatively small coefficient of 0.953, which was not significant at 0.05 ($p = 0.31$). Both indicated that the distribution of the data did not depart significantly from the normal distribution. Further analysis (see appendix 2) also supported the proposition that the data were normally distributed. The stem and leaf derived showed a bell-shaped

pattern, the Normal Q-Q Plot showed that majority of the observations were located close to the trend line.

4.4 Descriptive Statistics

Table 4.4 Showing Descriptive statistics on Audit tenure, Audit independence, audit fees and audit quality.

Variables	Mean	Std. Deviation	N
Audit Tenure	4.39	1.38	144
Audit Independence	3.35	1.63	144
Audit Fees	3.78	1.27	144
Audit Quality	4.24	1.42	144

Table 4.4 shows the descriptive features of both dependent and independent variables used in the study. It can be seen from the table for the 144 respondents that the average values of audit tenure, audit fees, auditor independence and audit quality are 4.39, 3.35, 3.78 and 4.24 with a standard deviation of 1.38, 1.63, 1.27 and 1.42 respectively. This implies that the respondents agreed that audit tenure influence audit quality. This was demonstrated with a mean value of 4.39, also the respondents agreed to audit independence having an effect on audit quality as demonstrated with a mean value of 3.35 while audit fees which show a mean value of 3.78 indicated that the respondents agreed that fees influence the quality of an auditor report.

4.5 Test of Multicollinearity

This test examined the relationship among the independents' variables. Multicollinearity is said to exist when the independent variables are highly correlated (0.90 and above) (Pallant, 2005). In order to solve this problem of multicollinearity, table 4.5 correlation matrix below shows the results of the correlation between the independent variables.

Table 4.5: Correlation Matrix of the Variables

Variables	Audit Quality	Mandatory Auditor Rotation	Audit Fees	Audit Independence
Audit Quality	1	0.638	0.889	0.569
Audit Tenure		1	0.668	0.533
Audit Fees			1	0.333
Audit Independence				1

Source: Survey Result, 2017

Table 4.5 above revealed that multicollinearity problem does not occur because the independent variables are not highly correlated as the highest correlation was 0.668 which is less than 0.7, therefore, the entire variable was retained and used in the study.

4.6 Empirical Analysis and discussion of regression results

Table 4.6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.839 ^a	.693	.662	.657	.693	342.84	3	140	.000	2.000

A. Predictors: (Constant), Audit Independence, Audit Fees, Audit Tenure

b. Dependent Variable: Audit Quality

(Level of significance at 5%)

Initial analysis using Pearson correlation coefficient method (see table 4.5 - correlation matrix) revealed that the independent variables (audit tenure, auditor independence and audit quality) were strongly related to each other while the dependent variable (audit quality) had a relatively strong correlation with the independent variables, indicating the possibility of using regression analysis on the data.

The coefficient of correlation (R) which measures the strength of relationship (see table 4.6) revealed a strong relationship between audit quality and mandatory auditor rotation, auditor independence and audit fees at $R = 0.839$, while the Coefficient of Determination (R^2) which indicate the accuracy of prediction shows that 69% variations in audit quality were predicted/explained by audit tenure, auditor independence and audit fees. What this means is that there might be other variables that can explain these variations but our model which includes mandatory auditor rotation and audit independence can explain approximately 69% of it. In other words, 31% of the variation

in audit quality cannot be explained by mandatory auditor rotation, auditor independence and audit fees alone. Therefore, there must be other variables that influence also.

Table 4.7: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	732.32	3	244.11	342.84	.000 ^b
	Residual	99.68	140	.712		
	Total	832.00	143			

a. Dependent Variable: Audit Quality

b. Predictors: (Constant), Audit Independence, Audit Fees, Audit Tenure
(Level of significance at 5%)

In general, the analysis yielded a significant regression model with F-value of 342.841 and significant at the 0.05 level ($p = 0.000$) (see table 4.7). Implying that the regression model as a whole is significant and can be reasonably acceptable to represent the relationship between the dependent (audit quality) and explanatory variables (audit tenure, auditor independence and audit fees) in the population of study.

Table 4.8: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	1.232	.369		3.34	.001		
1 Audit Tenure	.118	.044	.116	2.64	.004	.444	2.25
Audit Fees	.904	.042	.851	4.61	.000	.552	1.81
Audit Independence	.515	.051	.348	3.06	.000	.714	1.40

a. Dependent Variable: Audit Quality

Level of significance at 5%

Table 4.8 shows the parameter estimates of the regression which represent the slope of each explanatory variables and their contribution to the dependent variable. The t statistics indicate the significance of the constant and each of the parameter estimates. The regression model has at count constant of 3.34 and is significant at the 0.05 level ($p=0.001$). However, parameter estimates for audit tenure has a t-count at 2.64 and significant at 0.05 ($p = 0.004$), audit fees has a t-count of 4.61 and is significant at the 0.05 level ($p = 0.000$) while auditor independence has at count at 3.06 and significant at 0.05 level ($p = 0.000$). As for the contribution of these variables to the dependent variables, audit tenure makes a contribution at $\beta = 0.116$ while auditor independence and audit fees make a statistically significant contribution ($\beta = 0.348$ and $\beta = 0.851$) respectively. The beta values indicate the number of standard deviations that scores in the dependent variable (audit quality) would change if there was a one standard deviation unit change in the predictor. That is, a one unit increase in audit tenure, auditor independence and audit quality would lead to 0.116, 0.348 and 0.851 increase in audit quality respectively.

4.7 Restatement and Testing of Hypothesis

4.7.1 Testing of Hypothesis One (H_1)

There is a significant relationship between audit tenure and quality of opinion.

Audit tenure has a t count at 2.64 and is significant at 0.05 ($p = 0.004$). Therefore, hypothesis one which states that there was no significant effect of audit tenure on audit quality was rejected and the alternative hypothesis which states that there is a significant effect of audit tenure on audit quality is accepted.

This result was consistent with the research conducted by Jackson, Moldrich & Roebuck (2007) which state that the auditor rotation can provide the auditor with a better understanding of his clients, thus increasing audit quality. Ebimobowei & Keretu (2011) found out that mandatory auditor rotation is said to increase the quality of audit reports and Rahmina & Agoes (2014) revealed that audit tenure has a positive influence on audit quality.

4.7.2 Testing of Hypothesis Two (H₂)

There is a significant relationship between auditor independence and quality of audit report.

Auditor independence has a t count at 3.06, as well as having a significance of 0.000 which is less than 0.05. It can be concluded that the second hypothesis (H₂) is rejected while the alternative is accepted meaning that auditor independence significantly influences audit quality. The influence of auditor independence on audit quality is positive, which means that the higher the auditor independence, the higher the audit quality is. The results are consistent with a research conducted by Lawalata, Said &

Mediaty (2008) and Christiawan (2002) which states that there is a significant positive effect of auditor independence on audit quality.

4.7.3 Testing of Hypothesis Three (H₃)

There is a significant relationship between audit fees and quality of audit report.

Audit fee has t count at 4.61, and a significance of 0.000, less than 0.05, it can be concluded that the third hypothesis (H₃) is rejected while the alternative hypothesis is accepted meaning that audit fee has a significant effect on audit quality. The influence of audit fee on audit quality is positive, which means that the higher audit fee, the higher the audit quality is. The results are consistent with a research conducted by Yuniarti (2011) and Venkataraman, Weber & Willenborg (2008) which state that audit fee affect the audit quality. However, the results conflict with studies conducted by Sundgren & Tobias (2011) which state the audit fee has a negative impact on audit quality.

4.8 Discussion of findings

The purpose of this section is to interpret and discuss the results of the test carried out with respect to the hypothesis used for the study. Three main hypotheses were tested statistically to ascertain the effects of auditor rotation on audit quality.

The first research hypothesis sought to evaluate the impact of audit tenure on audit quality. The results of the regression analysis showed that audit tenure has a significant influence on audit quality. That is, audit tenure was perceived to have an effect on the quality of opinion an auditor expresses. The time an auditor conducts the examination

of the financial statement of the firm was perceived to positively influence the quality of an auditor's opinion. Similarly, the continuity of the firm into the foreseeable future was seen to affect the quality of opinion and auditor expresses. While the report an auditor produces at the end of an audit exercise showed how they are perceived to perform their duty skilfully. The result is consistent with the research conducted by Jackson *et al.*, (2007) which state that audit rotation can provide the auditor with a better understanding of his clients, thus increasing audit quality. Ebimobowei & Keretu (2011) found out that mandatory auditor rotation is said to increase the quality of audit reports and Rahmina & Agoes (2014) revealed that audit tenure have a positive influence on audit quality

The second research hypothesis explored whether there is a significant relationship between auditor independence and audit quality. It was discovered from the study that auditor independence significantly influences audit quality. The influence of auditor independence on audit quality is positive, which means that the higher the auditor independence, the higher the audit quality is. In addition, the attitude of the auditor who acts in accordance with conscience, honesty, looking at and presenting facts as they are was seen to influence the quality of an audit. In addition, the auditor's attitude of not taking sides and been free from conflicts of interest often reveal how reliable and professional the auditor was in carrying out his duties. These findings are consistent with the research conducted by Lawalata, Said & Mediaty (2008) and Christiawan

(2002) which states that there is a significant positive effect of auditor independence on audit quality.

The third research hypothesis explored the influence of audit fees on audit quality. The study shows that audit fee has a significant effect on audit quality. The influence of audit fee on audit quality is positive, which means that the higher audit fee, the higher the audit quality is. This implied that the size of the audit client was perceived to affect the quality of opinion auditor expresses because larger firms have the financial strength to pay a higher audit fee and as such a quality report is expected by the audit client compared to a smaller audit firm. While the complexity as reflected in the nature and diversity of the audit client's location and the quality of internal control and existence of unusual transaction would reveal the effectiveness of the tools utilized as well as the reliability of such methods. The risky nature of the audit client would cause the auditor to invariable increase fees as well as increase the quality of the auditor's reports as higher fees is often perceived to be the hallmark of quality. The results are consistent with Yuniarti (2011) and Venkataraman, Weber & Willenborg (2008) which state that audit fee affect the audit quality.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Mandatory auditor rotation, auditor independence and audit fees have been proposed by regulatory authorities around the world. The different cases of failures and the global financial crisis which affected the financial world brought about the need for such regulations. It has been proven over time that this crisis is in no small way unrelated to audit failures, and the long-term auditor-client relationship often impedes on the ability of the auditor to give an independent opinion on true and fair view of the financial statement of the client. Against this background, the study set out to achieve the following objectives; (i) to examine the effect of audit tenure on the quality of an auditor's opinion (ii) to determine the relationship between auditor independence and audit quality report (iii) to evaluate the effect of audit fees on audit quality.

In achieving the set objectives for the study, the extant literature on auditor rotation, audit independence, audit fees and audit quality was exhaustively reviewed. In addition, agency theory and Limperg theory formed the theoretical framework for the study. The agency theory states that no agent is trustworthy, as such, auditors must be independent of the company and its executives in order to maintain their trustworthiness and objectivity. Auditors provide credibility for the financial information presented which impacts on information value and the value of the entity

concerned. While Limperg theory which states that the role of auditors is to meet the needs of the users of the financial statements was supporting.

The study adopted cross-sectional survey design to a population of 239 auditors from registered complaint audit firms in Lagos out of which 144 auditors were purposively selected through the use of survey questionnaire administered to the auditors in selected audit firms in Nigeria. The primary data collected through survey questionnaire were analysed using descriptive statistical tools of mean, standard deviation and percentage frequency while regression analysis was used to measure the impact of mandatory auditor rotation, auditor independence, and audit fees on audit quality.

Having observed the variables of interest which were analysed using both descriptive and inferential statistics. The first research hypothesis sought to evaluate the impact of audit tenure on quality of audit report. From the regression analysis, it has been found that audit tenure has a significant influence on audit quality. The second research hypothesis explored whether or not there is a significant relationship between auditor independence and audit quality. It has been found from the study that there is a significant relationship between auditor independence and audit quality. The relationship between auditor independence and audit quality is positive, which means that the higher the auditor independence, the higher the audit quality is. The third research hypothesis explored the influence of audit fees on audit quality. The study revealed that audit fee has a significant effect on audit quality report. The influence of

audit fee on audit quality is positive, which means that the higher audit fee, the higher the audit quality is.

These findings were corroborated by the theories used in this study. The agency theory which explains the agency and risk sharing problems arising from the separation of ownership and control revealed from the study that auditors have a duty of care to present an honest opinion on the financial reports of an organization. These require independence in appearance and in fact. And as established in this study, auditor independence often increase the quality of an audit. Similarly, Limperg theory (theory of inspired confidence) which states that the role of auditors is to meet the needs of the users of the Financial Statements revealed from this study that majorly auditors' rotation would improve the quality of audit report as there was a significant influence between them.

5.2 Conclusion

The results of the analysis presented allowed us to answer the three (3) research questions posed at the beginning of the study. A positively significant relationship was found between audit tenure, audit quality, auditor independence and audit fees and the objective of this study were achieved.

As stated in hypothesis one where audit tenure was found to influence the quality of opinion, we conclude that the tenure of the audit, going concern and the quality of the auditor report affects the quality of the opinion.

Similarly, a significant positive relationship was found to exist between auditor independence and audit quality as evidenced by the hypothesis two tests. Thus, we concluded that the objectivity of the auditor and his integrity often influence the perception of auditors independence in appearance and fact on audit quality.

While the test to explore the influence of audit fees on audit quality found a significant positive effects, as the hypothesis three test was conducted, it was concluded that the size of the audit client, the complexity of their reporting and the level of risks was perceived to influence the fees the auditor charged as they often reflect in their final reports and opinion on the clients financial reports and the large fees paid to auditors may increase the effort exerted by auditors and may also make the auditors be economically dependent on the client.

Therefore, this study was able to empirically show that mandatory auditor rotation, auditor independence, and audit fees have a significant impact on audit quality.

5.3 Recommendations

The implications of these study's results have significant policy implications at the organization, industry, and policy levels. The results of this study may be useful to

policymakers, stakeholders, Nigeria Stock Exchange, Central Bank of Nigeria and other regulatory bodies in Nigeria. In addition, academic researchers may use the findings and the recommendations to stimulate further research in this area. Therefore, based on the study findings, the following recommendations are made:

Firstly, this study found out that audit tenure, auditor independence and audit fees can predict audit quality. The study, therefore, recommends that future researchers should look into other variables as an addendum to the variables used in this study to predict audit quality so as to make the study robust.

As revealed in this study that auditor fees and rotations have an impact on the audit quality. This study, therefore, recommends that policymakers and regulatory bodies should ensure an adequate number of years the audit-client relationship will last and the type of rotation to be done whether its firm rotation or partner rotation and standard audit fees should be applicable for audit assignments.

As found out in this study that auditor independence and audit quality are positively correlated. This study, therefore, recommends that regulatory bodies should promulgate policies that would ensure the independence of auditor in appearance and in fact.

5.4 Contribution to Knowledge

This research gave theoretical and operational contributions. The theoretical contribution of this research emanates from its contribution to the literature on audit quality in Nigeria which would make it serve as a reference and encourage subsequent research in audit quality. Operational contribution for accountants would provide a higher quality audit service and provide added value to the company and the public as users of financial statements. While the policy contribution of this study would encourage policymakers to ensure regulations and policies that limit the number of years audit-client relationship lasts, the real independence of auditors not only in appearance but also in fact and the number of fees the auditor is liable to charge their clients.

5.5 Suggestions for Further Study

Further study should also be carried out on the level of market concentration of audit firms, this is expected to show the variation of the effect of big 4 audit firms and nonbig 4 audit firms in Nigeria. In addition, research should be conducted on other areas of auditing as limited studies are found in this area due to the poor growth in the audit market. Similarly, a comparative analysis study should be carried out on the impacts of auditor rotation on the financial strength of listed organizations. While a cross-country comparison on the effect of mandatory auditor rotation, auditor independence and audit fees on audit quality can be carried out to relatively comparing the effect of the

aforementioned variables in other countries especially in developed and developing countries.

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APPENDIX 1

Questionnaire

Department of Account and Finance,
School of Business and Governance,
College of Humanities, Management and
Social sciences,
Kwara State University, Malete.

Dear Sir/Madam,

REQUEST FOR RESPONSE TO QUESTIONNAIRE

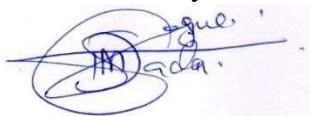
My name is Michael Olusegun, DADA a post graduate student in the Department of Account and Finance, Kwara State University, Malete carrying out a research work on **“Mandatory Auditor rotation, auditor independence, audit fees and Audit Quality: A survey of selected audit firms in Lagos”**. This study is in partial fulfilment of the requirement for the award of Masters Degree in Accounting.

This questionnaire is designed in way to collect necessary data that will aid in carrying out research on this study and information provided by you will be strictly for academic research purpose and treated with utmost confidentiality.

I will be grateful if you could do the honour of completing the attached questionnaire as objective as possible.

Thanks for your cooperation.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'Michael Olusegun, DADA', written over a horizontal line.

Michael Olusegun, DADA

QUESTIONNAIRE

Mandatory auditor rotation is the setting of limit to the number of years an audit firm/auditor can audit a given company's financial statements while audit quality is a way by which auditor conduct audit in generally accepted auditing standards to provide reasonable assurance that the audited financial statements and related disclosures are presented in conformity with relevant international auditing standards. With this understanding, you are required to tick (✓) the best option appropriately.

SECTION A: Demographic Characteristics

1. Educational Qualification:
HND () B.Sc. () M.Sc. () Ph.D. () Others
2. Professional Qualification
ACA () FCA () ACCA () CIMA () CIBN () Others
3. Age:
18 - 30 () 31- 45 () 46 - 60 () Above 60()
4. Gender:
Male () Female ()
5. Cadre/Rank:
Partner () Senior Manager () Manager () Assistant Manager ()
6. Years of experience
Less than 5 yrs () 6-10yrs () 11- 20 yrs () 21- 30 yrs () Greater than 30 yrs ()

SECTION B: Impacts of Mandatory auditor rotation on audit quality

The following sets of questions are to obtain your perception on the effects of audit tenure, auditor independence and audit fees on audit quality. Please tick in front of statements that correspond with the degree of your answer.

Note; Strongly Agree = SA, Agree = A, Undecided = U, Disagree = D and Strongly Disagree = SD

S/N	AUDIT TENURE	SA 5	A 4	U 3	D 2	SD 1
1.	Audit tenure would affect the quality of opinion an auditor expresses					
2	Internal Stakeholders are more likely to issue unbiased reports when mandatory rotation is involved					
3	Shareholders would get the true picture of the state of health of their company with mandatory auditor rotation as it connotes quality					
4	The length of an audit-client relationship incrementally influence Individuals confidence in Financial Statement as					
5	Auditor-Client Relationship may not be well established with mandatory auditor rotation there is lack of technical support					
6	Investors' confidence would be strong with mandatory auditor rotation as its perceived to influence the reliability of audit					
7	Fixed tenure may eliminate client pressure and improves reliability of audit methods					
8	Mandatory Auditor Rotation would provide smaller audit firms the opportunity to grow as there would be reduction in skills gap					
9	Audit Market concentration would be affected by tenure of auditors as it encourages competitiveness in tools utilized					
10	Mandatory Auditor rotation does not mean that audit quality will be higher if ethical values are not upheld					
	AUDITOR INDEPENDENCE					
11	The auditor will not be as independent as he was in the first few years of audit when he spends more time with the auditee (client)					
12	Auditors independence would be based on the integrity of the auditor as it improves how auditors are perceived to be free in fact					

13	Objectivity of Auditor in discharging their duties would show how independent they are especially when tools utilized are effective.					
14	Auditors in switching condition are more likely to modify their audit report as opposed to those in a situation where a continuous relationship is expected					

15	Auditors are likely to modify their audit report when the going concern of an audit client is in question					
16	An auditor is perceived to be independent when there is reliability on the method of audit used					
	AUDIT FEES					
17	High fees paid by a company to its auditors increase the economic bond between the auditor and the client					
18	Large fees paid to auditors may increase the effort exerted by auditors					
19	Large fees paid to auditors particularly those related to nonaudit services makes auditors more economically dependent on their clients					
20	The size of an auditee (client) would influence the fees auditor would charge					
21	Audit fees would increase the complexity of audit					
22	The size of risk involved in an audit exercise will affect the fees the auditor would charge					
	AUDIT QUALITY					
23	The going concern of the organization is certain when there is quality audit					
24	Auditor may tend to compromise the quality of their opinion most often based on their mind-set as auditors					
25	The perception of audit quality would be enhanced when ethical values are uphold by auditors					
26	Familiarity threats as exists are between individuals rather than institutions					
27	The skills of an auditor would influence the quality of opinion he expresses					
28	Reliability of auditing method used by the auditor would determine the quality of audit					

29	Long standing relationship can induce and auditor to give much importance to the economic interest in preserving the client than to quality					
30	A user of annual report would have higher confidence for the annual reports based on the experience of the auditor					
31	The length of audit contract affects the possibility that a company may receive a more favourable audit opinions					
32	Audit quality would assure financial reporting quality					
33	High audit quality increases the credibility of financial statements					

APPENDIX 2

Normality Test

Descriptive

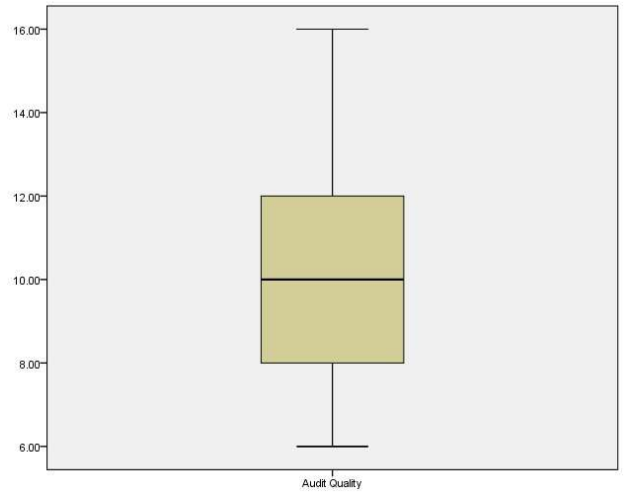
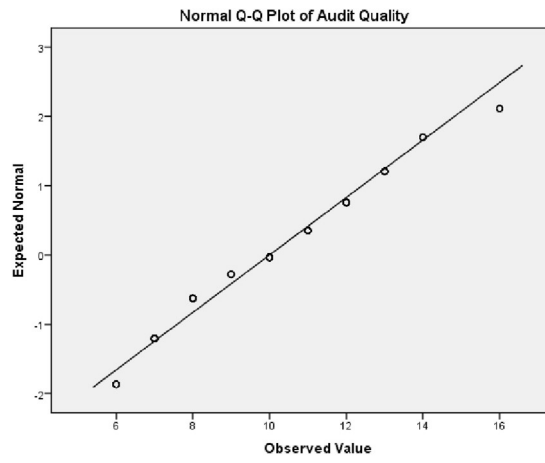
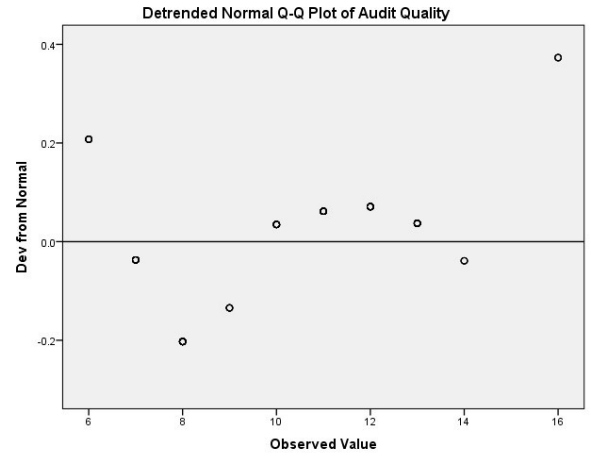
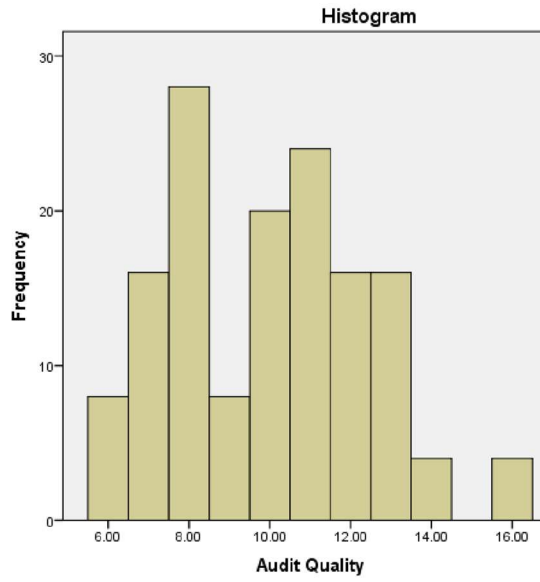
			Statistic	Std. Error
	Mean		4.243	.20101
	95% Confidence Interval for Mean	Lower Bound	9.6027	
		Upper Bound	5.3973	
	5% Trimmed Mean		9.9383	
Audit Quality	Median		3.0000	
	Variance		5.818	
	Std. Deviation		2.41209	
	Minimum		1.00	.202
	Maximum		5.00	.401

Range	3.00
Interquartile Range	4.00
Skewness	.267
Kurtosis	-.568

Tests of Normality

	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	Df	Sig.
Audit Quality	.158	144	.100	.953	144	.310

a. Lilliefors Significance Correction



APPENDIX 3 FACTOR ANALYSIS OF QUESTIONNAIRE

AUDIT TENURE

Descriptive statistics and percentage frequency on Audit tenure

S/N	Statement	Mean	SD	No	% Freq
1	Audit tenure would affect the quality of opinion an auditor expresses	4.82	1.12	104	72%=SA
2	Internal Stakeholders are more likely to issue unbiased reports when mandatory rotation is involved	4.97	1.01	114	79%=SA
3	Shareholders would get the true picture of the state of health of their company with mandatory auditor rotation as it connotes quality	2.81	1.73	108	75%=D
4	The length of an audit-client relationship incrementally influence Individuals confidence in Financial Statement as	3.82	1.09	96	67%=A
5	Auditor-Client Relationship may not be well established with mandatory auditor rotation there is lack of technical support	4.95	1.86	98	68%=SA
6	Investors' confidence would be strong with mandatory auditor rotation as its perceived to influence the reliability of audit	2.85	1.29	114	79%=D
7	Fixed tenure may eliminate client pressure and improves reliability of audit methods	2.79	1.19	111	77%=D
8	Mandatory Auditor Rotation would provide smaller audit firms the opportunity to grow as there would be reduction in skills gap	4.88	1.87	112	78%=SA
9	Audit Market concentration would be affected by tenure of auditors as it encourages competitiveness in tools utilized	3.94	1.99	117	81%=A
10	Mandatory Auditor rotation does not mean that audit quality will be higher if ethical values are not upheld	3.82	1.29	112	78%=A
11	Audit tenure would affect the quality of opinion an auditor expresses	4.97	1.15	105	73%=SA

Descriptive statistics on Indicators of Audit tenure as extracted from Questionnaire

Indicator	Mean	Std Deviation	N
Mandatory auditor rotation			
Audit Tenure	4.32	1.56	

Going Concern of Auditee	4.43	1.69	
Auditors report	3.97	1.01	
Overall	4.24	1.42	144

AUDITOR INDEPENDENCE

Descriptive statistics and percentage frequency on Auditor Independence

S/N	Statement	Mean	SD	No.	% Freq
1	The auditor will not be as independent as he was in the first few years of audit when he spends more time with the auditee (client)	4.24	1.46	107	74%=SA
2	Auditors independence would be based on the integrity of the auditor	4.41	1.97	98	68%=A
3	Objectivity of Auditor in discharging their duties would show how independent they are.	4.15	1.63	105	73%=SA
4	Auditors in switching condition are more likely to modify their audit report as opposed to those in a situation where a continuous relationship is expected	2.13	1.98	114	79%=D
5	Auditors are likely to modify their audit report when the going concern of an audit client is in question	3.02	1.18	78	54%=U
6	An auditor is perceived to be independent when there is reliability on the method of audit used	4.16	1.54	76	53%SA

Descriptive statistics on indicators of Auditor Independence as extracted from Questionnaire

Indicator of Auditor Independence	Mean	Std Deviation	N
Integrity	3.14	1.37	
Objectivity	3.56	1.89	
Overall	3.35	1.63	144

AUDIT FEES

Descriptive statistics and percentage frequency on Audit fees

S/N	Statement	Mean	SD	No	% Freq
-----	-----------	------	----	----	--------

1	High fees paid by a company to its auditors increase the economic bond between the auditor and the client	3.59	0.88	104	72%=SA
2	Large fees paid to auditors may increase the effort exerted by auditors	2.68	1.08	78	54%=D
3	Large fees paid to auditors particularly those related to non-audit services makes auditors more economically dependent on their clients	4.28	1.72	89	62%=A
4	The size of an auditee (client) would influence the fees auditor would charge	4.23	1.07	108	75%=A
5	Audit fees would increase the complexity of audit	4.12	1.61	69	48%=A

Descriptive statistics on indicators of Audit fees as extracted from Questionnaire

Indicator of Audit fees	Mean	Std Deviation	N
Size of Auditee	3.86	1.32	
Complexity	3.73	1.24	
Risk	3.75	1.25	
Overall	3.78	1.27	144

AUDIT QUALITY

Descriptive statistics and percentage frequency on Audit quality

S/N	Statement	Mean	SD	No	% Freq
1	The going concern of the organization is certain when there is quality audit	4.01	0.96	88	61%=A
2	Auditor may tend to compromise the quality of their opinion most often based on their mind-set as auditors	3.47	1.15	91	63%=A
3	The perception of audit quality would be enhanced when ethical values are uphold by auditors	3.04	1.06	65	45%=A
4	Familiarity threats as exists are between individuals rather than institutions	4.03	1.38	76	53%=SA

5	The skills of an auditor would influence the quality of opinion he expresses	3.08	1.03	68	47%=A
6	Reliability of auditing method used by the auditor would determine the quality of audit	3.90	1.01	94	65%=A
7	Long standing relationship can induce and auditor to give much importance to the economic interest in preserving the client than to quality	4.03	0.80	81	56%=A
8	A user of annual report would have higher confidence for the annual reports based on the experience of the auditor	4.20	0.81	63	44%=SD
9	The length of audit contract affects the possibility that a company may receive a more favourable audit opinions	3.40	1.03	76	53%=U
10	Audit quality would assure financial reporting quality	4.04	0.89	92	64%=D
11	High audit quality increases the credibility of financial statements	2.40	0.81	105	73%=SA

Descriptive statistics on Audit quality as extracted from Questionnaire

Indicator of Audit Quality	Mean	Std Deviation	N
Skill	4.82	1.59	
Ethical Value	4.23	1.64	
Mind-set	3.65	1.21	
Reliability of Audit Methods	4.22	1.36	
The Effectiveness of the tools utilized	3.78	1.24	
The availability of Technical Support	4.74	1.48	
Overall	4.24	1.42	144